April 30, 2014

Ms. Tomoko Stock, Chair
NAIC Restricted Asset (E) Subgroup
NAIC
1100 Walnut Street, Suite 1500
Kansas City, MO  64106

Re: Accounting and Reporting Treatment for Repurchase/Reverse Repurchase Agreements over 1 year in duration.

Dear Ms. Stock:

The American Council of Life Insurers (ACLI)\(^1\) requests that the NAIC’s Restricted Asset Subgroup of the Statutory Accounting Principles (E) Working Group (“SAPWG”) review and clarify certain accounting and reporting requirements for repurchase and reverse repurchase transactions (“Repos or Reverse Repo” as applicable and collectively “Repo Agreements”) under SSAP No. 103. Specifically, SSAP No. 103 provides reporting and accounting guidance for Repos with tenors of one year or less (“Short Duration Repos or Reverse Repos” as applicable and collectively “Short Duration Repo Agreements”). However, these guidelines do not address the treatment of Repos with a tenor greater than one year (“Long Duration Repos or Reverse Repos” as applicable and collectively “Long Duration Repo Agreements”). This lack of guidance has created an ambiguity in the product characterization and accounting treatment of Long Duration Repo Agreements thereby foreclosing investment opportunities in this product.

Accordingly, ACLI respectfully request that the SAPWG address this issue by providing clear, explicit and consistent accounting and reporting guidance for Long Duration Repo Agreements, with the goal of creating regulatory parity between Short and Long Duration Repo Agreements. We recognize, however, that any such revised guidance will provide different geography for the reporting requirements. We reference the SAPWG’s consideration of this matter in a Conference Call of March 6, 2013 and our initial letter addressing this subject dated May 8, 2013. Further, we request that the SAPWG move forward in

\(^1\) The American Council of Life Insurers (ACLI) is a Washington, D.C.-based trade association with more than 300 legal reserve life insurer and fraternal benefit society member companies operating in the United States. ACLI advocates in federal, state and international forums. Its members represent more than 90 percent of the assets and premiums of the U.S. life insurance and annuity industry. In addition to life insurance, annuities and other workplace and individual retirement plans, ACLI members offer long-term care and disability income insurance, and reinsurance. Its public website can be accessed at www.acli.com.
developing this guidance independent of the FASB’s finalization of their Proposed Accounting Standards for repurchase-to-maturity agreements.

Included in the attached Appendix, we have prepared a primer on US Repo Market. We hope that this information will be useful to the SAPWG in understanding the basis for our recommendation and the importance of Repo’s as an investment vehicle for insurers.

**Use of Long Duration Repos within the Insurance Industry**

Insurers execute Repo Agreements primarily as investors, and Short Duration Repo Agreements have been an essential component of an insurer’s investment portfolio. With a current transaction volume of $2.5 Trillion, the US Repo market is one of the largest sectors of the short-term credit market, and is a vital source of liquidity for institutional investors, including insurance companies. Within this market, no distinction is drawn between Short and Long Duration Repo Agreements. Section 1C of the Appendix, illustrates that a transaction’s tenor is merely one of several economic variables that may be tailored to meet a party’s investment objectives. Market participants are increasingly seeking investment opportunities in Long Duration Repo Agreements. However, the lack of accounting and reporting guidance has created an artificial distinction between Short and Long Duration Repo Agreements that, except for their tenor, are otherwise identical. As a result of this disparity, insurers have been prevented from investing in Long Duration Reverse Repos. The move toward Long Duration Repo Agreements in the market place has developed for several reasons outlined below.

- All repurchase and reverse repurchase transactions executed by insurers are generally subject to the terms and conditions of an industry standard Master Repurchase Agreement (“Agreement”). The Agreement, among other provisions, provides for: (i) the full “collateralization” and “overcollateralization” of the covered transactions, regardless of the tenor, (ii) the daily mark-to-market valuation and margining of all transactions under the Agreement, (iii) the netting and immediate close out of all transactions in the event either party defaults on its obligations under the Agreement, (iv) full recourse where the counterparty is responsible for any face amount shortfall that is not covered by the sale of the collateral

- Under Sections 555 and 559 of the US Bankruptcy Code, repurchase and reverse repurchase transactions are provided a “safe harbor” from the automatic stay of Section 342, allowing these transactions to be terminated and liquidated immediately upon the declaration of bankruptcy or insolvency by one of the parties to the transaction. The legal remedies available to the non-defaulting party under a repurchase or reverse repurchase transaction, combined with the “safe harbor”, provide extremely low risk and highly liquid investments for insurers. [See section 1G for further details.]

- Long Duration Repo Agreements are well suited investments for an insurer to match against its long term liabilities. An insurer will commonly execute a Reverse Repo through a secure “Tri-Party” arrangement illustrated in section 1E. Under this arrangement an insurer will send cash to a Tri-Party custodian and receive securities in the same manner. On the termination date the insurer, through the Tri-Party Custodian, will return the securities and receive the original cash principal along with interest, including any interim interest.

- Under International and Domestic regulatory regimes, banks are increasingly seeking longer term financing for high quality assets on their balance sheets. Consequently, these institutions have been turning to the Repo Agreement market as an efficient way to access this financing. Accordingly, Repo Agreements have provided an attractive, low risk investment opportunity for insurance companies.
**Repo and Capital Market Risks**

Repo Agreements are low risk investments, if managed prudently. The degree to which risk can be mitigated in a Repo Agreement depends on several variables including: (i) the selection of creditworthy counterparties, (ii) the availability of high quality collateral underlying the Repo Agreement, (iii) efficient collateral valuation, delivery and management systems and (iv) legal certainty regarding the disposition of the underlying securities. When these elements are deployed appropriately, the tenor of a Repo Agreement does not increase the risk of the transaction. These risk mitigation elements are not unique to Repos, but rather are common among all capital market transactions. [See section 2 of the Appendix for further detail]

**No Accounting Guidance for Long Duration Repos**

SSAP No. 103 provides guidance for Short Duration Reverse Repos, but does not address the accounting and reporting requirements for Long Duration Repo Agreements the SAPWG included this topic as a future project during the meeting of March 6, 2013. At this meeting the subgroup indicated:

"B. Repurchase/Reverse Repurchase Agreements: SSAP No. 103 provides explicit guidance for reverse repurchase transactions being accounted for as short-term investments. It has been identified that some repurchase and reverse repurchase agreements are long-term (over one year), with termination before maturity of the underlying asset. As the current guidance in SSAP No. 103 does not explicitly address the accounting and reporting for long-term scenarios, questions have been received on how to report these agreements. It is anticipated that this Subgroup will review the current guidance and provide recommendations as to the accounting and reporting for long-term repurchase and reserve repurchase agreements." [See section 3 in the Appendix for further details.]

**Recommended Guidance for Long Duration Repo Agreements**

ACLI strongly favors consistent accounting and reporting treatment for Short Duration and Long Duration Repo Agreements As described above, these transactions are substantively identical except for the tenor of the transaction (i.e., governed by the same transaction documents, same bankruptcy treatment, same underlying assets and same counterparties). We recognize, however, that the differences in the tenor between Short and Long Duration Repo Agreements will result in the geography of reporting to be different. Our recommendation is for Long Duration Reverse Repos to be reported in either Schedule D “Long-Term Bonds”, or Schedule BA “Other Long-term Invested Assets. Additionally, ACLI recommends that the reporting of Long Duration Reverse Repos appear in the RBC schedule LR017 entitled “Off-balance Sheet and Other Items”, unless these transactions are incorporated into the RBC schedule for Long-term Bonds or Other Long-term Invested Assets. In addition, ACLI recommends Long Duration Repo Agreements be reported in line 25 “aggregate write-ins for liabilities”, within the “Liabilities, Surplus and Other Funds” section.

Based on the minutes to the March 6, 2013 meeting, it appears that the SAPWG has considered following the FASB guidance on this topic. ACLI supports this approach. The spirit of the FASB Exposure Draft (Topic 860) is to conform the accounting treatment of “Repos at maturity” and “Repos before their maturity”. In their draft proposal, the FASB is attempting to close GAAP accounting loopholes by placing conditions on sale accounting and classifying Repos, without regard to the transactions tenor. Repo Agreements in which a party maintains effective control over the underlying collateral will be categorized as financing transactions or “Secured borrowing with a pledge of collateral”. Long-standing GAAP accounting for Repo Agreements is indifferent to the tenor of the transaction. The changes currently being debated by the FASB are consistent with the concept that the transaction tenor should not create
a regulatory disparity. In developing guidance for SSAP No.103 we request that you follow the same tenor indifference as adopted by FASB.

Additionally, we strongly recommend that developing guidance for Long Duration Repo Agreements should be addressed independent of the FASB’s finalization of their Proposed Accounting Standards for repurchase-to-maturity agreements for the following reasons:

- The issue currently being addressed by FASB concerns “repurchase-to-maturity agreements”, or repurchase agreements that are co-terminus with the maturity of the underlying asset. This is a separate topic that can be addressed by the FASB without impacting the SAPWG’s development of guidance for SSAP No. 103.

- Timing on the FASB Exposure Draft resolution is uncertain and should not be a condition to developing the reporting and accounting treatment for Long Duration Repo Agreements which will delay approval of this initiative.

**Conclusion**

In conclusion, we respectfully request SAPWG to direct its attention to providing guidance for the accounting and reporting of Long Duration Repo Agreements. These transactions represent an important investment opportunity for insurance companies. As discussed herein, accounting and reporting guidance provided for Long Duration Repo Agreements must be consistent with such guidance that currently exists for Short Duration Repo Agreements in order to provide regulatory parity for these similarly situated investments. Thank you for providing ACLI the opportunity to comment on this initiative.

Sincerely,

Michael Monahan  
Senior Director, Accounting Policy  

cc: Julie Gann, NAIC Staff  
    Dale Bruggeman, Chair – Statutory Accounting Principles Working Group  
    Robin Marcotte, NAIC Staff
APPENDIX

1. **Background**

1A. **Overview of the Repo Market**

The Repo Agreement market is one of the largest sectors of the short-term credit market and provides an important source of liquidity for institutional investors, including insurance companies. Repo Agreements possess the economic equivalents of a secured loan, but are characterized as the purchase and sale of securities. Repos are used by investors, as a short-term investment vehicle and by dealers as a key source of collateralized funding. According to the July 2012 Fact Sheet published by SIFMA, the Repo Agreement market was estimated to be $2.5 Trillion dollars for US Tri-Party Repo Agreements; (a form of Repo Agreement that uses a Third Party Custodian to maintain cash and securities for both parties to the Repo Agreement. See Section 1D below for a more detailed discussion.

