

Statement of Statutory Accounting Principles No. 91 – Revised

Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities

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Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities**SCOPE OF STATEMENT**

1. This statement establishes statutory accounting principles for transfers and servicing of financial assets, including asset securitizations and securitizations of policy acquisition costs, extinguishments of liabilities, repurchase agreements and reverse repurchase agreements, including dollar repurchase and dollar reverse repurchase agreements that are consistent with the Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy (Statement of Concepts). (Transfers of financial assets that are in substance real estate shall be accounted for based upon the requirements of SAAP No. 77.) This statement discusses generalized situations. Facts and circumstances and specific contracts need to be considered carefully in applying this statement. Securitizations of nonfinancial assets are outside the scope of this statement.

SUMMARY CONCLUSION

2. See *SSAP No. 25—Accounting for and Disclosures about Transactions with Affiliates and Other Related Parties* (SSAP No. 25) for additional accounting and disclosure guidance concerning related party transactions. In addition the guidance for the following topics have been addressed in Interpretations of the Emerging Accounting Issues Working Group (INT):

- a. Transfers of ownership interest that are in substance sales of real estate - INT 99-22 resolved this conflict between application of *SSAP No. 40—Real Estate* (SSAP No. 40) and *SSAP No. 18—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (SSAP No. 18).
- b. Exchanges of equity method investments for similar productive assets - INT 99-21 resolved this conflict between application of *SSAP No. 28—Nonmonetary Transactions* (SSAP No. 28) and SSAP No. 18.

3. SSAP No. 18, *SSAP No. 33—Securitization* (SSAP No. 33) and *SSAP No. 45—Repurchase Agreements, Reverse Repurchase Agreements and Dollar Repurchase Agreements* (SSAP No. 45) are superseded by the conclusions outlined in this statement.

4. This statement does not address the securitization of mortality or morbidity risk. The National Association of Insurance Commissioners' (NAIC's) Insurance Securitization Working Group of the Financial Condition (E) Committee is charged with the development of model laws, model regulations and proposed accounting guidance for the securitization of mortality and morbidity risk. When such proposed accounting guidance is finalized, the development of a statement will be considered.

5. Except as discussed in paragraphs 57 and 98, a transfer of a group of financial assets, or a portion of a financial asset in which the transferor surrenders control over those financial assets shall be accounted for as a sale to the extent that consideration other than beneficial interests in the transferred assets is received in exchange. The transferor has surrendered control over transferred assets if, and only if, all of the following conditions are met:

- a. The transferred assets have been isolated from the transferor—put presumptively beyond the reach of the transferor and its creditors, even in bankruptcy or other receivership (see paragraphs 18 and 19);
- b. Either (i) each transferee obtains the right, free of conditions that constrain it from taking advantage of that right (see paragraphs 20-24), to pledge or exchange the transferred assets or (ii) the transferee is a qualifying special-purpose entity as defined in paragraph 26 and the holders of beneficial interests in that entity have the right, free of conditions

that constrain them from taking advantage of that right (see paragraph 25), to pledge or exchange those interests and no condition both constrains the transferee (or holder) from taking advantage of its right to pledge or exchange and provide more than a trivial benefit to the transferor; and

- c. The transferor does not maintain effective control over the transferred assets through (i) an agreement that both entitles and obligates the transferor to repurchase or redeem them before their maturity (see paragraphs 39-41) or (ii) the ability to unilaterally cause the holder to return specific assets, other than through a cleanup call (see paragraphs 23-24 and 42-46).
6. Upon completion of any transfer of financial assets, the transferor shall:
- a. Initially recognize and measure at fair value, if practicable, servicing assets and servicing liabilities assumed under a separate contractual obligation to service financial assets (see paragraphs 11 and 51);
 - b. Allocate the previous carrying amount between the assets sold, if any, and the interests that continue to be held by a transferor, if any, based on their relative fair values at the date of transfer (see paragraphs 49 and 50); and
 - c. Continue to carry in its balance sheet any interest it continues to hold in the transferred assets, including, if applicable, beneficial interests in assets transferred to a qualifying special-purpose entity in a securitization, and undivided interests continued to be held by the transferor (see paragraphs 7.c., 49 and 50).
7. Upon completion of a transfer of financial assets that satisfies the conditions to be accounted for as a sale (see paragraph 5), the transferor (seller) shall:
- a. Eliminate the transferred assets from the balance sheet;
 - b. Allocate the previous carrying amount of the transferred assets to the securities representing beneficial interests continued to be held by the reporting entity, if any, and the securities representing beneficial interests not continued to be held, if any, based on the relative fair values of the transferred assets at the date of transfer;
 - c. Record in its balance sheet, the allocated carrying value of the securities representing beneficial interests continued to be held in the assets (e.g., loan-backed securities). Subsequent to the transfer of assets:
 - i. Retained residuals are to be carried at fair value with the difference between fair value and the allocated cost basis recognized as an unrealized gain or loss;
 - ii. Beneficial interests continued to be held shall be accounted for in accordance with the statutory accounting principles for the specific asset type (e.g., bonds shall be accounted for in accordance with *SSAP No. 26—Bonds, Excluding Loan-backed and Structured Securities*, loan-backed securities shall be accounted for in accordance with *SSAP No. 43R—Loan-Backed and Structured Securities* (SSAP No. 43R), preferred stock in accordance with *SSAP No. 32—Investments in Preferred Stock (including investments in preferred stock of subsidiary, controlled, or affiliated entities)* (SSAP No. 32).
 - d. Recognize all additional assets obtained (i.e., other than the securities representing beneficial interests continued to be held which are recorded in accordance with 7 c.) and liabilities incurred in consideration as proceeds of the sale;

- e. Initially measure such additional assets obtained and liabilities incurred in the sale at fair value (see *SSAP No. 100—Fair Value Measurements*), or if it is not practicable to estimate the fair value of an asset or a liability, apply alternative measures (paragraph 51); and
 - f. For reporting entities required to maintain an Interest Maintenance Reserve (IMR), the accounting for realized and unrealized capital gains and losses shall be in accordance with *SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve*. For reporting entities not required to maintain an IMR, realized capital gains and losses shall be reported as net realized capital gains or losses in the statement of income, and unrealized capital gains and losses shall be reported as net unrealized gains and losses in unassigned funds (surplus).
8. The transferee shall recognize all assets obtained and any liabilities incurred, and initially measure them at fair value.
9. Repurchase agreements, reverse repurchase agreements, collateral requirements, and dollar repurchase agreements are described in paragraphs 65-87. When an asset is sold and the proceeds are reinvested within 30 days in the same or substantially the same security, such transfers shall be considered to be wash sales and shall be accounted for as sales as discussed in paragraphs 68-70 and disclosed as required by paragraph 101. 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 assets.
10. If a transfer of financial assets in exchange for cash or other consideration (other than beneficial interests in the transferred assets) (a) does not meet the criteria for a sale in paragraph 5, or (b) is a sale of receivables with recourse (see paragraph 98); the transferor and transferee shall account for the transfer as a secured borrowing with pledge of collateral (see paragraph 13).

Recognition and Measurement of Servicing Assets and Liabilities

11. Servicing rights become a distinct asset or liability only when contractually separated from the underlying assets by sale or securitization of the assets with servicing retained, or separate purchase or assumption of the servicing. Servicing rights become a distinct asset or liability of the reporting entity pursuant to:
- a. A transfer of the servicer's financial assets that meets the requirements for sale accounting;
 - b. A transfer of financial assets to a qualifying SPE in a guaranteed mortgage obligation in which the transferor retains all of the resulting securities; or
 - c. An acquisition or assumption of a servicing obligation that does not relate to financial assets of the servicer.

A servicer that transfers or securitizes financial assets in a transaction that does not meet the requirements for sale accounting and is accounted for as a secured borrowing with the underlying assets remaining on the transferor's balance sheet shall not be recognized as a servicing asset or servicing liability.

12. If distinct servicing rights exist in accordance with the above guidelines, the reporting entity shall recognize a servicing asset or liability. When the servicing fees to be received exceed the cost of servicing the transferred assets, a servicing asset is recognized and nonadmitted. When the cost of servicing the transferred assets is greater than the servicing fees to be received, a liability shall be recorded for the excess to recognize this obligation. A corresponding loss shall be recorded through the Summary of

Operations in other income. Servicing assets and servicing liabilities shall be measured initially at fair value. Servicing assets or liabilities shall be measured subsequently at fair value at each reporting date with fluctuations in fair value reported as unrealized gains and losses. Declines in fair value which are determined to be other than temporary shall be recorded as realized losses.

Secured Borrowings and Collateral

13. 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 (see paragraph 10). The accounting for noncash¹ 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 13.c., the debtor (transferor) shall continue to carry the collateral as its asset, and the secured party (transferee) shall not recognize the pledged asset.

14. 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 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 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 13 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.

¹ Cash "collateral," sometimes used, for example, in securities lending transactions, shall be derecognized by the payer and recognized by the recipient, not as collateral, but rather as proceeds of either a sale or a borrowing.