![Average Weekly Repurchase Agreements Outstanding 2002-2012](source: Federal Reserve Bank of New York, As of July 11, 2012)

1B. **Definition of a Repo**

A Repo Agreement is a contractual arrangement between two parties whereby one party sells securities (borrower of cash) with a simultaneous contractual obligation to buy such securities back at a later date at the same price, plus interest on the sale proceeds. The buyer of the securities (lender of cash) invests cash for an agreed upon term and interest rate; the “repo rate”. Since the “buyer” receives the purchased securities, the transaction is akin to making a secured investment. Repo Agreements typically mature overnight, but also have two other types of maturities. “Open” or “Counting” maturities have no specified end date, and either party can terminate the Repo at any time. Any Repo that has a specified termination date longer than 1 day is defined as a “Term” Repo. Since a Repo agreement is a negotiated transaction, it can be structured for almost any length of time ranging from overnight to several years.

Standard market convention views Repo transactions from the dealer’ or “seller” perspective (i.e., the dealer sells securities to an investor who wants to invest money for a stated length of time). In most circumstances, the dealer is the borrower of cash, and the Investor or “buyer” (Insurance Companies) is the lender of cash. Each Repo transaction can be referred to as a Repo or Reverse Repo, depending on the perspective of the party to the transaction. In a Repo transaction, the “seller” of securities will typically borrow money from the investor or “buyer” at a negotiated rate; the “repo rate”. The repo rate will vary depending upon several factors including type, quality, size and amount of securities purchased as well as the maturity of the transaction and credit quality of the counterparty. Whether using this transaction for an individual security or an entire portfolio, Repo’s provide dealers with the ability to generate short term liquidity for a broad range of asset types owned by the dealer. All market participants could use Repos as either an investment, or a secured funding source; insurance companies typically use it for short term investments. The following is a schematic of a Repo transaction:

![Diagram of Term Repo from a Dealer's Perspective](image1)

![Diagram of Term Reverse Repo from a Dealer's Perspective](image2)
1C. Terms of a Repo

All of the economic terms of a Repo transaction are negotiated between the parties to the transaction. This flexibility enables each party to the Repo to tailor the transaction to meet their specific investment and liquidity needs. Either party is free to negotiate the material economic terms of a Repo transaction which include the following provisions:

1. Haircut and Variation Margining - A Haircut is imposed to reduce the level of risk exposure in a Repo transaction. It is common for the “buyer” of securities (i.e. the lender of cash) to ask for an initial margin a (margin required at the inception of the transaction), whereby the market value of the securities sold (i.e. the collateral) is greater than the value of the cash received by the seller... Simply stated, a haircut is another term for overcollateralization. A haircut is typically expressed in a margin ratio: collateral value divided by cash. For example a 5% haircut would translate into the sale of $105mm of securities in exchange for $100mm in cash. Higher haircuts are also applied to counterparties or assets with lower credit quality, and assets with greater price volatility. In addition to the haircut, variation margin is a standard requirement for Repo transactions. Variation margin is typically a daily margin call on the parties to reconcile any daily exposure that exists between the market value of the underlying securities and the outstanding cash position. The following table indicates the average range of haircuts by asset class reported by institutional investors:

<table>
<thead>
<tr>
<th>Asset Class</th>
<th>06/30/2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>US Treasuries</td>
<td>.5 to 3%</td>
</tr>
<tr>
<td>US Agencies</td>
<td>1 to 2%</td>
</tr>
<tr>
<td>Investment Grade Corporate Bonds</td>
<td>5 to 10%</td>
</tr>
<tr>
<td>Equity</td>
<td>10%+</td>
</tr>
</tbody>
</table>

Source: Fitch Haircut Survey, ICMA

2. Collateral – The Tri-Party Repo market, which represents a significant segment of the entire U.S. Repo market. U.S. government securities, agency mortgage-backed securities, and collateralized mortgage obligations comprise approximately 80% of the security types underlying Tri-Party Repo Transactions. The remaining 20% is spread over other liquid asset classes.

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3. **Collateral Eligibility and Substitution** – Collateral Eligibility is the term used to specify the characteristics of security types or “collateral” acceptable to each of the parties to the Repo. Elements of Collateral Eligibility include; issuer concentration limits, minimum issuer credit ratings, and maturity limits, etc. In addition, the seller of securities (i.e. the borrower) will often have the right to substitute collateral during the term of the Repo transaction.

4. **Repo Rate** – The return earned on a Repo transaction is expressed as an interest rate in respect of the cash component of the transaction. For a US dollar denominated Repos, the repo rate is quoted as a fixed rate or a floating rate plus a spread. The Repo rate is influenced by the tenor, delivery type, credit quality of the counterparty, and the type, quality, size, and market value of the securities purchased.

5. **Tenor** – Maturities in the Repo market ranges from overnight to several years. Trades can settle for cash same day or any future date, and mature on any date agreed upon by the parties to the transaction. The tenor of the transaction will however, influence the Repo rate.

6. **Interest Payment Frequency** – Market convention dictates that interest is paid at the maturity of the Repo. However for longer term trades, the parties may choose for the payment of interest at more frequent intervals.

7. **Types of Repos** – See the next section (1D).
1D. **Types of Repos**

There are three types of repurchase agreements used in the markets: Deliverable, Held-in-Custody and Tri-party. Tri-party agreements are most commonly used by money market funds and institutional investors, while deliverable agreements are less often used and held-in-custody agreements are rarely used. Held-in-custody and Tri-Party Repo will have a Repo Rate advantage over Deliverable Repo.

- **Deliverable** – A Repo in which the underlying securities are delivered to the investor’s clearing bank.

![Diagram of Deliverable Repo](image1)

- **Held-in-custody** – A Repo in which the Eligible collateral consists of physical or book entry securities and is held by the seller of securities in a general segregation account, or at one of the seller’s clearing banks.

![Diagram of Held-in-custody Repo](image2)

- **Tri-Party** - A Repo in which the parties establish separate accounts at a custodian bank or a clearing facility. Delivery of the underlying securities and cash is made through the custodian or clearing agent to each of the parties respective accounts. The Repo is collateralized from the pool of securities that remains after the completion of the day's deliveries. The buyer of securities receives a (electronic) confirmation detailing the specific collateral and market value from both the seller and the custodian or clearing bank.4

![Diagram of Tri-Party Repo](image3)

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The basic flow of events for a Tri Party Repo can be summarized as follows:

1. Dealer and Investor agree upon a repo transaction.
2. Dealer and Investor each advise the Tri-Party agent of the transaction. (Bank of New York or JPM Chase Bank).
3. The Investor deposits cash into a demand deposit account at the Tri-Party.
4. Dealer then delivers the securities to the dealer account at the Tri-Party.
5. Cash is transferred to the Dealer’s account and securities to the Investor’s account after the tri-party agent confirms the collateral quality and adequacy.
6. On the termination date, the dealer and investor will confirm with each other the end date.
7. The Tri-Party agent will be advised of the termination date and then simultaneously transfer of cash (principal and repo interest) and securities.

1F. **SSAP No. 103 Tenor Distinction**

In the Repo market, there is no distinction between Short Duration Repos and Long Duration Repos. This is clearly illustrated in section 1C, where the transaction tenor is one of many economic terms may be tailored to meet a party’s investment objectives. However, for the purpose of this discussion, we make a distinction because SSAP No. 103 provides reporting and accounting guidance for Short Duration Repos but fails to provide similar guidance for treatment of Long Duration Repos. Absent such guidance a “Term” Repo may be construed as any transaction with a maturity greater than 1 day; whether such maturity is 2 days or 10 years. Notwithstanding the term to maturity, all remaining legal, contractual and transaction mechanics of a Repo transaction are identical.

Moreover, the over collateralization and mark-to-market provisions of all Repo transactions mitigate the risk between Short and Long Duration Repos that otherwise exist in comparable short term and long term investments. There is no distinct point in a Repo transaction where a longer maturity date increases the risk profile of the transaction.

1. The majority of Repo market transactions are short term in nature with tenors of three months or less. However, there is a robust market with sufficient liquidity for Long Duration Repos

2. Roll frequency - Parties executing Short Duration Repos will roll their contracts more frequently (extending the transaction on the termination date to a new termination date) than parties executing Long Duration Repos.

3. With Long Duration Repos the securities and cash exchanged between the parties is locked down for a longer period of time. However, the tenor lockdown in a Long Duration Repo compensates the buyer with a higher Repo rate compared to Short Duration Repos which represents the opportunity cost of liquidity. The decision to execute a Short or Long Duration Repo is very similar to an investor’s determination of a maturity date when purchasing cash bonds. The investor must weigh the benefits and disadvantages of varying maturities, where shorter cash bond maturities have less risk and reward compared to longer maturities.

1G. **Legal Considerations**

Under Sections 555 and 559 of the US Bankruptcy Code, repurchase and reverse repurchase transactions are provided a “safe harbor” from the automatic stay of Section 342. This “safe harbor” allows Repo transactions to be terminated and liquidated upon the declaration of bankruptcy or insolvency by one of the parties to the transaction. Section 559 covers the termination and liquidation by the non-bankrupt party of a repurchase or reverse repurchase transaction with a tenor of one year or less. Section 555 addresses the termination and liquidation by the non-bankrupt party of a broad array of securities contracts, which include repurchase and reverse repurchase transactions with tenors of greater than one year. Notwithstanding the separate provisions covering repurchase and reverse repurchase transactions with different tenors, the bankruptcy treatment and protections afforded these transactions are identical.
2. **Risks**

2A. **Capital Markets Risk**

Repos are low risk investments, when managed prudently. The degree to which Repos can mitigate risk depends upon the careful selection of counterparties, the availability of high quality collateral, efficient collateral valuation, delivery and management systems and legal certainty regarding the disposition of the underlying securities. The following risks listed below are not unique to Repos, but rather, are risks common to all capital market transactions.

- **Counterparty Credit Risk** – The risk of the borrower in the Repo transaction defaulting on its obligation in the transaction. Typically, in an event of default, the borrower will either become insolvent, or fail to deliver margin requirements. The risk then becomes the extent to which the collateral could deteriorate while the lender seizes the collateral and sells it during the “close-out period”. As discussed earlier, Repos and Reverse Repos are afforded a safe harbor within the US Bankruptcy code, whereby, the lender would be able to take possession of and sell the collateral within immediately. Counterparties to Tri-Party Repo transactions are secured by collateral held at a third-party custodian. However, in the event of a default, lenders are subject to collateral risk in the event that the sale of the collateral at fair value does not cover the original cash principal. Careful selection of the counterparties is vital to the risk profile of the Repo.