Extinguishments of Liabilities

15. A debtor shall derecognize a liability if, and only if, it has been extinguished (see *SSAP No. 15—Debt and Holding Company Obligations* (SSAP No. 15)). A liability has been extinguished if either of the following conditions is met:

- a. The debtor pays the creditor and is relieved of its obligation for the liability. Paying the creditor includes delivery of cash, other financial assets, goods, or services or reacquisition by the debtor of its outstanding debt securities whether the securities are canceled or held as so-called treasury bonds; or
- b. The debtor is legally released from being the primary obligor under the liability, either judicially or by the creditor.

16. An exchange of debt instruments with substantially different terms is also considered a debt extinguishment and shall be accounted for in accordance with paragraph 15. A debtor's exchange of debt instruments (in a nontroubled debt situation) is accomplished with debt instruments that are substantially different if the present value of the cash flows under the terms of the new debt instrument is at least 10 percent different from the present value of the remaining cash flows under the terms of the original instrument. If the difference between the present value of the cash flows under the terms of the new debt instrument and the present value of the remaining cash flows under the terms of the original debt instrument is less than 10 percent, a creditor should evaluate whether the modification is more than minor based on the specific facts and circumstances (and other relevant considerations) surrounding the modification.

17. If a creditor releases a debtor from primary obligation on the condition that a third party assumes the obligation and that the original debtor becomes secondarily liable, that release extinguishes the original debtor's liability. However, in those circumstances, whether or not explicit consideration was paid for that guarantee, the original debtor becomes a guarantor. As a guarantor, it shall recognize a guarantee obligation in the same manner as would a guarantor that had never been primarily liable to that creditor, with due regard for the likelihood that the third party will carry out its obligations. The guarantee obligation shall be initially measured at fair value, and that amount reduces the gain or increases the loss recognized on extinguishment.

Isolation Beyond the Reach of the Transferor and Its Creditors

18. The nature and extent of supporting evidence required for an assertion in financial statements that transferred financial assets have been isolated—put presumptively beyond the reach of the transferor and its creditors, either by a single transaction or a series of transactions taken as a whole—depends on the facts and circumstances. All available evidence that either supports or questions an assertion shall be considered. That consideration includes making judgments about whether the contract or circumstances permit the transferor to revoke the transfer. It also may include making judgments about the kind of bankruptcy or other receivership into which a transferor or special-purpose entity might be placed, whether a transfer of financial assets would likely be deemed a true sale at law, whether the transferor is affiliated with the transferee, and other factors pertinent under applicable law. Derecognition of transferred assets is appropriate only if the available evidence provides reasonable assurance that the transferred assets would be beyond the reach of the powers of a bankruptcy trustee or other receiver for the transferor. Transactions between related parties or affiliates are accounted for in accordance with SSAP No. 25.

19. Many common financial transactions, for example, typical repurchase agreements and securities lending transactions, isolate transferred assets from the transferor, although they may not meet the other criteria for surrender of control.

Conditions That Constrain a Transferee

20. Sale accounting is allowed under paragraph 5 only if each transferee has the right to pledge, or the right to exchange, the transferred assets or beneficial interests it received, but constraints on that right also matter. Many transferor-imposed or other conditions on a transferee's right to pledge or exchange a transferred asset both constrain a transferee from pledging or exchanging the transferred assets and, through that constraint, provide more than a trivial benefit to the transferor. For example, a provision in the transfer contract that prohibits selling or pledging a transferred loan receivable not only constrains the transferee but also provides the transferor with the more-than-trivial benefits of knowing who has the asset, a prerequisite to repurchasing the asset, and of being able to block the asset from finding its way into the hands of a competitor for the loan customer's business or someone that the loan customer might consider an undesirable creditor. Transferor-imposed contractual constraints that narrowly limit timing or terms, for example, allowing a transferee to pledge only on the day assets are obtained or only on terms agreed with the transferor, also constrain the transferee and presumptively provide the transferor with more-than-trivial benefits.

21. However, some conditions do not constrain a transferee from pledging or exchanging the asset and therefore do not preclude a transfer subject to such a condition from being accounted for as a sale. For example, a transferor's right of first refusal on the occurrence of a bona fide offer to the transferee from a third party presumptively would not constrain a transferee, because that right in itself does not enable the transferor to compel the transferee to sell the assets and the transferee would be in a position to receive the sum offered by exchanging the asset, albeit possibly from the transferor rather than the third party. Further examples of conditions that presumptively would not constrain a transferee include (a) a requirement to obtain the transferor's permission to sell or pledge that is not to be unreasonably withheld, (b) a prohibition on sale to the transferor's competitor if other potential willing buyers exist, (c) a regulatory limitation such as on the number or nature of eligible transferees (as in the case of securities issued under Securities Act Rule 144A or debt placed privately), and (d) illiquidity, for example, the absence of an active market. Judgment is required to assess the significance of some conditions. For example, a prohibition on sale to the transferor's competitor would be a significant constraint if that competitor were the only potential willing buyer other than the transferor.

22. A condition imposed by a transferor that constrains the transferee presumptively provides more than a trivial benefit to the transferor. A condition not imposed by the transferor that constrains the transferee may or may not provide more than a trivial benefit to the transferor. For example, if the transferor refrains from imposing its usual contractual constraint on a specific transfer because it knows an equivalent constraint is already imposed on the transferee by a third party, it presumptively benefits more than trivially from that constraint. However, the transferor cannot benefit from a constraint if it is unaware at the time of the transfer that the transferee is constrained.

Transferor's Rights or Obligations to Reacquire Transferred Assets

23. Some rights or obligations to reacquire transferred assets both constrain the transferee and provide more than a trivial benefit to the transferor, thus precluding sale accounting under paragraph 5. For example, a freestanding call option written by a transferee to the transferor benefits the transferor and, if the transferred assets are not readily obtainable in the marketplace, is likely to constrain a transferee because it might have to default if the call was exercised and it had exchanged or pledged the assets. A freestanding forward purchase-sale contract between the transferor and the transferee on transferred assets not readily obtainable in the marketplace would benefit the transferor and is likely to constrain a transferee in much the same manner. Judgment is necessary to assess constraint and benefit. For example, put options written to the transferee generally do not constrain it, but a put option on a not-readily-obtainable asset may benefit the transferor and effectively constrain the transferee if the option is sufficiently deep-in-the-money when it is written that it is probable that the transferee will exercise it and the transferor will reacquire the transferred asset. In contrast, a sufficiently out-of-the-money call option held by the transferor may not constrain a transferee if it is probable when the option is written that it will

not be exercised. Freestanding rights to reacquire transferred assets that are readily obtainable presumptively do not constrain the transferee from exchanging or pledging them and thus do not preclude sale accounting under paragraph 5.

24. Other rights or obligations to reacquire transferred assets, regardless of whether they constrain the transferee, may result in the transferor's maintaining effective control over the transferred assets, as discussed in paragraphs 42-46, thus precluding sale accounting under paragraph 5.

Conditions That Constrain a Holder of Beneficial Interests in a Qualifying SPE

25. The considerations in paragraphs 20-24, about conditions that may or may not constrain a transferee that is not a qualifying SPE from pledging or exchanging the transferred assets, also extend to conditions that may or may not constrain a beneficial interest holder (BIH) from pledging or exchanging its beneficial interests in assets transferred to a qualifying SPE. For example, if BIHs agree to sell their beneficial interests in a qualifying SPE back to the transferor upon request at the price paid plus a stated return, that arrangement clearly conveys more than a trivial benefit to the transferor; sale accounting for the transfer to the qualifying SPE would be precluded if that agreement constrained a BIH from exchanging or pledging its beneficial interest.