- **Collateral Value Risk** – The risk of deterioration in the value of collateral held during the Repo term, specifically during the “close-out” period. This risk will only materialize upon an event of default of the “seller of securities (the borrower cash), where the liquidation of the collateral is necessary. Whether the collateral deteriorates due to general price volatility, or credit issues with the underlying collateral, the risk is similar. Careful due diligence regarding the universe of eligible collateral is very important. The credit risk on the collateral should have minimal correlation with the credit risk of the counterparty. In general, eligible collateral should have minimal credit and liquidity risks in order to minimize price volatility and maximize ease of liquidation in the event of default. An additional consideration to mitigate the Collateral Value Credit risk is obtaining additional collateral in the form of a haircut. This haircut protects the lender during the “close-out” period from general price volatility and undue counterparty exposure. For highly liquid collateral such as US Treasuries, illiquidity concerns are negligible.

- **Interest Rate Risk** – Repos are akin to taking positions in loans and deposits, which are exposed to interest rate risks. For example, an investor that executes a term reverse repo transaction (cash is received by an investor) and contracts to pay a floating repo rate (Libor + Spread). Because the investor is paying a floating rate, he is exposed in a rising rate scenario. Interest rate risk is a typical risk of a fixed income investor.

- **Operational Risk** – Operational risk is not specific to Repos, but applies to all participants in the capital markets. It refers to all the risks that are internal to a firm, such as system failure, fraud, inadequate procedures, back office errors, etc. Another key operational risk is settlement risk or specifically, delivery risk. This is the risk that counterparty does not fulfill its contractual obligations on the trade or maturity date. With a Tri-Party arrangement, operational risk is minimal.
2B. Repo 105

Repo 105 was a US GAAP accounting loophole utilized by Lehman Brothers (“Lehman”) during the financial crisis in 2008. Repo 105 transactions consisted of Lehman selling securities through a Repo and using the cash obtained to temporarily remove securities inventory from its balance sheet. Repo 105 transactions, normally had a duration of seven to ten days prior to quarter end, and created a materially misleading picture of the firm’s financial condition. Lehman accounted for Repo 105 transactions as “sales” as opposed to financing transactions based upon the higher than normal collateralization in these Repo transactions. This over collateralization required a minimum of five percent of the market value of the securities sold pursuant to the Repo. (i.e. $105 of securities in exchanged for $100 cash borrowed). By recharacterizing the Repo 105 transaction as a “sale”, Lehman removed inventory from its balance sheet. Lehman’s reports did not disclose the cash borrowing from the Repo 105 transaction, even though Lehman had borrowed tens of billions of dollars in repos. Lehman used the cash from the Repo 105 transaction to pay down other liabilities, thus reducing both the total liabilities and the total assets reported on its balance sheet; thereby lowering its leverage ratios. A few days after the new quarter began, Lehman would borrow the necessary funds to unwind the Repo 105 transaction and restore the assets to its balance sheet.5

This accounting loophole has subsequently been addressed by FASB through an amendment to the codified version of SFAS 140 (the “SFAS 140 Amendment”). The SFAS140 Amendment eliminates the “transferor’s ability” criterion from the consideration of effective control for Repos that both entitle and obligate the transferor to repurchase or redeem financial assets before their maturity. In Accounting Standards Update 2011-03, FASB has concluded that the assessment of effective control should focus on a transferor’s contractual rights and obligations with respect to transferred financial assets, and not on whether the transferor has the practical ability to perform in accordance with those rights or obligations. The SFAS 140 Amendment effectively closes this loophole and requires that the securities sold under the Repo must be kept on the balance sheets of the seller. Consequently, this amendment prevents any understatement of leverage ratios through the Repo 105 type transaction.6

An insurer’s use of Repos as an investment vehicle cannot be compared to Lehman’s employment of Repo 105. As described above, insurance companies use Repos as an investment to support the company’s liability or liquidity needs. Within this framework of liability and liquidity management there is an industry need for Repos with a tenor greater than one year as a long term investment.

3. Accounting for Repurchase/Reverse Repurchase Agreement

SSAP No. 103 provides guidance for Short Duration Reverse Repos, but does not address the accounting and reporting requirements for Long Duration Repo Agreements the SAPWG included this topic as a future project during the meeting of March 6, 2013. At this meeting the subgroup indicated:

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6 Barry Epstein “Closing the GAAP: FASB Addresses Apparent Loophole that Enabled the Lehman Repo 105 Fraud”, (05/2011)
"B. Repurchase/Reverse Repurchase Agreements: SSAP No. 103 provides explicit guidance for reverse repurchase transactions being accounted for as short-term investments. It has been identified that some repurchase and reverse repurchase agreements are long-term (over one year), with termination before maturity of the underlying asset. As the current guidance in SSAP No. 103 does not explicitly address the accounting and reporting for long-term scenarios, questions have been received on how to report these agreements. It is anticipated that this Subgroup will review the current guidance and provide recommendations as to the accounting and reporting for long-term repurchase and reserve repurchase agreements."

Status: The FASB exposed for public comment proposed guidance in Topic 860 to clarify when repurchase agreements and securities lending transactions maintain effective control and should be accounted for as secured borrowings, and when control is not maintained and the transactions should be reviewed for derecognition (sale accounting). This FASB proposal addresses longer-term transactions, including repurchase agreements to maturity, and cash-settled repurchase agreements before maturity. Comment letters have been reviewed by FASB, and tentative decisions have been made with the last update on March 12, 2014."

Along with SSAP No. 103, the accounting guidance SSAP No. 2 Cash, Drafts, and Short-term Investments, Paragraph 10 (Short Term Investments) states the following: “All investments with remaining maturities (or repurchase dates under repurchase agreements) of one year or less at the time of acquisition (excluding those investments classified as cash equivalents as defined in paragraph 3 shall be considered short-term investments. Short-term investments include, but are not limited to, bonds, commercial paper, money market instruments, repurchase agreements, and collateral and mortgage loans which meet the above criteria. Short-term investments shall not include certificates of deposit.”

In addition to the SSAP guidance, the NAIC Annual Statement affirms: “repurchase agreements with tenors of one year or less are reported as either: a) Schedule E, Part 2 – “Cash Equivalents” if at acquisition, the maturity was three months or less; or b) Schedule DA – “Short-term Investments” if at acquisition, the maturity is one year or less, but greater than three months.” Since SSAP No. 2, 103, and the NAIC Annual Statement Instructions do not address the reporting of Long Duration Repos, the inference is for these investments to be classified as non-admitted assets; which is very punitive treatment.

ACLI strongly favors consistent accounting and reporting treatment for Short Duration and Long Duration Repo Agreements As described above, these transactions are substantively identical except for the tenor of the transaction (i.e. governed by the same transaction documents, same bankruptcy treatment, same underlying assets and same counterparties). We recognize however, that the differences in the tenor between Short and Long Duration Repo Agreements will result in the geography of reporting to be different. Our recommendation is for Long Duration Reverse Repos to be reported in either Schedule D “Long-Term Bonds”, or Schedule BA “Other Long-term Invested Assets. Additionally, ACLI recommends that the reporting of Long Duration Reverse Repos appear in the RBC schedule LR017 entitled “Off-balance Sheet and Other Items”, unless these transactions are incorporated into the RBC schedule for Long-term Bonds or Other Long-term Invested Assets. In addition, ACLI recommends Long Duration Repo Agreements be reported in line 25 “aggregate write-ins for liabilities”, within the “Liabilities, Surplus and Other Funds” section.

Based on the minutes to the March 6, 2013 meeting, it appears that the SAPWG has considered following the FASB guidance on this topic. ACLI supports this approach. The spirit of the FASB Exposure Draft (Topic 860) is to conform the accounting treatment of “Repos at maturity” and “Repos before their maturity”. In their draft proposal, the FASB is attempting to close GAAP accounting loopholes by placing conditions on sale accounting and classifying Repos, without regard to the transactions tenor. Repo
Agreements in which a party maintains effective control over the underlying collateral will be categorized as financing transactions or “Secured borrowing with a pledge of collateral”. Long-standing GAAP accounting for Repo Agreements is indifferent to the tenor of the transaction. The changes currently being debated by the FASB are consistent with the concept that the transaction tenor should not create a regulatory disparity. In developing guidance for SSAP No.103 we request that you follow the same tenor indifference as adopted by FASB.

Additionally, we strongly recommend that developing guidance for Long Duration Repo Agreements should be addressed independent of the FASB’s finalization of their Proposed Accounting Standards for repurchase-to-maturity agreements for the following reasons:

- The issue currently being addressed by FASB concerns “repurchase-to-maturity agreements”, or repurchase agreements that are co-terminus with the maturity of the underlying asset. This is a separate topic that can be addressed by the FASB without impacting the SAPWG’s development of guidance for SSAP No. 103.

- Timing on the FASB Exposure Draft resolution is uncertain and should not be a condition to developing the reporting and accounting treatment for Long Duration Repo Agreements which will delay approval of this initiative.
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To: Restricted Asset (E) Subgroup

From: Julie Gann, NAIC Staff

Re: Repurchase Agreements – Initial Memo

Date: March 24, 2014

The Restricted Asset Subgroup of the Statutory Accounting Principles (E) Working Group has previously identified repurchase agreements, reverse repurchase agreements and tri-party repurchase agreements as transactions that may generate restricted assets, which should be reviewed to ensure appropriate statutory accounting and reporting. This memorandum intends to describe these various transactions, highlight the current statutory accounting guidance, and identify specific issues that may warrant further discussion by the Subgroup.

Key Definitions: (Note – In this memo, the different types of agreements are collectively referred to as “repos”. The GAAP definitions are different from SAP. Staff recommends using the standard investment definitions with consideration to update the guidance in SSAP No. 103.)

Repurchase Agreements
An agreement under which the transferor (repo party) transfers a security to a transferee (repo counterparty or reverse party) in exchange for cash and concurrently agrees to reacquire that security at a future date for an amount equal to the cash exchanged plus a stipulated interest factor. Instead of cash, other securities or letters of credit sometimes are exchanged. Some repurchase agreements call for repurchase of securities that need not be identical to the securities transferred. (FASB Master Glossary)

Repurchase Agreement Accounted for as Collateralized Borrowing
A repurchase agreement (repo) refers to a transaction in which a seller-borrower of securities sells those securities to a buyer-lender with an agreement to repurchase them at a stated price plus interest at a specified date or in specified circumstances. A repurchase agreement accounted for as a collateralized borrowing is a repo that does not qualify for sale accounting under FASB Topic 860. The payable under a repurchase agreement accounted for as a collateralized borrowing refers to the amount of the seller-borrower's obligation recognized for the future repurchase of the securities from the buyer-lender. In certain industries, the terminology is reversed; that is, entities in those industries refer to this type of agreement as a reverse repo. (FASB Master Glossary)

Reverse-Repurchase Agreements
A reverse repurchase agreement accounted for as a collateralized borrowing (also known as a reverse repo) refers to a transaction that is accounted for as a collateralized lending in which a buyer-lender buys securities with an agreement to resell them to the seller-borrower at a stated price plus interest at a specified date or in specified circumstances. The receivable under a reverse repurchase agreement accounted for as a collateralized borrowing refers to the amount due from the seller-borrower for the repurchase of the securities from the buyer-lender. In certain industries, the terminology is reversed; that is, entities in those industries refer to this type of agreement as a repo. (FASB Master Glossary)
Repurchase Financing
A repurchase agreement that relates to a previously transferred financial asset between the same counterparties (or consolidated affiliates of either counterparty) that is entered into contemporaneously with, or in contemplation of, the initial transfer. *(FASB Master Glossary)*

Dollar-Roll Repurchase Agreement
An agreement to sell and repurchase similar but not identical securities. The securities sold and repurchased are usually of the same issuer. Dollar rolls differ from regular repurchase agreements in that the securities sold and repurchased have all of the following characteristics: a) they are represented by different certificates; b) they are collateralized by different but similar mortgage pools (for example, conforming single-family residential mortgages); c) they generally have different principal amounts. Fixed coupon and yield maintenance dollar agreements comprise the most common agreement variations. In a fixed coupon agreement, the seller and buyer agree that delivery will be made with securities having the same stated interest rate as the interest rate stated on the securities sold. In a yield maintenance agreement, the parties agree that delivery will be made with securities that will provide the seller a yield that is specified in the agreement. *(FASB Master Glossary)*

Tri-Party Repo
The distinguishing feature of a tri-party repo is that a custodian bank or international clearing organization, the tri-party agent, acts as an intermediary between the two parties to the repo. The tri-party agent is responsible for the administration of the transaction including collateral allocation, marking to market, and substitution of collateral.

General Collateral Finance (GCF) Repo
A type of repurchase agreement which is executed without the designation of specific securities as collateral until near the end of the trading day. General collateral financing (GCF) trades utilize several Inter-Dealer Brokers, who act as intermediaries for the GCF trades. GCF trades allow both borrowers and lenders in the repo market to reduce their costs and decrease the complexity of handling securities and fund transfers for repo agreements. The delay granted in specifying the exact collateral for the repo is advantageous for borrowers, who are then able to utilize the securities they have on hand to clear other, unrelated trades as necessary throughout the day. This avoids the time-consuming process of swapping collateral if it becomes needed by the borrower. GCF trades are also advantageous in that the use of the Inter-Dealer Broker allows borrowers and lenders to net out all of their GCF repo obligations at the end of each trading day, greatly decreasing the number of costly securities and fund transfers that must take place. In addition, GCF repos are used to switch among the dealers the securities that are available to collateralize third-party repos. GCF Repo transactions are settled on a tri-party basis, which requires dealer participants to have an account with either one or both of the participating clearing banks: The Bank of New York Mellon or JPMorgan Chase.

Current SSAP Guidance
Current SSAP guidance for repos is included in *SSAP No. 103—Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (SSAP No. 103). Although SSAP No. 103 was recently effective on Jan. 1, 2013, the guidance for repos was not substantially revised from the previous authoritative guidance in *SSAP No. 91R—Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (SSAP No. 91R).

*As noted in Issue Paper No. 141—Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (Issue Paper No. 141), which was the issue paper supporting SSAP No. 103, the guidance for repos was retained from SSAP No. 91R as the guidance had been recently revised as illustrated in Issue Paper No. 144—Substantive Revisions to SSAP No. 91R: Securities Lending.
The following summarizes key points of the current statutory accounting for repos. (The explicit guidance from SSAP No. 103 is included in Appendix A.)

- Repos are used to obtain or use short-term funds.
- Repos meet the definition of an asset, and are admitted to the extent they conform to SSAP No. 103.
- Repos can be transacted in a variety of ways:
  - Can be similar to securities lending with or without ability for collateral to be sold or pledged.
  - Can be short-term, have indefinite terms or lengths, or end at maturity of the transferred asset.
  - Some may not require repurchase of identical securities.
  - Can meet “sale” accounting or be structured as “secured borrowings”
- Repos must meet collateral requirements for admitted asset classification.

Repos with Sale Accounting Treatment:
- Transferor sells assets (derecognizes assets) and recognizes a forward purchase commitment.
- Transferee purchases assets (recognizes assets) and recognizes a forward resale commitment.

Repos with Secured Borrowing:
- Transferor retains recognition of assets, proceeds received are recognized as a liability, and the difference between the proceeds and the re-purchase price is recognized as interest expense.
- Transferee does not recognize assets, amount paid is recognized as a short-term investment, and the difference between the amount paid and the amount that will be received to “sell-back” is interest income.

Accounting for Collateral:
The accounting for collateral depends on whether the contract allows the entity receiving collateral to sell or repledge, and whether pledging entity has defaulted. (SSAP No. 103, paragraph 19)

Entity Receiving Collateral Has No Right to Sell or Repledge:
- Entity pledging retains assets pledged as collateral, identifying assets as pledged on investment schedules.
- Entity receiving does not report the collateral received or the liability to return.

Entity Receiving Collateral Has Right to Sell or Repledge:
- Entity pledging retains assets pledged as collateral, identifying assets as pledged on investment schedules.
- If the entity receiving sells the collateral, it recognizes the proceeds from the sale, and an obligation to return the collateral to the transferor. (The receiving entity does not recognize the collateral as an asset.)

Entity Pledging Collateral Has Defaulted and is No Longer Entitled to the Pledged Asset:
- Entity pledging shall derecognize the pledged asset.
- Entity receiving shall recognize the collateral as its asset initially at fair value. If the entity had sold the pledged collateral (so proceeds from sale would have been recognized, with a liability recognized for the return of the collateral), the transferee should derecognize the obligation to return the collateral.

As noted in SSAP No. 103, paragraph 19b, unless the entity pledging has defaulted, that entity would continue to carry the collateral as its asset, and the receiving entity would not recognize the pledged asset. (Note – The words “transferee” and “transferor” in paragraph 19b pertains to the person receiving/pledging collateral. These roles are not necessarily consistent with the roles in a repo agreement. In a repo, the “transferor” transfers assets to the “transferee”. With the receipt of the transferred asset, the “transferee” pledges assets to the “transferor”.)

The guidance in paragraph 19 is consistent with GAAP for non-cash collateral (860-30-25-5). The GAAP guidance for cash collateral identifies that cash collateral cannot be distinguished from borrowing cash, and as cash is fungible, it is impossible to determine whether the cash has been used by the secured party. As such, all cash collateral is recorded as an asset by the receiving entity, along with a liability for the obligation to return the collateral to the payer. The entity pledging records a receivable asset for the return of the collateral (860-30-25-3).

Note: The SSAP No. 103 guidance for secured borrowings is different than the SSAP No. 103 guidance for...
securities lending transactions. Per the securities lending guidance in paragraph 83, reporting entities that have the ability to sell or repledge collateral recognize the collateral as an asset on their balance sheet, as well as the obligation to return the collateral. Only collateral that cannot be sold or repledged is shown “off-balance sheet”.

Collateral Requirements:

- **Repurchase Transaction**: Reporting entity shall receive collateral having a fair value at the transaction date at least equal to 95% of the fair value of the securities transferred as of that date. If at any time the fair value of the collateral received is less than 95% of the fair value of the transferred securities, the counterparty is obligated to transfer additional collateral by the end of the next business day so that the total collateral held at least equals 95%. If the collateral is less than 95%, the difference between the actual collateral and 95% will be nonadmitted.

  *This guidance has been previously communicated as confusing as non-cash collateral in a secured borrowing is not recognized on the books. However, if the 95% threshold is not met, he “transferred” asset under the repo transaction, which is still recognized, is partly nonadmitted.*

- **Reverse-Repurchase Transaction**: Reporting entity shall receive as collateral transferred securities having a fair value at least equal to 102% of the purchase price paid by the reporting entity for the securities. If at any time, the fair value of the collateral is less than 100% of the purchase price paid, the counterparty shall be obligated to provide additional collateral, the fair value of which, together with the fair value of all collateral held, at least equals 102% of the purchase price.

  *This guidance has also been previously communicated as confusing as the wording implies that the transaction was a “sale” (purchase price paid). There is also no explicit nonadmittance language in this paragraph if the collateral is not met. (Other guidance allude to nonadmittance, but it is not explicit.)*

Additional Information:

- **FSOC**: In May 2013, the Financial Stability Oversight Council (FSOC) highlighted certain potential financial stability risks in the tri-party repurchase market.

  The tri-party repo market remains vulnerable to runs by lenders in the event that concerns emerge regarding the financial condition of borrowers such as securities broker-dealers, who depend heavily on this channel for short-term funding. Additional risks stem from the continued heavy reliance on discretionary intraday credit in the settlement process, and the limited capacity of lenders to manage the ramifications of a default by a major borrower. Some progress has been made in increasing the resiliency of the tri-party market. The reliance on intraday credit extended by the clearing banks has begun to decline and, as additional changes are made to the settlement process, should be largely eliminated by the end of 2014. Nonetheless, a default of a large broker-dealer or other large borrower would leave lenders with large volumes of collateral that they would likely seek to liquidate quickly.

- **SEC**: In July 2013, the SEC issued guidance for money market fund managers to prepare in advance to handle a default of a tri-party repo. The following is a summary of key excerpts:
  - If repurchase agreements include specified default procedures, which require the fund to provide notifications, instructions, etc., the fund may want to consider having such notifications or other documents prepared in advance to the extent practicable.
  - The fund should consider the operational aspects of managing a repo default, including whether the fund is capable of holding, valuing, trading, and accounting for the collateral underlying the repos.
  - The fund should consider potential legal considerations under the Investment Company Acts in the event of a repo default. For example, the fund may want to consider whether they can hold certain types of repo collateral and remain in compliance with rule 2a-7 of the Investment Company Act of
1940. The fund may want to identify required notices to the SEC, and determine whether the defaulted repo would be subject to any automatic stays under the US bankruptcy code or federal banking laws or regulations. If there is an automatic stay, the fund may want to evaluate what the impact of such stay would have on the fund.

- **GAAP**: The FASB is currently considering proposed amendments to amend when repurchase agreements would be considered a secured borrowing or be accounted for as a sale transaction. The FASB status for this project identifies that it is expected to be finalized in the 2nd quarter of 2014.