Qualifying SPE

26. A qualifying SPE is a trust or other legal vehicle that meets all of the following conditions:

- a. It is demonstrably distinct from the transferor (paragraphs 27 and 28);
- b. Its permitted activities:
 - i. Are significantly limited;
 - ii. Were entirely specified in the legal documents that established the SPE or created the beneficial interests in the transferred assets that it holds; and
 - iii. May be significantly changed only with the approval of the holders of at least a majority of the beneficial interests held by entities other than any transferor, its affiliates, and its agents (paragraphs 29 and 30).
- c. It shall hold only:
 - i. Financial assets transferred to it that are passive in nature (paragraph 31);
 - ii. Passive derivative financial instruments that pertain to beneficial interests (other than another derivative financial instrument) issued or sold to parties other than the transferor, its affiliates, or its agents (paragraphs 31 and 32);
 - iii. Financial assets (for example, guarantees or rights to collateral) that would reimburse it if others were to fail to adequately service financial assets transferred to it or to timely pay obligations due to it and that it entered into when it was established, when assets were transferred to it, or when beneficial interests (other than derivative financial instruments) were issued by the SPE;
 - iv. Servicing rights related to financial assets that it holds;
 - v. Temporarily, nonfinancial assets obtained in connection with the collection of financial assets that it holds (paragraph 33);

- vi. Cash collected from assets that it holds and investments purchased with that cash pending distribution to holders of beneficial interests that are appropriate for that purpose (that is, money-market or other relatively risk-free instruments without options and with maturities no later than the expected distribution date).
- d. If it can sell or otherwise dispose of noncash financial assets, it can do so only in automatic response to one of the following conditions:
 - i. Occurrence of an event or circumstance that:
 - (a) Is specified in the legal documents that established the SPE or created the beneficial interests in the transferred assets that it holds;
 - (b) Is outside the control of the transferor, its affiliates, or its agents; and
 - (c) Causes, or is expected at the date of transfer to cause, the fair value of those financial assets to decline by a specified degree below the fair value of those assets when the SPE obtained them (paragraphs 34 and 35.)
 - ii. Exercise by a BIH (other than the transferor, its affiliates, or its agents) of a right to put that holder's beneficial interest back to the SPE (paragraph 36);
 - iii. Exercise by the transferor of a call specified in the legal documents that established the SPE, transferred assets to the SPE, or created the beneficial interests in the transferred assets that it holds (paragraphs 42-46);
 - iv. Termination of the SPE or maturity of the beneficial interests in those financial assets on a fixed or determinable date that is specified at inception (paragraph 37).

Need to Be Demonstrably Distinct from the Transferor

27. A qualifying SPE is demonstrably distinct from the transferor only if it cannot be unilaterally dissolved by any transferor, its affiliates, or its agents and either:
- a. At least 10 percent of the fair value of its beneficial interests is held by parties other than any transferor, its affiliates, or its agents; or
 - b. The transfer is a guaranteed mortgage securitization.

28. An ability to unilaterally dissolve an SPE can take many forms, including but not limited to holding sufficient beneficial interests to demand that the trustee dissolve the SPE, the right to call all the assets transferred to the SPE, and a right to call or a prepayment privilege on the beneficial interests held by other parties.

Limits on Permitted Activities

29. The powers of the SPE must be limited to those activities allowed by paragraph 26 for it to be a qualifying SPE. Many kinds of entities are not so limited. For example, any bank, insurance company, pension plan, or investment company has powers that cannot be sufficiently limited for it to be a qualifying SPE.

30. The BIHs other than any transferor, its affiliates, or its agents may have the ability to change the powers of a qualifying SPE. If the powers of a previously qualifying SPE are changed so that the SPE is

no longer qualifying, unless the conditions in paragraph 5.b. are then met by the SPE itself and the conditions in paragraphs 5.a. and 5.c. continue to be met, that change would bring the transferred assets held in the SPE back under the control of the transferor (paragraph 47).

Limits on What a Qualifying SPE May Hold

31. A financial asset or derivative financial instrument is passive only if holding the asset or instrument does not involve its holder in making decisions other than the decisions inherent in servicing. An equity instrument is not passive if the qualifying SPE can exercise the voting rights and is permitted to choose how to vote. Investments are not passive if through them, either in themselves or in combination with other investments or rights, the SPE or any related entity, such as the transferor, its affiliates, or its agents, is able to exercise control, as defined in *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities, A Replacement of SSAP No. 88* (SSAP No. 97) over the investee. A derivative financial instrument is not passive if, for example, it includes an option allowing the SPE to choose to call or put other financial instruments that would allow it and its related entities to control 10% or more of the financial instruments issuer; but other derivative financial instruments can be passive, for example, interest rate caps and swaps and forward contracts. Derivative financial instruments that result in liabilities, like other liabilities of a qualifying SPE, are a kind of beneficial interest in the qualifying SPE's assets.

32. A derivative financial instrument pertains to beneficial interests (other than another derivative financial instrument) issued only if it:

- a. Is entered into:
 - i. When the beneficial interests are issued by the qualifying SPE to parties other than the transferor, its affiliates, or its agents or sold to such other parties after being issued by the qualifying SPE to the transferor, its affiliates, or its agents; or
 - ii. When a passive derivative financial instrument needs to be replaced upon occurrence of an event or circumstance (specified in the legal documents that established the SPE or created the beneficial interests in the transferred assets that it holds) outside the control of the transferor, its affiliates, or its agents, for example, when the counterparty to the derivative defaults or is downgraded below a specified threshold.
- b. Has a notional amount that does not initially exceed the amount of those beneficial interests and is not expected to exceed them subsequently;
- c. Has characteristics that relate to, and partly or fully but not excessively counteract, some risk associated with those beneficial interests or the related transferred assets.

33. A qualifying SPE may hold nonfinancial assets other than servicing rights only temporarily and only if those nonfinancial assets result from collecting the transferred financial assets. For example, a qualifying SPE could be permitted to temporarily hold foreclosed nonfinancial collateral. In contrast, an entity cannot be a qualifying SPE if, for example, it receives from a transferor significant secured financial assets likely to default with the expectation that it will foreclose on and profitably manage the securing nonfinancial assets.

Limits on Sales or Other Dispositions of Assets

34. Examples of requirements to sell, exchange, put, or distribute (hereinafter referred to collectively as dispose of) noncash financial assets that are permitted activities of a qualifying SPE—because they respond automatically to the occurrence of an event or circumstance that:

- a. Is specified in the legal documents that established the SPE or created the beneficial interests in the transferred assets that it holds;
- b. Is outside the control of the transferor, its affiliates, or its agents; and
- c. Causes, or is expected to cause, the fair value of those assets to decline by a specified degree below the fair value of those assets when the qualifying SPE obtained them include requirements to dispose of transferred assets in response to:
 - i. A failure to properly service transferred assets that could result in the loss of a substantial third-party credit guarantee;
 - ii. A default by the obligor;
 - iii. A downgrade by a major rating agency of the transferred assets or of the underlying obligor to a rating below a specified minimum rating;
 - iv. The involuntary insolvency of the transferor; or
 - v. A decline in the fair value of the transferred assets to a specified value less than their fair value at the time they were transferred to the SPE.

35. The following are examples of powers or requirements to dispose of noncash financial assets that are not permitted activities of a qualifying SPE, because they do not respond automatically to the occurrence of a specified event or circumstance outside the control of the transferor, its affiliates, or its agents that causes, or is expected to cause, the fair value of those transferred assets to decline by a specified degree below the fair value of those assets when the SPE obtained them:

- a. A power that allows an SPE to choose to either dispose of transferred assets or hold them in response to a default, a downgrade, a decline in fair value, or a servicing failure;
- b. A requirement to dispose of marketable equity securities upon a specified decline from their “highest fair value” if that power could result in disposing of the asset in exchange for an amount that is more than the fair value of those assets at the time they were transferred to the SPE;
- c. A requirement to dispose of transferred assets in response to the violation of a nonsubstantive contractual provision (that is, a provision for which there is not a sufficiently large disincentive to ensure performance).

36. A qualifying SPE may dispose of transferred assets automatically to the extent necessary to comply with the exercise by a BIH (other than the transferor, its affiliates, or its agents) of its right to put beneficial interests back to the SPE in exchange for:

- a. A full or partial distribution of those assets;
- b. Cash (which may require that the SPE dispose of those assets or issue beneficial interests to generate cash to fund settlement of the put);
- c. New beneficial interests in those assets.

37. A qualifying SPE may have the power to dispose of assets to a party other than the transferor, its affiliate, or its agent on termination of the SPE or maturity of the beneficial interests, but only automatically on fixed or determinable dates that are specified at inception. For example, if an SPE is required to dispose of long-term mortgage loans and terminate itself at the earlier of (a) the specified

maturity of beneficial interests in those mortgage loans or (b) the date of prepayment of a specified amount of the transferred mortgage loans, the termination date is a fixed or determinable date that was specified at inception. In contrast, if that SPE has the power to dispose of transferred assets on two specified dates and the SPE can decide which transferred assets to sell on each date, the termination date is not a fixed or determinable date that was specified at inception.

Investments in Special-Purpose Entities

38. Reporting entities that have qualifying special-purpose entities as affiliates shall carry their investment in such entity at its underlying statutory book value in accordance with *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities, A Replacement of SSAP No. 88* (SSAP No. 97). Additionally, transactions entered involving affiliated qualifying special-purpose entities are subject to the provisions of SSAP No. 25.

Agreements That Maintain Effective Control Over Transferred Assets

39. An agreement that both entitles and obligates the transferor to repurchase or redeem transferred assets from the transferee maintains the transferor's effective control over those assets, and the transfer is therefore to be accounted for as a secured borrowing, if and only if all of the following conditions are met:

- a. The assets to be repurchased or redeemed are the same or substantially the same as those transferred (paragraph 40);
- b. The transferor is able to repurchase or redeem them on substantially the agreed terms, even in the event of default by the transferee (paragraph 41);
- c. The agreement is to repurchase or redeem them before maturity, at a fixed or determinable price; and
- d. The agreement is entered into concurrently with the transfer.

40. To be substantially the same, the asset that was transferred and the asset that is to be repurchased or redeemed need to have all of the following characteristics:

- a. The same primary obligor (except for debt guaranteed by a sovereign government, central bank, government-sponsored enterprise or agency thereof, in which case the guarantor and the terms of the guarantee must be the same);
- b. Identical form and type so as to provide the same risks and rights;
- c. The same maturity (or in the case of mortgage-backed pass-through and pay-through securities have similar remaining weighted-average maturities that result in approximately the same market yield);
- d. Identical contractual interest rates;
- e. Similar assets as collateral; and
- f. The same aggregate unpaid principal amount or principal amounts within accepted good delivery standards for the type of security involved.

41. To be able to repurchase or redeem assets on substantially all of the agreed terms, even in the event of default by the transferee, a transferor must at all times during the contract term have obtained

cash or other collateral sufficient to fund substantially all of the cost of purchasing replacement assets from others.

Ability to Unilaterally Cause the Return of Specific Transferred Assets

42. Some rights to reacquire transferred assets (or to acquire beneficial interests in transferred assets held by a qualifying SPE), regardless of whether they constrain the transferee, may result in the transferor's maintaining effective control over the transferred assets through the unilateral ability to cause the return of specific transferred assets. Such rights preclude sale accounting under paragraph 5. For example, an attached call in itself would not constrain a transferee who is able, by exchanging or pledging the asset subject to that call, to obtain substantially all of its economic benefits. An attached call could result, however, in the transferor's maintaining effective control over the transferred asset(s) because the attached call gives the transferor the ability to unilaterally cause whoever holds that specific asset to return it. In contrast, transfers of financial assets subject to calls embedded by the issuers of the financial instruments, for example, callable bonds or prepayable mortgage loans, do not preclude sale accounting. Such an embedded call does not result in the transferor's maintaining effective control, because it is the issuer rather than the transferor who holds the call.

43. If the transferee is a qualifying SPE, it has met the conditions in paragraph 26 and therefore must be constrained from choosing to exchange or pledge the transferred assets. In that circumstance, any call held by the transferor is effectively attached to the assets and could—depending on the price and other terms of the call—maintain the transferor's effective control over transferred assets through the ability to unilaterally cause the transferee to return specific assets. For example, a transferor's unilateral ability to cause a qualifying SPE to return to the transferor or otherwise dispose of specific transferred assets at will or, for example, in response to its decision to exit a market or a particular activity, could provide the transferor with effective control over the transferred assets.

44. A call that is attached to transferred assets maintains the transferor's effective control over those assets if, under its price and other terms, the call conveys more than a trivial benefit to the transferor. Similarly, any unilateral right to reclaim specific assets transferred to a qualifying SPE maintains the transferor's effective control over those assets if the right conveys more than a trivial benefit to the transferor. A call or other right conveys more than a trivial benefit if the price to be paid is fixed, determinable, or otherwise potentially advantageous, unless because that price is so far out of the money or for other reasons it is probable when the option is written that the transferor will not exercise it. Thus, for example, a call on specific assets transferred to a qualifying SPE at a price fixed at their principal amount maintains the transferor's effective control over the assets subject to that call. Effective control over transferred assets can be present even if the right to reclaim is indirect. For example, if an embedded call allows a transferor to buy back the beneficial interests of a qualifying SPE at a fixed price, then the transferor remains in effective control of the assets underlying those beneficial interests. A cleanup call, however, is permitted as an exception to that general principle.

45. A right to reclaim specific transferred assets by paying their fair value when reclaimed generally does not maintain effective control, because it does not convey a more than trivial benefit to the transferor. However, a transferor has maintained effective control if it has such a right and also holds the residual interest in the transferred assets. For example, if a transferor can reclaim such assets at termination of the qualifying SPE by purchasing them in an auction, and thus at what might appear to be fair value, then sale accounting for the assets it can reclaim would be precluded. Such circumstances provide the transferor with a more than trivial benefit and effective control over the assets, because it can pay any price it chooses in the auction and recover any excess paid over fair value through its residual interest.

46. A transferor that has a right to reacquire transferred assets from a qualifying SPE does not maintain effective control if the reclaimed assets would be randomly selected and the amount of the assets reacquired is sufficiently limited because that would not be a right to reacquire specific assets. Nor does a

transferor maintain effective control through an obligation to reacquire transferred assets from a qualifying SPE if the transfer could occur only after a specified failure of the servicer to properly service the transferred assets that could result in the loss of a third-party guarantee (paragraph 34.c.i.) or only after a BIH other than the transferor, its affiliate, or its agent requires a qualifying SPE to repurchase that beneficial interest (paragraph 36.b.), because the transferor could not cause that reacquisition unilaterally.

Changes That Result in the Transferor's Regaining Control of Assets Sold

47. A change in law, status of the transferee as a qualifying SPE, or other circumstance may result in the transferor's regaining control of assets previously accounted for appropriately as having been sold, because one or more of the conditions in paragraph 5 are no longer met. Such a change, unless it arises solely from either the initial application of this statement or a change in market prices (for example, an increase in price that moves into-the-money a freestanding call that was originally sufficiently out-of-the-money that it was judged not to constrain the transferee), is accounted for in the same manner as a purchase of the assets from the former transferee(s) in exchange for liabilities assumed (paragraph 7). After that change, the transferor recognizes in its financial statements those assets together with liabilities to the former transferee(s) or BIHs in those assets (paragraph 30). The transferor initially measures those assets and liabilities at fair value on the date of the change, as if the transferor purchased the assets and assumed the liabilities on that date. The former transferee would derecognize the assets on that date, as if it had sold the assets in exchange for a receivable from the transferor. Subsequent to that date, the reporting entity shall follow statutory accounting for the assets and liabilities in accordance with the guidance in the SSAPs.

Assets Obtained and Liabilities Incurred as Proceeds

48. The proceeds from a sale of financial assets consist of the cash and any other assets obtained, including separately recognized servicing assets, in the transfer less any liabilities incurred, including separately recognized servicing liabilities. Any asset obtained that is not an interest in the transferred asset is part of the proceeds from the sale. Any liability incurred, even if it is related to the transferred assets, is a reduction of the proceeds. Any derivative financial instrument entered into concurrently with a transfer of financial assets is either an asset obtained or a liability incurred and part of the proceeds received in the transfer. All proceeds and reductions of proceeds from a sale shall be initially measured at fair value.

Interests That Continue to be Held by a Transferor

49. Other interests in transferred assets, those that are not part of the proceeds of the transfer, are interests that continue to be held by a transferor over which the transferor has not relinquished control. They shall be measured at the date of the transfer by allocating the previous carrying amount between the assets sold, if any, and the interests that continue to be held by a transferor, based on their relative fair values. That procedure shall be applied to all transfers in which interests continue to be held by the transferor, even those that do not qualify as sales. Examples of interests that continue to be held by a transferor include securities backed by the transferred assets, undivided interests, and cash reserve accounts and residual interests in securitization trusts. If a transferor cannot determine whether an asset is an interest continued to be held or proceeds from the sale, the asset shall be treated as proceeds from the sale and accounted for in accordance with paragraph 48.

50. If the interests that continue to be held by a transferor are subordinated to more senior interests held by others, that subordination may concentrate into the interests that continue to be held by a transferor most of the risks inherent in the transferred assets and shall be taken into consideration in estimating the fair value of the interests that continue to be held by a transferor. For example, if the amount of the gain recognized, after allocation, on a securitization with a subordinated interest continued to be held is greater than the gain would have been had the entire asset been sold, the transferor needs to be able to identify why that can occur. Otherwise, it is likely that the impact of the interest continued to be

held being subordinate to a senior interest has not been adequately considered in the determination of the fair value of the subordinated interest continued to be held.

If It Is Not Practicable to Estimate Fair Values

51. If it is not practicable to estimate the fair values of assets, the transferor shall record those assets at an allocated cost basis of zero. If it is not practicable to estimate the fair values of liabilities, the transferor shall recognize no gain on the transaction and shall record those liabilities at the greater of:

- a. The excess, if any, of (i) the fair values of assets obtained less the fair values of other liabilities incurred, over (ii) the sum of the carrying values of the assets transferred;
- b. The amount that would be recognized in accordance with SSAP No. 5R.

Securitizations

52. Financial assets such as mortgage loans are assets commonly transferred in securitizations. Securitizations of mortgage loans may include pools of single-family residential mortgages or other types of real estate mortgage loans, for example, multifamily residential mortgages and commercial property mortgages. Both financial and nonfinancial assets can be securitized; life insurance policy loans, patent and copyright royalties also have been securitized. Securitizations of nonfinancial assets are outside the scope of this statement.

53. An originator of a typical securitization (the transferor) transfers a portfolio of financial assets to an SPE, commonly a trust. In "pass-through" and "pay-through" securitizations, receivables are transferred to the SPE at the inception of the securitization, and no further transfers are made; all cash collections are paid to the holders of beneficial interests in the SPE. In "revolving-period" securitizations, receivables are transferred at the inception and also periodically (daily or monthly) thereafter for a defined period (commonly three to eight years), referred to as the revolving period. During the revolving period, the SPE uses most of the cash collections to purchase additional receivables from the transferor on prearranged terms.