- **State Law**: The NY law restricts repurchase transactions that exceed one year. *(N.Y. Ins. Law Sec. 1411)*

  No domestic insurer shall enter into any agreement in connection with the sale of any property to repurchase such property or any part thereof, except that such an insurer may (subject to the provisions of subsection (b) of this section) sell securities subject to an unconditional obligation to repurchase the same on a date not more than one year from the date of sale. This subsection shall not apply to the purchase or sale of directors’ qualifying shares.

  Referenced Subsection (b) - No such insurer shall participate in any underwriting of the purchase or sale of securities in advance of their issuance. Any such insurer may enter into any agreement to sell or withhold from sale any of its property as long as the insurer is not participating in an underwriting. The disposition of its property shall be the responsibility of its board of directors.

- **Federal Reserve Bank of New York – Tri-Party Repo Infrastructure Reform Task Force**: In 2009, this Task Force was formed at the request of the New York Fed to address weaknesses that became visible over the course of the financial crisis. The Task Force delivered a final report in February 2012, at which time the New York Fed announced that the Federal Reserve would intensify its supervisory oversight of key tri-party market participants' efforts to implement the Task Force recommendations in a timely fashion.

  **Press Release Feb. 15, 2012 – Statement on the Release of the Tri-party Repo Infrastructure Reform Task Force’s Final Report**: The Task Force was formed to develop options to address three fundamental areas of concern identified by policymakers at the Federal Reserve: (1) market participants’ overreliance on intraday credit from tri-party clearing banks, (2) risk management practices that are vulnerable to procyclical pressures, and (3) the absence of an effective and transparent process for the orderly liquidation of a defaulted broker-dealer’s collateral. The Task Force released a set of recommendations in May 2010 to modify industry operations and practices to sharply reduce the market’s dependency on intraday credit provided by clearing banks. At that time, the Task Force indicated that the industry would complete the recommended operational changes in 2011. This goal was not achieved.

  **Statement Feb. 13, 2014 – Update on Tri-Party Repo Infrastructure Reform**: This press release provides a detail of the status two years following the Task Force’s final report. (Excerpts)

  - As 2014 begins, Clearing banks have done much to re-engineer their tri-party repo settlement systems in ways that significantly reduce the amount of intraday credit needed for daily settlement, including ending the daily unwind of cash and collateral for non-maturing trades and redesigning the process for settling maturing trades in a more liquidity-efficient manner, thereby requiring less clearing bank credit.

  - Market participants have important changes in their practices and behaviors that have helped to reduce the demand for intraday credit. Repo buyers and sellers are confirming the majority of their trades earlier in the day, providing the clearing banks with better and timelier information, which helps them to run settlement in a more credit-efficient manner.

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Progress has been made by some dealers in extending the tenor and laddering the maturity of their repo books, particularly for less liquid securities, so that maturities are less concentrated on any given day than they were in the past, reducing their need for credit.

Additional work is still needed, however, to fully realize the objective of a safer tri-party repo settlement process that is more resilient to stress. By the end of first quarter 2014, both clearing banks will have put in place a more automated, centralized and streamlined process for collateral optimization and allocation that will speed these processes and facilitate their interaction with the new settlement infrastructure that has been developed.

The goal articulated in the Task Force’s roadmap, namely the full integration of the General Collateral Finance Repo (GCF Repo); settlement into the new tri-party repo settlement process, will not be completed fully in 2014. The process for settling GCF Repo trades must become more liquidity-efficient, and thus more aligned with the broader tri-party repo settlement infrastructure in order to make the platform truly resilient to stress.

A third policy imperative that the Federal Reserve has long highlighted—namely the risk of destabilizing fire sales of repo collateral by tri-party repo investors in the event of a default of a large tri-party repo borrower—is not currently being addressed by industry participants. Many tri-party repo investors are highly vulnerable to liquidity pressures and credit losses that may cause them to liquidate the collateral of a defaulted counterparty very quickly, even if they must do so at a loss. The ensuing price declines could trigger margin calls and deleveraging well beyond the repo market, spreading instability across the financial system. Unfortunately, no mechanism currently exists or is being developed to ensure that investors will act collectively and in a measured way in liquidating their collateral.

Tri-party repo market participants have made good progress to date in reducing reliance on intraday credit as a source of systemic risk in this market. But more work clearly remains to be done to make this important wholesale funding market more resilient to stress so that the events of 2008 are not repeated.

Bankruptcy / Automatic Stay Provisions:

- In 1984, Congress exempted repos from bankruptcy provisions if they were collateralized by Treasuries, federal agencies like Fannie Mae, bank certificates of deposit and bankers’ acceptances. In 2005, Congress expanded the scope of the bankruptcy exemption in 1984 was extended so that repos collateralized with mortgage-related securities are also exempt from the borrower’s bankruptcy. *(Per the congress exemptions, repo lenders who hold these types of collateral will be repaid before other creditors when a repo borrower files bankruptcy. As insurers generally follow the receivership laws of the state, it is uncertain whether similar provisions are part of the state laws. A legal inquiry has requested research on this item. Staff believes that if an insurer is considered a “Systemically Important Financial Institution” (SIFI) they would be subject to the U.S. bankruptcy laws.)*

- Insurer Receivership Model Act (Model #255): Section 711 provides “automatic stay” provisions for any netting agreement or qualified financial contracts in the event of an insolvency, financial condition, default or commencement of formal delinquency proceedings. *(As of January 2014, there were 21 states that have adopted provisions similar to Section 711 of IRMA.)*
Definitions included in the Model #255:

- "Qualified financial contract" means any commodity contract, forward contract, repurchase agreement, securities contract, swap agreement and any similar agreement that the commissioner determines by regulation, resolution or order to be a qualified financial contract for the purposes of this Act.

Model Note: This definition of “qualified financial contract” is intended to be consistent with definitions applicable under federal law in instances of insolvency of other types of financial institutions. It is not the intention of this provision, or of Section 711, to affect the scope of permissible investments of insurers or the valuation thereof, or to modify any other regulatory framework applicable to investments or investment practices of insurers.

- "Netting agreement" means (1) a contract or agreement (including terms and conditions incorporated by reference therein), including a master agreement (which master agreement, together with all schedules, confirmations, definitions and addenda thereto and transactions under any thereof, shall be treated as one netting agreement), that documents one or more transactions between the parties to the agreement for or involving one or more qualified financial contracts and that provides for the netting, liquidation, setoff, termination, acceleration or close out under or in connection with one or more qualified financial contracts or present or future payment or delivery obligations or payment or delivery entitlements thereunder (including liquidation or close-out values relating to such obligations or entitlements) among the parties to the netting agreement; (2) any master agreement or bridge agreement for one or more master agreements described in Paragraph (1) of this subsection; or (3) any security agreement or arrangement or other credit enhancement or guarantee or reimbursement obligation related to any contract or agreement described in Paragraph (1) or (2) of this subsection; provided that any contract or agreement described in Paragraph (1) or (2) of this subsection relating to agreements or transactions that are not qualified financial contracts shall be deemed to be a netting agreement only with respect to those agreements or transactions that are qualified financial contracts.

Initial Discussion Areas – Restricted Asset (E) Subgroup:

1. Short-Term/Long-Term Transactions - Should statutory accounting guidance related to repo agreements be limited to short-term transactions (current guidance), or should guidance be incorporated to address long-term repo agreements? (With the current guidance limited to short-term transactions, long-term repo agreements are not considered admitted assets.)

   Repurchase agreements can be structured as short-term transactions that are unwound/re-wound every day. So although a short-term transaction, the repurchase agreement could continue indefinitely. However, with this transaction, both parties have the ability to not renew if market factors or concerns arise with regards to the counterparty. A long-term transaction increases risk as the parties are not able to unwind the transaction when market or counterparties concerns arise.

2. Clarification of Guidance - Should the guidance for repurchase transactions be clarified, with the potential of expanded disclosures and/or restricted asset reporting classifications to ensure proper identification and availability of assets? If so, may consider disclosure to highlight the extent of quarterly/annual repo activity, rather than a year-end snapshot, to fully understand the extent of repo transactions within a reporting entity.

   The recognition of assets depends on whether the repurchase transaction is accounted for as a sale, or as a secured borrowing. Current A/S investment schedules should document whether the asset is subject to a repurchase, reverse-repurchase, or dollar repurchase/reverse-repurchase agreement. However, staff suspects that the accounting and reporting of these transactions (particularly with collateral) may be inconsistent.

   Although the collateral guidance is adopted from GAAP, staff has concerns regarding the current process which specifies that transferees should not recognize collateral pledged to them even if they have repledged the collateral. (Under the current guidance, only if the collateral is sold, would the reporting entity recognize the proceeds from the sale and the obligation to return.) The Subgroup may want to consider whether there is
a regulatory reason to adopt a process that differs from GAAP (similar to securities lending) and/or impose restrictions on the repledging of pledged collateral that is not recognized on the balance sheet. Staff also suggests enhanced disclosures for collateral received, including repledging possibilities.

3. **Repurchase Agreement Contract** - Should consider the reporting of repurchase agreements on a transferee’s financial statement in a secured borrowing. Per the current SSAP No. 103 guidance, the amount paid is recognized as a short-term investment. Without the collateral asset actually being recognized, this asset simply reflects the “repurchase contract”. Discussion may be desired on whether this “contract” is a “readily marketable” asset that meets the admitted asset criteria in SSAP No. 4:

   The ability to meet policyholder obligations is predicated on the existence of readily marketable assets available when both current and future obligations are due. Assets having economic value other than those which can be used to fulfill policyholder obligations, or those assets which are unavailable due to encumbrances or other third party interests should not be recognized on the balance sheet,” and are, therefore, considered nonadmitted.

4. **Automatic Stay Provisions** - Should consider whether “automatic” stay provisions would impact the reporting of collateral within the financial statements. Similar to the question above, may want to discuss whether pledged collateral that is subject to an automatic stay provision is an asset that has economic value other than which can be used to fulfill policyholder obligations. If the asset is unavailable for policyholders, per the guidance in SSAP No. 4, it should be nonadmitted.

5. **Asset Restrictions** - Should consider if restrictions should be established for all elements of the repo transaction to require cash or other investments that qualify as admitted assets.

   a) For entities receiving collateral - In the event of default the collateral would be the assets recognized. Requiring collateral assets that qualify as admitted asset status would safeguard the financial condition of the non-defaulting reporting entity. (If non-admitted assets were received as collateral, surplus would be decreased until the reporting entity was able to successfully liquidate the collateral.) (Depending on the ultimate guidance for recognizing collateral or the loaned asset, if non-qualifying collateral was received, guidance could be considered to require nonadmittance of the asset recognized on the financial statements – so if the collateral is not recognized, the loaned asset would be nonadmitted. The NAIC Investments of Insurers Model Law (#280) does provide restrictions as to acceptable collateral for repos.)

   b) For entities “lending” securities meeting “sale” criteria – If a reporting entity engaged in an repo transaction with non-admitted assets, “lending” under a contract that meets the terms of “sale” accounting would allow the reporting entity to improve surplus (through derecognition of the non-admitted assets) as a temporary measure to provide the appearance of an improved financial position. (May want to consider limitations on the application of repos structured under “sale” accounting to prevent involvement with non-admitted assets, or incorporate other provisions to reflect a surplus-neutral (not surplus improved) presentation from a temporary transaction with non-admitted assets.)