54. Beneficial interests in the SPE are sold to investors and the proceeds are used to pay the transferor for the assets transferred. Those beneficial interests may comprise either a single class having equity characteristics or multiple classes of interests, some having debt characteristics and others having equity characteristics. The cash collected from the portfolio is distributed to the investors and others as specified by the legal documents that established the SPE.

55. Pass-through, pay-through, and revolving-period securitizations that meet the criteria in paragraph 5 qualify for sale accounting under this statement. All financial assets obtained or continued to be held and liabilities incurred by the originator of a securitization that qualifies as a sale shall be recognized and measured as provided in paragraph 7; that includes the implicit forward contract to sell new receivables during a revolving period, which may become valuable or onerous to the transferor as interest rates and other market conditions change.

Sales of Future Revenues

56. In addition to securitization of assets, some reporting entities have entered into transactions characterized as a sale of future revenues. These transactions are sometimes referred to as securitizations and are sometimes characterized as selling deferred acquisition costs. A sale of future revenues by a reporting entity shall not result in the immediate recognition of income or surplus. The proceeds of any such sale shall be established as a liability and shall be reduced as the proceeds are repaid.

Removal-of-Accounts Provisions

57. Many transfers of financial assets in securitizations empower the transferor to reclaim assets subject to certain restrictions. Such a power is sometimes called a removal-of-accounts provision (ROAP). If there is a ROAP, the transfer of assets shall not be accounted for as a sale.

Securities Lending Transactions

58. Securities lending transactions are generally initiated by broker-dealers and other financial institutions that need specific securities to cover a short sale or a customer's failure to deliver securities sold. Securities lending transactions typically extend less than one year. Transferees (borrowers) of securities generally are required to provide collateral to the transferor (lender) of securities, commonly cash but sometimes other securities or standby letters of credit, with a value slightly higher than that of the securities borrowed. If the collateral is cash, the transferor typically earns a return by investing that cash at rates higher than the rate paid or rebated to the transferee. If the collateral is other than cash, the transferor typically receives a fee. Securities custodians or other agents commonly carry out securities lending activities on behalf of clients. Because of the protection of collateral (typically valued daily and adjusted frequently for changes in the market price of the securities transferred) and the short terms of the transactions, most securities lending transactions in themselves do not impose significant credit risks on either party. Other risks arise from what the parties to the transaction do with the assets they receive. For example, investments made with cash collateral impose market and credit risks on the transferor.

59. Many securities lending transactions are accompanied by an agreement that entitles and obligates the transferor to repurchase or redeem the transferred assets before their maturity under which the transferor maintains effective control over those assets (paragraphs 39-41). Those transactions shall be accounted for as secured borrowings, in which cash (or securities that the holder or its agent is permitted by contract or custom to sell or repledge) received as collateral is considered the amount borrowed, the securities loaned are considered pledged as collateral against the cash or securities borrowed, and any rebate paid to the transferee of securities is interest on the cash or securities the transferor is considered to have borrowed.

60. If the conditions in paragraph 5 are met, securities lending transactions shall be accounted for:
- a. By the transferor as a sale of the "loaned" securities, for proceeds consisting of the collateral² and a forward repurchase commitment; and
 - b. By the transferee as a purchase of the "borrowed" securities in exchange for the collateral and a forward resale commitment. During the term of that agreement, the transferor has surrendered control over the securities transferred and the transferee has obtained control over those securities with the ability to sell or transfer them at will. In that case, creditors of the transferor have a claim only to the "collateral" and the forward repurchase commitment.

61. The transferor of securities being "loaned" accounts for collateral received in the same way whether the transfer is accounted for as a sale or a secured borrowing. The collateral received shall be recognized as the transferor's asset—as shall investments made with that collateral, even if made by agents or in pools with other securities lenders—along with the obligation to return the collateral. If securities that may be sold or repledged are received by the transferor or its agent, the transferor of the

² If the "collateral" in a transaction that meets the criteria in paragraph 5 is a financial asset that the holder or its agent is permitted by contract or custom to sell or repledge, that financial asset is proceeds of the sale of the "loaned" securities. To the extent that the "collateral" consists of letters of credit or other financial instruments that the holder or its agent is not permitted by contract or custom to sell or repledge, a securities lending transaction does not satisfy the sale criteria and is accounted for as a loan of securities by the transferor to the transferee.

securities being “loaned” accounts for those securities in the same way as it would account for collateral received. Collateral which may be sold or repledged by the transferor or its agent is reflected on the balance sheet, along with the obligation to return the asset³. Collateral received which may not be sold or repledged by the transferor or its agent is off balance sheet⁴. For collateral on the balance sheet, the reporting is determined by the administration of the program.

- a. Securities lending programs where the collateral received by the reporting entity’s unaffiliated agent that can be sold or repledged is reported on the balance sheet. The collateral received and reinvestment of that collateral by the reporting entity’s unaffiliated agent shall be reflected as a one-line entry on the balance sheet (Securities Lending Collateral) and a detailed schedule will be required each quarter and at year-end to list the description of the collateral asset. This description shall include the NAIC rating, fair value; book adjusted carrying value and maturity date. A separate liability shall also be established to record the obligation to return the collateral (Collateral from Securities Lending Activities).
- b. Securities lending programs where the collateral received by the reporting entity that can be sold or repledged is reported on the balance sheet. If the reporting entity is the administrator of the program, then, the collateral received and any reinvestment of that collateral is reported with the invested assets of the reporting entity based on the type of investment (i.e. bond, common stock, etc). A separate liability shall also be established to record the obligation to return the collateral (Collateral from Securities Lending Activities).
- c. Securities lending programs where the collateral received by the reporting entity’s affiliated agent can report using either one line reporting (paragraph 61.a.) or investment schedule reporting (paragraph 61.b.).

62. Reinvestment of the collateral by the reporting entity or its agent, shall follow the same impairment guidance as other similar invested assets reported on the balance sheet. Any fees received by the transferor for loaning the securities shall be recorded as miscellaneous investment income.

Securities Lending Transactions – Collateral Requirements

63. The reporting entity shall receive collateral having a fair value as of the transaction date at least equal to 102 percent of the fair value of the loaned securities at that date. If at any time the fair value of the collateral received from the counterparty is less than 100 percent of the fair value of the loaned securities, 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 102 percent of the fair value of the loaned securities. If the collateral received from the counterparty is less than 100 percent at the reporting date, the difference between the actual collateral and 100 percent will be nonadmitted. Collateral value is measured and compared to the loaned securities in aggregate by counterparty.

64. In the event that foreign securities are loaned and the denomination of the currency of the collateral is other than the denomination of the currency of the loaned foreign securities, the amount of collateral shall be at least equal to 105 percent of the fair value of the loaned securities at that date. If at any time the fair value of the collateral received from the counterparty is less than 102 percent of the fair

³ If cash is received by the transferor or its agent and reinvested or repledged it is reported on balance sheet. It is explicitly intended that when the lender bears reinvestment risk, that collateral is on balance sheet.

⁴ An example of collateral which is off balance sheet is securities are received by the transferor or its agent in which the collateral must be held and returned, without the ability to transfer or repledge the collateral. This would involve limited situations in which the transferor or agent is prohibited from reinvesting the collateral.

value of the loaned securities, the reporting entity must obtain 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 105 percent of the fair value of the loaned securities. If the collateral received from the counterparty is less than 100 percent at the reporting date, the difference between the actual collateral and 100 percent will be nonadmitted. Collateral value is measured and compared to the loaned securities in aggregate by counterparty.

Repurchase Agreements and "Wash Sales"

65. 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 cash⁵ 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.

66. 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 asset. Some repurchase agreements call for repurchase of securities that need not be identical to the securities transferred.

67. If the conditions in paragraph 5 are met, including the criterion in paragraph 5.c., 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 assets that shall be accounted for as sales include transfers with agreements to repurchase at maturity and transfers with repurchase agreements in which the transferee has not obtained collateral sufficient to fund substantially all of the cost of purchasing replacement assets. (Repurchase financing is addressed in paragraphs 74-79.)

68. 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 assets.

69. As with securities lending transactions, under many agreements to repurchase transferred assets before their maturity the transferor maintains effective control over those assets. Repurchase agreements that do not meet all the criteria in paragraph 5 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 40) securities as those concurrently transferred is assured. Therefore, those transactions shall be accounted for as secured borrowings by both parties to the transfer.

⁵ Instead of cash, other securities or letters of credit sometimes are exchanged.

70. 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 pledging 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

71. 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 40 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.

72. For repurchase agreements that are accounted for as collateralized borrowings in accordance with paragraph 69 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.

73. 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

74. 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.

75. 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 stated 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.

76. 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) transfer 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.

77. Repurchase financing that is entered into contemporaneously with, or in contemplation of, an initial transfer of a 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 78 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 5, including paragraph 5.c. If the linked transaction does not meet the requirements for sale accounting, the linked transaction shall be accounted for based on the economics 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.

78. 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.)

79. In accordance with paragraph 77, an initial transfer of assets and a repurchase financing shall not be considered separate transactions unless the provisions of paragraph 78 are met. If the provisions of paragraph 78 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

80. 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 40 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.

81. For reverse repurchase agreements that are accounted for as collateralized lendings in accordance with paragraph 69 of this statement, the underlying securities shall continue to be accounted for as an investment 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

82. 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 anytime 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 anytime 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

83. 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 40, 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.

84. For the seller in a dollar reverse repurchase agreement accounted for as collateralized borrowing in accordance with paragraph 69 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.

85. 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 40.

86. 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.

87. For the purchaser in a dollar repurchase agreement accounted for as collateralized lending in accordance with paragraph 69 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

88. Agreements to repurchase and resell securities that do not meet the definitions in paragraphs 59 and 69 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

89. 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.

90. Reporting entities shall offset such liabilities and assets only to the extent that one of the following occurs:

- a. A legal right of offset exists as defined in *SSAP No. 64—Offsetting and Netting of Assets and Liabilities* (SSAP No. 64); or
- b. The securities have the same settlement date, are executed with the same counterparty in accordance with a master netting arrangement, involve securities that exist in “book entry” form, and settle on securities transfer systems that have the same key elements and operating characteristics as the Fedwire Securities Transfer System.

91. Otherwise, separate assets and liabilities shall be recognized.

Loan Syndications

92. Borrowers often borrow amounts greater than any one lender is willing to lend. Therefore, it is common for groups of lenders to jointly fund those loans. That may be accomplished by a syndication under which several lenders share in lending to a single borrower, but each lender loans a specific amount to the borrower and has the right to repayment from the borrower.

93. A loan syndication is not a transfer of financial assets. Each lender in the syndication shall account for the amounts it is owed by the borrower. Repayments by the borrower may be made to a lead lender who then distributes the collections to the other lenders of the syndicate. In those circumstances, the lead lender is also functioning as a servicer and, therefore, shall only recognize its portion of the loan as an asset.

Loan Participations

94. Groups of banks or other entities also may jointly fund large borrowings through loan participations in which a single lender makes a large loan to a borrower and subsequently transfers undivided interests in the loan to other entities.

95. Transfers by the originating lender may take the legal form of either assignments or participations. The transfers are usually on a nonrecourse basis, and the transferor (originating lender) continues to service the loan. The transferee (participating entity) may or may not have the right to sell or transfer its participation during the term of the loan, depending upon the terms of the participation agreement.

96. If the loan participation agreement gives the transferee the right to pledge or exchange those participations and the other criteria in paragraph 5 are met, the transfers to the transferee shall be accounted for by the transferor as sales of financial assets. A transferor's right of first refusal on a bona fide offer from a third party, a requirement to obtain the transferor's permission that shall not be unreasonably withheld, or a prohibition on sale to the transferor's competitor is a limitation on the transferee's rights but presumptively does not constrain a transferee from exercising its right to pledge or exchange. However, if the loan participation agreement constrains the transferees from pledging or exchanging their participations, the transferor has not relinquished control over the loan and shall account for the transfers as secured borrowings.

Factoring Arrangements

97. Factoring arrangements are a means of discounting accounts receivable on a nonrecourse, notification basis. Accounts receivable are sold outright, usually to a transferee (the factor) that assumes the full risk of collection, without recourse to the transferor in the event of a loss. Debtors are directed to send payments to the transferee. Factoring arrangements that meet the criteria in paragraph 5 shall be accounted for as sales of financial assets because the transferor surrenders control over the receivables to the factor.

Transfers of Receivables with Recourse

98. In a transfer of receivables with recourse, the transferor is obligated under the terms of the recourse provision to make payments to the transferee or to repurchase receivables sold under certain circumstances, typically for defaults up to a specified percentage. A transfer of receivables with recourse shall not be recognized as a sale but rather, as a financing. A transfer of receivables without recourse shall only be recognized if the transferor receives cash for the receivables. The sale shall be recognized when cash is received. Sales of premium receivables are addressed in *SSAP No. 42—Sale of Premium Receivables*.

Disclosures

99. 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. This would also apply to separate accounts;
 - ii. If the entity has pledged any of its assets as collateral, the carrying amount and classification of those assets as of the date of the latest statement of financial position presented;
 - iii. If the entity or its agent has accepted collateral that it is permitted by contract or custom to sell or repledge, it shall be recorded on the balance sheet. Regardless of whether the transaction is considered "on-balance sheet" or "off-balance sheet," the reporting entity shall provide the following information by type of program (repurchase agreement, securities lending, or dollar repurchase agreement) as of the date of each statement of financial position: (1) 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, (2) the aggregate fair value of all securities acquired from the sale, trade and use of the accepted collateral (reinvested collateral), and (3) information about the sources and uses of that collateral;
- iv. For securities lending transactions, disclose collateral for transactions that extend beyond one year from the reporting date;
 - v. For securities lending transactions administered by an affiliated agent in which “one-line” reporting (per paragraph 61.a.) of the reinvested collateral per paragraph 61.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 (per paragraph 61.b). Identify the rational 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
 - vi. 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 pledged.
- 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.
- c. If debt was considered to be extinguished by in-substance defeasance, a general description of the transaction and the amount of debt that is considered extinguished at the end of the period so long as that debt remains outstanding;
- d. If assets are set aside solely for satisfying scheduled payments of a specific obligation, a description of the nature of restrictions placed on those assets;
- e. If it is not practicable to estimate the fair value of certain assets obtained or liabilities incurred in transfers of financial assets during the period, a description of those items and the reasons why it is not practicable to estimate their fair value;
- f. For all servicing assets and servicing liabilities:
- i. A description of the valuation techniques or other models, including significant assumptions within models, used to estimate the fair value of servicing assets and servicing liabilities; and

- ii. Changes in fair value resulting from changes in valuation inputs or assumptions used in models and descriptions of other changes in fair value.
- g. If the entity has securitized financial assets during any period presented and accounts for that transfer as a sale, for each major asset type (for example, mortgage loans):
- i. Its accounting policies for initially measuring the interests that continue to be held by a transferor, if any, used in determining their fair value. (Fair value shall be determined in accordance with *SSAP No. 100—Fair Value Measurements.*); and
 - ii. The characteristics of securitizations (a description of the transferor’s continuing involvement with the transferred assets, including, but not limited to, servicing, recourse, and restrictions on interests that continue to be held by a transferor) and the gain or loss from sale of financial assets in securitizations;
 - iii. The key assumptions used in measuring the fair value of interests that continue to be held by a transferor at the time of securitization (including, at a minimum, quantitative information about discount rates, expected prepayments including the expected weighted-average life of prepayable financial assets, and anticipated credit losses, if applicable); and
 - iv. Cash flows between the securitization SPE and the transferor (including proceeds from new securitizations, purchases of delinquent or foreclosed loans, servicing fees, and cash flows received on interests continued to be held.)
- h. If the entity has interests that continue to be held by a transferor in securitized financial assets at the date of the latest statement of financial position presented, for each major asset type (for example, mortgage loans):
- i. Its accounting policies for subsequently measuring those interests that continue to be held by a transferor, including the methodology used in determining their fair value. (Fair value shall be determined in accordance with *SSAP No. 100—Fair Value Measurements.*);
 - ii. The key assumptions used in subsequently measuring the fair value of those interests (including, at a minimum, 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, if applicable);
 - iii. A sensitivity analysis or stress test showing the hypothetical effect on the fair value of those interests of two or more unfavorable variations from the expected levels for each key assumption that is reported under ii. above independently from any change in another key assumption, and a description of the objectives, methodology, and limitations of the sensitivity analysis or stress test; and
 - iv. For the securitized assets and any other financial assets that the entity manages together with the interests that continue to be held by the transferor⁶:
 - (a) The total principal amount outstanding, the portion that has been derecognized, and the portion that continues to be recognized in each

⁶ Excluding securitized assets that an entity continues to service but with which it has no other continuing involvement.

- category reported in the statement of financial position, at the end of the period;
 - (b) Delinquencies at the end of the period; and
 - (c) Credit losses, net of recoveries, during the period.
- v. Disclosure of average balances during the period is encouraged, but not required.
- i. 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;
 - j. 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
 - k. A description of the terms of reverse repurchase agreements whose amounts are included in borrowed money.
100. Disclose any transfers of receivables with recourse.
101. A reporting entity shall disclose the following information for wash sales, as defined in paragraph 9, involving transactions for securities with a NAIC designation of 3 or below, or unrated:
- a. A description of the reporting entity's objectives regarding these transactions;
 - b. An aggregation of transactions by NAIC designation 3 or below, or unrated;
 - c. The number of transactions involved during the reporting period;
 - d. The book value of securities sold;
 - e. The cost of securities repurchased; and
 - f. The realized gains/losses associated with the securities involved.
102. Refer to the preamble for further discussion regarding disclosure requirements. The disclosures required by paragraph 101 shall be made for the current quarter in the quarterly statement and for the year in the annual statement.