6. **Related Party Repos** - Should consider limitations or modifications in accounting/reporting for repurchase transactions with related parties or with entities for which other transactions occur.

   a) Under the current guidance adopted from GAAP, if entity receiving collateral sold that pledged asset, does the entity that provided the collateral receive notice that the asset has been sold? Under a secured borrowing, the entity pledging the asset continues to recognize the asset until default occurs. So, in theory, the same asset could be recognized on two separate entities financial statements. (The asset would be recognized by the entity pledging the collateral, and the entity that purchased it from the entity to which it was pledged. As the entity receiving the collateral does not recognize the asset, even if they have the ability to sell or re-pledge, upon selling the asset, the entity would only recognize the proceeds from the sale, and a liability to return.)
b) May discuss if it is possible for an entity to engage in multiple transactions with a single entity, within a holding company group, or with different entities in which a pledged asset “received” as part of a repo transaction (not recognized on the financial statements) is “re-pledged”? If such situations occur, should restrictions, improved disclosures and/or reporting provisions be established?

**Illustration of Repurchase Transaction – Secured Borrowing**

<table>
<thead>
<tr>
<th>Transferor (“Transfers” Securities)</th>
<th>Transferee (“Receives” Securities)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Repurchase Agreement – Secured Borrowing</strong></td>
<td><strong>Repurchase Agreement – Secured Borrowing</strong></td>
</tr>
<tr>
<td>1) Debit – Cash Credit – Liability Under Repurchase Agreement</td>
<td>1) Debit – Short-Term Repurchase Agreement Credit - Cash</td>
</tr>
<tr>
<td><strong>Repurchase Agreement - Unwind</strong></td>
<td><strong>Repurchase Agreement - Unwind</strong></td>
</tr>
<tr>
<td>2) Debit – Liability Under Repurchase Agreement Debit – Interest Expense Credit – Cash</td>
<td>2) Debit – Cash Credit – Interest Income Credit – Short-Term Repurchase Agreement</td>
</tr>
<tr>
<td>Interest expense should be recognized on the straight-line or constant yield method over the terms of the agreement.</td>
<td>Interest income recognized on the straight-line or constant yield method over the terms of the agreement.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Transferred Asset / Collateral</th>
<th>Transferred Asset / Collateral</th>
</tr>
</thead>
<tbody>
<tr>
<td>3) The “transferred” asset remains on the financial statements of the transferor with a notation on the financial statement schedules that it is subject to a repurchase agreement.</td>
<td>3) The “received” asset is not recognized on the financial statements.</td>
</tr>
<tr>
<td>4) Collateral of at least 95% of the fair value shall be pledged to this entity. This collateral (unless cash), or the obligation to return is not recognized on the financial statements regardless if the entity has ability to sell or repledge.</td>
<td>4) Pledges collateral of at least 95% of the fair value of the “received” asset. The collateral pledged remains on the financial statements, but has a notation that it is pledged.</td>
</tr>
<tr>
<td>5) If collateral drops below 95%, the “transferred” asset (still recognized on the books) is “nonadmitted” for the amount in which the collateral is less than 95%.</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Pledged Collateral is Re-Pledged by Transferor</th>
<th>Pledged Collateral is Sold by Transferor</th>
</tr>
</thead>
<tbody>
<tr>
<td>6) No Impact to the Financial Statements. The collateral is still not recognized on the financial statements.</td>
<td>5) No impact to the financial statements. The asset used as collateral is still recognized with a notation that it is pledged.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Pledged Collateral is Sold by Transferor</th>
<th>Transferee Defaults</th>
</tr>
</thead>
<tbody>
<tr>
<td>7) Debit – Cash (from sale of collateral) Credit – Obligation to Return Collateral</td>
<td>6) No impact to the financial statements. The asset pledged as collateral is still recognized with a notation that it is pledged.</td>
</tr>
<tr>
<td>With this scenario, it would seem that the asset would be shown as an asset on the “purchasing” entity’s financial statements as well as the “transferees” financial statements.</td>
<td>As noted, could this asset possibly be recognized in two separate financial statements?</td>
</tr>
<tr>
<td></td>
<td>7) Debit – “Received Asset” Credit – Pledged Collateral Asset</td>
</tr>
<tr>
<td>With the default, the “transferred” asset is derecognized from the financial statements. Since the entity had already sold the asset, it would not be recognized on the entity’s financial statements.</td>
<td>With the default, the asset received from the repurchase agreement is recognized on the financial statements.</td>
</tr>
</tbody>
</table>
Appendix A – SSAP No. 103 – Excerpts of Repo Guidance: *(Only relevant excerpts are included.)*

### Secured Borrowing

14. **If a transfer of an entire financial asset, a group of entire financial assets, or a participating interest in an entire financial asset does not meet the conditions for a sale in paragraph 8, or if a transfer of a portion of an entire financial asset does not meet the definition of a participating interest (paragraph 7), the transferor and transferee shall account for the transfer as a secured borrowing with pledge of collateral (paragraph 19).** The transferor shall continue to report the transferred financial assets in its statement of financial position with no change in their measurement (that is, basis of accounting).

### Secured Borrowings and Collateral

19. **A debtor may grant a security interest in certain assets to a lender (the secured party) to serve as collateral for its obligation under a borrowing, with or without recourse to other assets of the debtor. An obligor under other kinds of current or potential obligations, for example, interest rate swaps, also may grant a security interest in certain assets to a secured party. If collateral is transferred to the secured party, the custodial arrangement is commonly referred to as a pledge. Secured parties sometimes are permitted to sell or repledge (or otherwise transfer) collateral held under a pledge. The same relationships occur, under different names, in transfers documented as sales that are accounted for as secured borrowings (paragraph 14). The accounting for noncash collateral by the debtor (or obligor) and the secured party depends on whether the secured party or its agent has the right to sell or repledge the collateral and on whether the debtor has defaulted.**

- **a.** If the secured party (transferee) or its agent has the right by contract or custom to sell or repledge the collateral, then the debtor (transferor) shall report that asset in its balance sheet.

- **b.** If the secured party (transferee) sells collateral pledged to it, it shall recognize the proceeds from the sale and its obligation to return the collateral. The sale of the collateral is a transfer subject to the provisions of this statement.

- **c.** If the debtor (transferor) defaults under the terms of the secured contract and is no longer entitled to redeem the pledged asset, it shall derecognize the pledged asset, and the secured party (transferee) shall recognize the collateral as its asset initially measured at fair value or, if it has already sold the collateral, derecognize its obligation to return the collateral.

- **d.** Except as provided in paragraph 19.c., the debtor (transferor) shall continue to carry the collateral as its asset, and the secured party (transferee) shall not recognize the pledged asset.

20. **Reporting entities may enter into certain transactions that require the granting of a security interest in certain assets to another party to serve as collateral (INT 09-08) for their performance under a contract. If the assets pledged are recorded as admitted assets under SSAP No. 4—Assets and Nonadmitted Assets (SSAP No. 4) and INT 01-31: Assets Pledged as Collateral (INT 01-31) and are not impaired under the provisions of SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets (SSAP No. 5R), the pledging entity records the collateral as an admitted asset until committing a contract default that has not been cured in accordance with the contract provisions. At the time of an uncured default, the provisions of paragraph 19 shall be used to determine the appropriate accounting treatment for the collateral. If the secured party utilizes collateral to offset all or a portion of the liability owed by the pledging entity as a result of the default, then the collateral amount utilized to offset the liability shall be removed from the balance sheet. At the same time, the amount of the liability that was offset shall be removed from the balance sheet since that obligation has been satisfied through the secured party’s utilization of that collateral. To the extent that an uncured default remains without the secured party utilizing the collateral to offset the obligation, the pledging insurer shall only record an admitted asset for the amount of collateral that it can redeem.**
Disclosures:

24. Disclosures required by this statement may be reported in the aggregate for similar transfers if separate reporting of each transfer would not provide more useful information to financial statement users. A transferee shall disclose how similar transfers are aggregated. A transferee shall distinguish transfers that are accounted for as sales from transfers that are accounted for as secured borrowings. In determining whether to aggregate the disclosures for multiple transfers, the reporting entity shall consider quantitative and qualitative information about the characteristics of the transferred financial assets. For example, consideration should be given, but not limited, to the following:

   a. The nature of the transferee’s continuing involvement.
   b. The types of financial assets transferred.
   c. Risks related to the transferred financial assets to which the transferee continues to be exposed after the transfer and the change in the transferee’s risk profile as a result of the transfer.

25. The disclosures shall be presented in a manner that clearly and fully explains to financial statement users the transferee’s risk exposure related to the transferred financial assets and any restrictions on the assets of the entity. An entity shall determine, in light of the facts and circumstances, how much detail it must provide to satisfy the disclosure requirements of this statement and how it aggregates information for assets with different risk characteristics. The entity must strike a balance between obscuring important information as a result of too much aggregation and excessive detail that may not assist financial statement users to understand the entity’s financial position. For example, an entity shall not obscure important information by including it with a large amount of insignificant detail. Similarly, an entity shall not disclose information that is so aggregated that it obscures important differences between the different types of involvement or associated risks.

26. The disclosures in paragraph 28.f. of this statement apply to transfers accounted for as sales when the transferee has continuing involvement with transferred financial assets as a result of a securitization, asset-backed financing arrangement, or a similar transfer. If specific disclosures are required for a particular form of the transferee’s continuing involvement by other SSAPs, the transferee shall provide the information required in paragraphs 28.f.i.(a) and 28.f.ii.(a) of this statement with a cross-reference to the separate notes to financial statements so a financial statement user can understand the risks retained in the transfer. The entity need not provide each specific disclosure required in paragraphs 28.f.i.(b), 28.f.ii.(a)(1)–(4), and 28.f.ii.(b)–(e) if the disclosure is not required by other SSAPs and the objectives of paragraph 23 are met. For example, if the transferee’s only form of continuing involvement is a derivative, the entity shall provide the disclosures required in paragraphs 28.f.i.(a) and 28.f.ii.(a) of this statement and the disclosures about derivatives required by applicable SSAPs. In addition, the entity would evaluate whether the other disclosures in paragraph 28.f. are necessary for the entity to meet the objectives in paragraph 23.