Relevant Literature

103. The accounting guidance in this statement is consistent with the guidance included in SSAP No. 18, SSAP No. 33 and SSAP No. 45, and is expanded to include issues addressed in *FASB Statement No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (FAS 140).
104. This statement adopts FAS 140 with the following modifications:
- a. Servicing rights assets are nonadmitted;

- b. Sales treatment is not permitted for transactions including recourse provisions or removal-of-accounts provisions on the transferred assets whereas GAAP would permit the recognition of the transfer as a sale under some circumstances;
- c. As statutory financial statements are prepared on a legal entity basis, special purpose entities shall not be consolidated in a reporting entity's statutory financial statements;
- d. Leases shall be accounted for in accordance with *SSAP No. 22—Leases*;
- e. Reporting entities required to maintain an IMR shall account for realized and unrealized capital gains and losses in accordance with SSAP No. 7; and
- f. The concepts of revolving-period securitizations, banker's acceptances and risk participations in banker's acceptances are not applicable for statutory accounting purposes.
- g. This statement does not adopt the accounting for collateral as outlined in FAS 140.

105. This statement adopts with modification *FASB Statement No. 156: Accounting for Servicing of Financial Assets, an amendment of FASB Statement No. 140* (FAS 156). Specific items adopted or rejected are identified below. Items within FAS 156 not specifically noted as adopted shall be considered rejected:

- a. This statement adopts FAS 156 guidance indicating that all servicing assets and servicing liabilities should initially be measured at fair value.
- b. This statement adopts FAS 156 guidance requiring the inclusion of separately recognized servicing assets and servicing liabilities in the calculation of proceeds from the sale of assets.
- c. This statement rejects the optionality provided within FAS 156 for subsequent measurement of servicing assets and servicing liabilities using either fair value or an amortization method. This statement requires application of a fair value method for subsequent measurement.
- d. This statement adopts guidance in FAS 156 confirming adoption of guidance previously adopted from FAS 140 regarding servicing assets and servicing liabilities established from the transfer of financial assets to a qualifying SPE in a guaranteed mortgage securitization in which the transferor retains all of the resulting securities.
- e. This statement adopts revisions in FAS 156 replacing the term 'retained interests' with 'interests that continue to be held by the transferor' with amendments to the definition to exclude servicing assets and servicing liabilities from this definition.

106. This statement adopts *FASB Staff Position 140-3, Accounting for Transfers of Financial Assets and Repurchase Financing Transactions* (FSP FAS 140-3) and *AICPA Statement of Position 90-3, Definition of the Term Substantially the Same for Holders of Debt Instruments, as used In Certain Audit Guides and a Statement of Position*. This statement adopts *FASB Emerging Issues Task Force (EITF) No. 87-34, Sale of Mortgage Servicing Rights with a Subservicing Agreement*, *FASB EITF No. 88-11, Allocation of Recorded Investment When a Loan as Part of a Loan is Sold*, *FASB EITF No. 88-18, Sales of Future Revenues*, *FASB EITF No. 88-22, Securitization of Credit Card and Other Receivable Portfolios*, *FASB EITF No. 90-21, Balance Sheet Treatment of a Sale of Mortgage Servicing Rights with a Subservicing Agreement*, *FASB EITF No. 95-5, Determination of What Risks and Rewards, If Any, Can Be Retained and Whether Any Unresolved Contingencies May Exist in a Sale of Mortgage Loan Servicing Rights*, ~~and~~ *FASB EITF No. 96-19, Debtor's Accounting for a Modification or Exchange of Debt Instruments* ~~and~~ *FASB EITF No. 01-7, Creditor's Accounting for a Modification or Exchange of Debt Instruments*.

107. This statement rejects *FASB EITF No. 84-5, Sale of Marketable Securities with a Put Option*, and *FASB EITF No. 92-2, Measuring Loss Accruals by Transferors of Receivables with Recourse* and *FTB 01-1: Effective Date for Certain Financial Institutions of Certain Provisions of Statement 140 related to Isolation of Transferred Financial Assets*.

Effective Date and Transition

108. This statement is effective for years beginning on and after January 1, 2005 and shall be applied prospectively. Substantive revisions in paragraphs 6, 11-12, 99.f., 105 and Exhibit B illustrations are effective January 1, 2009. Substantive revisions in paragraphs 13, 60-64, 66, 72, 81, 82 and 99 regarding securities lending transactions and repurchase agreements and additional disclosures were adopted in May 2010 and are effective December 31, 2010. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*.

109. For each servicing contract in existence before January 1, 2005, previously recognized or nonadmitted servicing rights and excess servicing receivables shall be combined, net of any previously recognized servicing obligations under that contract, as a servicing asset (nonadmitted) or liability. Thereafter, the subsequent measurement provisions of this statement shall be applied to the servicing assets (nonadmitted) or liabilities for those servicing contracts.

AUTHORITATIVE LITERATURE

Statutory Accounting

- *Statement of Statutory Accounting Principles No. 18—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*
- *Statement of Statutory Accounting Principles No. 33—Securitization*
- *Statement of Statutory Accounting Principles No. 45—Repurchase Agreements, Reverse Repurchase Agreements and Dollar Repurchase Agreements*
- *Purposes and Procedures Manual of the NAIC Securities Valuation Office*
- *Issue Paper No. 134—Servicing Assets/Liabilities, An Amendment of SSAP No. 91*

Generally Accepted Accounting Principles

- *FASB Statement No. 156: Accounting for Servicing of Financial Assets, an amendment of FASB Statement No. 140*
- *FASB Statement No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*
- *FASB Staff Position 140-3, Accounting for Transfers of Financial Assets and Repurchase Financing Transactions*
- *AICPA Statement of Position 90-3, Definition of the Term Substantially the Same for Holders of Debt Instruments, as used In Certain Audit Guides and a Statement of Position*
- *FASB Emerging Issues Task Force No. 87-34, Sale of Mortgage Servicing Rights with a Subservicing Agreement*

- *FASB Emerging Issues Task Force No. 88-11, Allocation of Recorded Investment When a Loan as Part of a Loan is Sold*
- *FASB Emerging Issues Task Force No. 88-18, Sales of Future Revenues*
- *FASB Emerging Issues Task Force No. 88-22, Securitization of Credit Card and Other Receivable Portfolios*
- *FASB Emerging Issues Task Force No. 90-21, Balance Sheet Treatment of a Sale of Mortgage Servicing Rights with a Subservicing Agreement*
- *FASB Emerging Issues Task Force No. 95-5, Determination of What Risks and Rewards, If Any, Can Be Retained and Whether Any Unresolved Contingencies May Exist in a Sale of Mortgage Loan Servicing Rights*
- *FASB Emerging Issues Task Force No. 96-19, Debtor's Accounting for a Modification or Exchange of Debt Instruments*

RELEVANT ISSUE PAPERS

- *Issue Paper No. 122—Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*
- *Issue Paper No. 134—Servicing Assets/Liabilities, An Amendment of SSAP No. 91*
- *Issue Paper No. 144—Substantive Revisions to SSAP No. 91R: Securities Lending*

EXHIBIT A - GLOSSARY**Asset Securitization**

An asset securitization is the process of converting assets which would normally serve as collateral for a loan into securities. The largest category of securitized assets is real estate mortgage loans, which serve as collateral for mortgage-backed securities.

Beneficial Interests

Rights to receive all or portions of specified cash inflows to a trust or other entity, including senior and subordinated shares of interest, principal, or other cash inflows to be passed-through or paid-through, premiums due to guarantors, commercial paper obligations and residual interests, whether in the form of debt or equity.

Beneficial Interest Holder (“BIH”)

Holder of beneficial interests

Cleanup Call

An option held by the servicer, which may be the transferor, to purchase transferred financial assets, or the remaining beneficial interests not held by the transferor, its affiliates, or its agents in a qualifying SPE (or in a series of beneficial interests in transferred assets within a qualifying SPE), when the amount of outstanding assets falls to a level at which the cost of servicing those assets becomes burdensome in relation to the benefits or servicing.

Collateral

Personal or real property in which a security interest has been given.

Derecognize

Remove previously recognized assets or liabilities from the balance sheet.

Derivative Financial Instrument

A derivative instrument (as defined in *SSAP No. 86—Accounting for Derivative Instruments and Hedging, Income Generation, and Replication (Synthetic Asset) Transactions*) that is a financial instrument (refer to *SSAP No. 27—Disclosure of Information about Financial Instruments with Off-Balance-Sheet Risk and Financial Instruments with Concentrations of Credit Risk*, paragraph 2).