27. To apply the disclosures in paragraph 28, an entity shall consider all involvements by the transferee or its agents to be involvements by the transferee.

28. A reporting entity shall disclose the following:

   a. For collateral:

      i. If the entity has entered into repurchase agreements or securities lending transactions, its policy for requiring collateral or other security and the fair value of the loaned security;

      ii. If the entity has pledged any of its assets as collateral that are not reclassified and separately reported in the statement of financial position pursuant to paragraph 19.a., the carrying amounts and classifications of both those assets and associated liabilities as of the date of the latest statement of financial position presented, including qualitative information about the relationship(s) between those assets and associated liabilities. For example, if assets are restricted solely to satisfy a specific obligation, the carrying amounts of those assets and associated liabilities, including a description of the nature of restrictions placed on the assets, shall be disclosed.
iii. If the entity or its agent has accepted collateral that it is permitted by contract or custom to sell or repledge, the fair value as of the date of each statement of financial position presented of that collateral and of the portion of that collateral that it has sold or repledged, and information about the sources and uses of that collateral. Additionally, the reporting entity shall disclose the aggregate amount of contractually obligated open collateral positions (aggregate amount of securities at current fair value or cash received for which the borrower may request the return of on demand) and the aggregate amount of contractually obligated collateral positions under 30-day, 60-day, 90-day, and greater than 90-day terms.

iv. If the entity has accepted collateral that it is not permitted by contract or custom to sell or repledge, provide detail on these transactions, including the terms of the contract, and the current fair value of the collateral.

v. For all securities lending transactions, disclose collateral for transactions that extend beyond one year from the reporting date; and

vi. For securities lending transactions administered by an affiliated agent in which “one-line” reporting (paragraph 83.a.) of the reinvested collateral per paragraph 83.c. is optional, at the discretion of the reporting entity, disclose the aggregate value of the reinvested collateral which is “one line” reported and the aggregate value of items which are reported in the investment schedules (paragraph 83.b.). Identify the rationale between the items which are one line reported and those that are investment schedule reported and if the treatment has changed from the prior period and

vii. For securities lending transactions, include separately, the amount of any loaned securities within the separate account and if the policy and procedures for the separate account differ from the general account.

b. The reporting entity shall provide the following information by type of program (repurchase agreement, securities lending or dollar repurchase agreement) with respect to the reinvestment of the cash collateral and any securities which it or its agent receives as collateral that can be sold or repledged.

i. The aggregate amount of the reinvested cash collateral (amortized cost and fair value). Reinvested cash collateral shall be broken down by the maturity date of the invested asset – under 30-day, 60-day, 90-day, 120-day, 180-day, less than 1 year, 1-2 years, 2-3 years and greater than 3 years.

ii. To the extent that the maturity dates of the liability (collateral to be returned) does not match the invested assets, the reporting entity shall explain the additional sources of liquidity to manage those mismatches.

f. For securitizations, asset-backed financing arrangements, and similar transfers accounted for as sales when the transferor has continuing involvement (as defined in the glossary) with the transferred financial assets:

i. For each income statement presented:

(a) The characteristics of the transfer (including a description of the transferor’s continuing involvement with the transferred financial assets, the nature and initial fair value of the assets obtained as proceeds and the liabilities incurred in the transfer, and the gain or loss from sale of transferred financial assets. For initial fair value measurements of assets obtained and liabilities incurred in the transfer, the following information:

(1) The level within the fair value hierarchy in which the fair value measurements in their entirety fall, segregating fair value measurements using quoted prices in active markets for identical assets or liabilities (Level 1), significant other observable inputs (Level 2), and significant unobservable inputs (Level 3)
(2) The key inputs and assumptions used in measuring the fair value of assets obtained and liabilities incurred as a result of the sale that relate to the transferor’s continuing involvement (including, at a minimum, but not limited to, and if applicable, quantitative information about discount rates, expected prepayments including the expected weighted-average life of prepayable financial assets, and anticipated credit losses, including expected static pool losses)

(b) Cash flows between a transferor and transferee, including proceeds from new transfers, proceeds from collections reinvested in revolving-period transfers, purchases of previously transferred financial assets, servicing fees, and cash flows received from a transferor’s beneficial interests.

ii. For each statement of financial position presented, regardless of when the transfer occurred:

(a) Qualitative and quantitative information about the transferor’s continuing involvement with transferred financial assets that provides financial statement users with sufficient information to assess the reasons for the continuing involvement and the risks related to the transferred financial assets to which the transferor continues to be exposed after the transfer and the extent that the transferor’s risk profile has changed as a result of the transfer (including, but not limited to, credit risk, interest rate risk, and other risks), including:

(1) The total principal amount outstanding, the amount that has been derecognized, and the amount that continues to be recognized in the statement of financial position.

(2) The terms of any arrangements that could require the transferor to provide financial support (for example, liquidity arrangements and obligations to purchase assets) to the transferee or its beneficial interest holders, including a description of any events or circumstances that could expose the transferor to loss and the amount of the maximum exposure to loss.

(3) Whether the transferor has provided financial or other support during the periods presented that it was not previously contractually required to provide to the transferee or its beneficial interest holders, including when the transferor assisted the transferee or its beneficial interest holders in obtaining support, including:

(i.) The type and amount of support

(ii.) The primary reasons for providing the support

(4) Information is encouraged about any liquidity arrangements, guarantees, and/or other commitments provided by third parties related to the transferred financial assets that may affect the transferor’s exposure to loss or risk of the related transferor’s interest.

(b) The entity’s accounting policies for subsequently measuring assets and liabilities that relate to the continuing involvement with the transferred financial assets;

(c) The key inputs and assumptions used in measuring the fair value of assets or liabilities that relate to the transferor’s continuing involvement (including, at a minimum, but not limited to, and if applicable, quantitative information about discount rates, expected prepayments including the expected weighted-average life of prepayable financial assets, and anticipated credit losses, including expected static pool losses);

(d) For the transferor’s interests in the transferred financial assets, a sensitivity analysis or stress test showing the hypothetical effect on the fair value of those interests (including any servicing assets or servicing liabilities) of two or more unfavorable variations from the expected levels for each key assumption that is reported under paragraph 28.f.ii.(c) independently from any change in another key assumption, and a description of the objectives, methodology, and limitations of the sensitivity analysis or stress test.
(e) Information about the asset quality of transferred financial assets and any other assets that it manages together with them. This information shall be separated between assets that have been derecognized and assets that continue to be recognized in the statement of financial position. This information is intended to provide financial statement users with an understanding of the risks inherent in the transferred financial assets as well as in other assets and liabilities that it manages together with transferred financial assets. For example, information for receivables shall include, but is not limited to:

(i.) Delinquencies at the end of the period; and
(ii.) Credit losses, net of recoveries, during the period.

g. Disclosure requirements for transfers of financial assets accounted for as secured borrowing:

i. The carrying amounts and classifications of both assets and associated liabilities recognized in the transferor’s statement of financial position at the end of each period presented, including qualitative information about the relationship(s) between those assets and associated liabilities. For example, if assets are restricted solely to satisfy a specific obligation, the carrying amounts of those assets and associated liabilities, including a description of the nature of restrictions placed on the assets.

h. Description of any loaned securities, including the amount, a description of, and the policy for, requiring collateral, and whether or not the collateral is restricted;

i. A description of the securities underlying repurchase and reverse repurchase agreements, dollar repurchase and dollar reverse repurchase agreements, including book values and fair values, and maturities for the following categories: (i) securities subject to reverse repurchase agreements; (ii) securities subject to repurchase agreements; (iii) securities subject to dollar repurchase agreements; and (iv) securities subject to dollar reverse repurchase agreements; and

j. A description of the terms of reverse repurchase agreements whose amounts are included in borrowed money.

k. Disclose any transfers of receivables with recourse.

l. A reporting entity shall disclose the following information for wash sales, as defined in paragraph 12, involving transactions for securities with a NAIC designation of 3 or below, or unrated that do not have an NAIC designation:

i. A description of the reporting entity’s objectives regarding these transactions;

ii. An aggregation of transactions by NAIC designation 3 or below, or unrated that do not have an NAIC designation;

iii. The number of transactions involved during the reporting period;

iv. The book value of securities sold;

v. The cost of securities repurchased; and

vi. The realized gains/losses associated with the securities involved.

m. All repurchase and reverse repurchase transactions and securities borrowing and securities lending transactions shall be shown gross when detailed on the respective investment schedules. However, repurchase and reverse repurchase transactions and securities borrowing and securities lending transactions may be reported net in the financial statements (pages 2 and 3 of the statutory financial statements) in accordance with SSAP No. 64—Offsetting and Netting of Assets and Liabilities (SSAP No. 64) when a valid right to offset exists. When these transactions are offset in accordance with SSAP No. 64 and reported net in the financial statements, the disclosure requirements in SSAP No. 64, paragraph 6, shall be followed.
Repurchase Agreements and "Wash Sales"

87. Government securities dealers, banks, other financial institutions, and corporate investors commonly use repurchase agreements to obtain or use short-term funds. Under those agreements, the transferor ("repo party") transfers a security to a transferee ("repo counterparty" or "reverse party") in exchange for cash and concurrently agrees to reacquire that security at a future date for an amount equal to the cash exchanged plus a stipulated "interest" factor. Repurchase agreements, reverse repurchase agreements and dollar repurchase agreements meet the definition of assets as defined in SSAP No. 4—Assets and Nonadmitted Assets and are admitted assets to the extent they conform to the requirements of this statement.

88. Repurchase agreements can be affected in a variety of ways. Some repurchase agreements are similar to securities lending transactions in that the transferee or its agent has the right to sell or repledge the securities to a third party during the term of the repurchase agreement. In other repurchase agreements, the transferee does not have the right to sell or repledge the securities during the term of the repurchase agreement. For example, in a tri-party repurchase agreement, the transferor transfers securities to an independent third-party custodian that holds the securities during the term of the repurchase agreement. Also, many repurchase agreements are for short terms, often overnight, or have indefinite terms that allow either party to terminate the arrangement on short notice. However, other repurchase agreements are for longer terms, sometimes until the maturity of the transferred financial asset. Some repurchase agreements call for repurchase of securities that need not be identical to the securities transferred.

89. If the conditions in paragraph 8 are met, the transferor shall account for the repurchase agreement as a sale of financial assets and a forward repurchase commitment, and the transferee shall account for the agreement as a purchase of financial assets and a forward resale commitment. Other transfers that are accompanied by an agreement to repurchase the transferred financial assets that may be accounted for as sales include transfers with agreements to repurchase at maturity. (Repurchase financing is addressed in paragraphs 96-101.)

90. Furthermore, "wash sales" that previously were not recognized if the same financial asset was purchased within 30 days before or after the sale shall be accounted for as sales under this statement. Unless there is a concurrent contract to repurchase or redeem the transferred financial assets from the transferee, the transferor does not maintain effective control over the transferred financial assets.

91. As with securities lending transactions, under many agreements to repurchase transferred financial assets before their maturity the transferor maintains effective control over those financial assets. Repurchase agreements that do not meet all the conditions in paragraph 8 shall be treated as secured borrowings. Fixed-coupon and dollar-roll repurchase agreements, and other contracts under which the securities to be repurchased need not be the same as the securities sold, qualify as borrowings if the return of substantially the same (paragraph 52) securities as those concurrently transferred is assured. Therefore, those transactions shall be accounted for as secured borrowings by both parties to the transfer.

92. If a transferor has transferred securities to an independent third-party custodian, or to a transferee, under conditions that preclude the transferee from selling or repledging the assets during the term of the repurchase agreement (as in most tri-party repurchase agreements), the transferor has not surrendered control over those assets.

Repurchase Agreements

93. Repurchase agreements are defined as agreements under which a reporting entity sells securities and simultaneously agrees to repurchase the same or substantially the same securities at a stated price on a specified date. For securities to be substantially the same, the criteria defined in paragraph 52 must be met, and for mortgage-backed securities excluding mortgage pass-through securities, the projected cash flows of the securities must be substantially the same under multiple scenario prepayment assumptions.

94. For repurchase agreements that are accounted for as collateralized borrowings in accordance with paragraph 91 of this statement, the underlying securities shall continue to be accounted for as an investment owned by the reporting entity. The proceeds from the sale of the securities shall be recorded as a liability, and the difference between the proceeds and the amount at which the securities will be subsequently reacquired shall be reported as interest expense, calculated on the straight-line method or the scientific interest (constant yield) method, over the term of the agreement.
95. Reporting entities generally take possession of the underlying collateral under repurchase agreements and in many cases may obtain additional collateral when the estimated fair value of such securities falls below their current contract value. However, to the extent that the current fair value of the collateral is less than the recorded amount, the shortfall shall reduce the admitted asset value of the repurchase agreement.

Repurchase Financing
96. Repurchase financing is a repurchase agreement that relates to a previously transferred financial asset between the same counterparties (or affiliates of either counterparty) that is entered into contemporaneously with, or in contemplation of, the initial transfer.

97. A repurchase financing involves the transfer of a previously transferred financial asset back to the initial transferor as collateral for a financing between the initial transferee (the borrower) and the initial transferor (the lender). A repurchase financing also typically involves the initial transferor returning the transferred financial asset (or substantially the same asset) to the initial transferee when the financing is repaid on a state date. A repurchase financing is entered into in contemplation of the initial transfer if both transactions are considered together at the execution of the initial transfer.

98. When the transferor transfers a financial asset and also enters into a repurchase financing with the transferee, there are typically three transfers of the financial assets:
   a. Initial transfer – An initial transferor transfers a financial asset to an initial transferee.
   b. Repurchase financing – The initial transferee (the borrower) transfers the previously transferred financial asset back to the initial transferor (the lender) as collateral for a financing between the initial transferor and initial transferee.
   c. Settlement – The initial transferor (the lender) returns the financial asset (or substantially the same asset) to the initial transferee (the borrower) upon receipt of payment from the initial transferee.

99. Repurchase financing that is entered into contemporaneously with, or in contemplation of, an initial transfer of financial asset between the same counterparties (or affiliates of either counterparty) shall not be separately accounted for as a transfer of a financial asset and a related repurchase financing unless (a) the two transactions have a valid and distinct business or economic purpose for being entered into separately and (b) the repurchase financing does not result in the initial transferor regaining control over the financial asset. Unless the provisions in paragraph 100 are met, the initial transfer and repurchase financing shall be evaluated as a linked transaction. The linked transaction shall be evaluated to determine whether it meets the requirements for sale accounting per paragraph 8. If the linked transaction does not meet the requirements for sale accounting, the linked transaction shall be accounted for based on the economies of the combined transactions, which generally represent a forward contract. SSAP No. 86—Accounting for Derivative Instruments and Hedging, Income Generation, and Replication (Synthetic Asset) Transactions shall be used to evaluate whether the linked transaction shall be accounted for as a derivative.

100. An initial transfer of a financial asset and repurchase financing that are entered into contemporaneously with, or in contemplation of, one another shall be considered linked unless all of the following criteria are met at the inception of the transaction:
   a. The initial transfer and the repurchase financing are not contractually contingent on one another. Even if no contractual relationship exists, the pricing and performance of either the initial transfer or the repurchase financing must not be dependent on the terms and execution of the other transaction.
   b. The repurchase financing provides the initial transferor with recourse to the initial transferee upon default. That recourse must expose the initial transferor to the credit risk of the initial transferee, or its affiliates, and not solely to the market risk of the transferred financial asset. The initial transferee’s agreement to repurchase the previously transferred financial asset (or substantially the same asset) for a fixed price and not fair value.
c. The financial asset subject to the initial transfer and repurchase financing is readily obtainable in the marketplace. In addition, the initial transfer of a financial asset and the repurchase financing are executed at market rates. This criterion may not be circumvented by embedding off-market terms in a separate transaction contemplated with the initial transfer or the repurchase financing.

d. The financial asset and repurchase agreement are not coterminous (the maturity of the repurchase financing must be before the maturity of the financial asset.)

101. In accordance with paragraph 99, an initial transfer of assets and a repurchase financing shall not be considered separate transactions unless the provisions of paragraph 100 are met. If the provisions of paragraph 100 are met, the initial transfer shall be evaluated to determine whether it meets the requirements for sale accounting without taking into consideration the repurchase financing. In such situations, the repurchase financing shall then be separately analyzed as a repurchase agreement.

Reverse Repurchase Agreements

102. Reverse repurchase agreements are defined as agreements under which a reporting entity purchases securities and simultaneously agrees to resell the same or substantially the same securities at a stated price on a specified date. For securities to be substantially the same, the criteria defined in paragraph 52 must be met, and for mortgage-backed securities excluding mortgage pass-through securities, the projected cash flows of the securities must be substantially the same under multiple scenario prepayment assumptions.

103. For reverse repurchase agreements that are accounted for as collateralized lendings in accordance with paragraph 91 of this statement, the underlying securities shall not be accounted for as investments owned by the reporting entity. The amount paid for the securities shall be reported as a short-term investment, and the difference between the amount paid and the amount at which the securities will be subsequently resold shall be reported as interest income, calculated on the straight-line method or the scientific interest (constant yield) method, over the term of the agreement.

Collateral Requirements – Repurchase and Reverse Repurchase Agreements

104. The collateral requirements for repurchase and reverse repurchase agreements are as follows:

Repurchase Transaction

a. The reporting entity shall receive collateral having a fair value as of the transaction date at least equal to 95 percent of the fair value of the securities transferred by the reporting entity in the transaction as of that date. If at any time the fair value of the collateral received from the counterparty is less than 95 percent of the fair value of the securities so transferred, the counterparty shall be obligated to deliver additional collateral by the end of the next business day the fair value of which, together with the fair value of all collateral then held in connection with the transaction, at least equals 95 percent of the fair value of the transferred securities. If the collateral is less than 95 percent at the reporting date, the difference between the actual collateral and 95 percent will be nonadmitted.

Reverse Repurchase Transaction

b. The reporting entity shall receive as collateral transferred securities having a fair value at least equal to 102 percent of the purchase price paid by the reporting entity for the securities. If at any time the fair value of the collateral is less than 100 percent of the purchase price paid by the reporting entity, the counterparty shall be obligated to provide additional collateral, the fair value of which, together with fair value of all collateral then held in connection with the transaction, at least equals 102 percent of the purchase price.

Dollar Repurchase Agreements

105. Dollar repurchase and dollar reverse repurchase agreements are defined as repurchase and reverse repurchase agreements involving debt instruments that are pay-through securities collateralized with Government National Mortgage Association (GNMA), Federal Home Loan Mortgage Corporation (FHLMC) and Federal National Mortgage Association (FNMA) collateral, and pass-through certificates sponsored by GNMA, mortgage participation certificates issued by the FHLMC or similar securities issued by the FNMA. Dollar repurchase agreements are also commonly referred to as dollar roll transactions. To meet the definition of dollar repurchase and dollar reverse repurchase agreements, the securities underlying the agreements must meet the criteria defined in paragraph 52, and for mortgage-backed securities excluding mortgage pass-through securities, the...
projected cash flows of the securities must be substantially the same under multiple scenario prepayment assumptions.

106. For the seller in a dollar repurchase agreement accounted for as collateralized borrowing in accordance with paragraph 91 of this statement, a liability is recorded for the amount of proceeds of the sale and the sold mortgage-backed securities are not removed from the accounting records. During the period of the agreement, interest income is recorded as if the mortgage-backed security had been held during the term of the agreement. This is offset by an equal amount of interest expense related to the proceeds received from the sale. Additional interest expense is recorded representing the difference between the sales price and the repurchase price of the mortgage-backed securities sold.

107. When the mortgage-backed securities are repurchased under the agreement, the original mortgage-backed securities sold are removed from the accounting records and the purchased mortgage-backed securities are recorded. The principal amount of the mortgage-backed securities repurchased must be in good delivery form consistent with paragraph 52.

108. If the principal amount repurchased is greater than the amount sold, the cash paid is recorded as an additional investment in the newly acquired certificates. If the principal amount repurchased is less than the amount sold, a gain or loss relating to the original certificates held is recorded.

109. For the purchaser in a dollar reverse repurchase agreement accounted for as collateralized lending in accordance with paragraph 91 of this statement, an asset is recorded for the amount of the purchase. Upon completion of the reverse repurchase agreement, cash is received in exchange for a "substantially the same" security. The difference between the purchase and reselling price represents interest income for the lending of short-term funds.

Separate Transactions
110. Agreements to repurchase and resell securities that do not meet the definitions in paragraphs 79-92 of this statement shall be accounted for as two separate transactions, that is, as a sale and purchase or as a purchase and sale, in accordance with the relevant statutory accounting guidance. For example, sales of bonds would result in recognition of realized gains or losses.

Offsetting
111. Reporting entities may operate on both sides of the repurchase agreement market resulting in recording of liabilities and assets representing repurchase and reverse repurchase agreements, respectively.

112. Reporting entities shall offset such liabilities and assets only to the extent that a legal right to offset exists as defined in SSAP No. 64, paragraph 2. Otherwise, separate assets and liabilities shall be recognized.