Embedded Call (See paragraphs 42 and 44)

A call option held by the issuer of a financial instrument that is part of and trades with the underlying instrument. For example, a bond may allow the issuer to call it by posting a public notice well before its stated maturity that asks the current holder to submit it for early redemption and provides that interest ceases to accrue on the bond after the early redemption date. Rather than being an obligation of the initial purchaser of the bond, an embedded call trades with and diminishes the value of the underlying bond.

Financial Asset

Cash, evidence of an ownership interest in an entity, or a contract that conveys to a second entity a contractual right (a) to receive cash or another financial instrument from a first entity or (b) to exchange other financial instruments on potentially favorable terms with the first entity.

Financial Liability

A contract that imposes on one entity a contractual obligation (a) to deliver cash or another financial instrument to a second entity or (b) to exchange other financial instruments on potentially unfavorable terms with the second entity.

Guaranteed Mortgage Securitization

A securitization of mortgage loans which includes a substantive guarantee by a third party.

Interests That Continue to be Held by a Transferor

Other interests in transferred assets, those that are not part of the proceeds of the transfer, over which the transferor has not relinquished control. Includes securities backed by the transferred assets, undivided interests, and cash reserve accounts and residual interests in securitization trusts.

Proceeds

Cash, derivatives, or other assets that are obtained in a transfer of financial assets, less any liabilities incurred.

Recourse

The right of a transferee of receivables to receive payment from the transferor of those receivables for (a) failure of debtors to pay when due, (b) the effects of prepayments, or (c) adjustments resulting from defects in the eligibility of the transferred receivables.

Residual

Residuals are a class of purchased beneficial interests or interests that continue to be held by the transferor that have rights to the last cash flows from the pool of securitized assets and are not rated by a Nationally Recognized Statistical Rating Organization (NRSRO). Residuals are to be carried at fair value with the difference between fair value and the allocated cost basis recognized as an unrealized gain or loss;

Securitization

The process by which financial assets are transformed into securities.

Security Interest

A form of interest in property that provides that upon default of the obligation for which the security interest is given, the property may be sold in order to satisfy that obligation.

Seller

A transferor that relinquishes control over financial assets by transferring them to a transferee in exchange for consideration.

Servicing Asset

A contract to service financial assets under which the estimated future revenues from contractually specified servicing fees, late charges, and other ancillary revenues are expected to more than adequately compensate the servicer for performing the servicing. A servicing contract is either (a) undertaken in conjunction with selling or securitizing the financial assets being serviced or (b) purchased or assumed separately.

Servicing Liability

A contract to service financial assets under which the estimated future revenues from stated servicing fees, late charges, and other ancillary revenues are not expected to adequately compensate the servicer for performing the servicing.

Transfer

The conveyance of a noncash financial asset by and to someone other than the issuer of that financial asset. Thus, a transfer includes selling a receivable, putting it into a securitization trust, or posting it as collateral but excludes the origination of that receivable, the settlement of that receivable, or the restructuring of that receivable into a security in a troubled debt restructuring.

Transferee

An entity that receives a financial asset, a portion of a financial asset, or a group of financial assets from a transferor.

Transferor

An entity that transfers a financial asset, a portion of a financial asset, or a group of financial assets that it controls to another entity.

Undivided Interest

Partial legal or beneficial ownership of an asset as a tenant in common with others. The proportion owned may be pro rata, for example, the right to receive 50 percent of all cash flows from a security, or non-pro rata, for example, the right to receive the interest from a security while another has the right to the principal.

Unilateral Ability (See paragraphs 42 and 43)

A capacity for action not dependent on the actions (or failure to act) of any other party.

EXHIBIT B - ILLUSTRATIONS**Illustration—Recording Transfers with Proceeds of Cash, Derivatives, and Other Liabilities**

1. Company A sells loans with a fair value of \$1,100 and a carrying amount of \$1,000. Company A retains no servicing responsibilities but obtains an option to purchase from the transferee loans similar to the loans sold (which are readily obtainable in the marketplace) and assumes a limited recourse obligation to repurchase delinquent loans.

Company A agrees to provide the transferee a return at a floating rate of interest even though the contractual terms of the loan are fixed rate in nature (that provision is effectively an interest rate swap).

Fair Values

Cash proceeds	\$1,050
Interest rate swap	40
Call option	70
Recourse obligation	60

Net Proceeds

Cash received	\$1,050
Plus: Call option	70
Interest rate swap	40
Less: Recourse obligation	(60)
Net proceeds	<u>\$1,100</u>

Gain on Sale

Net proceeds	\$1,100
Carrying amount of loans sold	<u>1,000</u>
Gain on sale	<u>\$ 100</u>

Journal Entry

Cash	1,050	
Interest rate swap	40	
Call option	70	
Loans		1,000
Recourse obligation		60
Gain on sale		100
To record transfer		

Illustration—Recording Transfers of Partial Interests

2. Company B sells a pro rata nine-tenths interest in loans with a fair value of \$1,100 and a carrying amount of \$1,000. There is no servicing asset or liability, because Company B estimates that the benefits of servicing are just adequate to compensate it for its servicing responsibilities.

Fair values	
Cash proceeds for nine-tenths sold	\$990
One-tenth interest continued to be held by the transferor	110
[((\$990 ÷ 9/10) × 1/10)]	

Carrying Amount Based on Relative Fair Values

	<u>Fair Value</u>	<u>Percentage Of Total Fair Value</u>	<u>Allocated Carrying Amount</u>
Nine-tenths interest sold	\$990	90	\$900
One-tenth interest continued to be held by the transferor	<u>110</u>	<u>10</u>	<u>100</u>
Total	<u>\$ 1,100</u>	<u>100</u>	<u>\$1,000</u>

Gain on Sale

Net proceeds	\$ 990
Carrying amount of loans sold	<u>900</u>
Gain on sale	<u>\$90</u>

Journal Entry

Cash	990	
Loans		900
Gain on sale		90
To record transfer		

Illustration—Sale of Receivables with Servicing Obtained

3. Company C originates \$1,000 of loans that yield 10 percent interest income for their estimated lives of 9 years. Company C sells the \$1,000 principal plus the right to receive interest income of 8 percent to another entity for \$1,000. Company C will continue to service the loans, and the contract stipulates that its compensation for performing the servicing is the right to receive half of the interest income not sold. The remaining half of the interest income not sold is considered an interest-only strip receivable. At the date of the transfer, the fair value of the loans is \$1,100. The fair values of the servicing asset and the interest-only strip receivable are \$40 and \$60, respectively.

Fair Values

Cash proceeds	\$1,000
Servicing asset	40
Interest-only strip receivable	60

Net Proceeds

Cash proceeds	\$1,000
Servicing asset	40
Net Proceeds	\$1,040

Carrying Amount Based on Relative Fair Values

	<u>Fair Value</u>	<u>Percentage Of Total Fair Value</u>	<u>Allocated Carrying Amount</u>
Loans sold	\$ 1,040	94.55	\$945.50
Interest-only strip receivable	<u>60</u>	<u>5.4</u>	<u>54.50</u>
Total	<u>\$ 1,100</u>	<u>100.0</u>	<u>\$ 1,000.00</u>

Gain on Sale

Net proceeds	\$1,040
Carrying amount of loans sold	<u>945</u>
Gain on sale	<u>\$ 94.50</u>

Journal Entries

Cash	1,000	
Interest-only strip receivable	54.50	
Servicing Asset	40	
Loans		1,000
Gain on sale		94.50

To record transfer and to recognize interest-only strip receivable and servicing asset

Interest-only strip receivable	5.50	
Equity		5.50

To begin to subsequently measure interest-only strip receivable like an available-for-sale security (FAS 140, paragraph 14 as revised by FAS 156)

Illustration—Recording Transfers of Partial Interests with Proceeds of Cash, Derivatives, Other Liabilities, and Servicing

4. Company D originates \$1,000 of prepayable loans that yield 10 percent interest income for their 9-year expected lives. Company D sells nine-tenths of the principal plus interest of 8 percent to another entity. Company D will continue to service the loans, and the contract stipulates that its compensation for performing the servicing is the 2 percent of the interest income not sold. Company D obtains an option to purchase from the transferee loans similar to the loans sold (which are readily obtainable in the marketplace) and incurs a limited recourse obligation to repurchase delinquent loans. At the date of transfer, the fair value of the loans is \$1,100.

Fair Values

Cash proceeds	\$900
Call option	70
Recourse obligation	60
Servicing asset	90
One-tenth interest continued to be held by transferor	100

Net Proceeds

Cash received	\$900
Plus: Servicing Asset	90
Plus: Call option	70
Less: Recourse obligation	(60)
Net proceeds	<u>\$1,000</u>

Carrying Amount Based on Relative Fair Values

	<u>Fair Value</u>	<u>Percentage Of Total Fair Value</u>	<u>Allocated Carrying Amount</u>
Interest sold	\$ 1,000	90.9	\$ 909
One-tenth interest continued to be held by transferor	<u>100</u>	<u>9.1</u>	<u>91</u>
Total	<u>\$ 1,100</u>	<u>100</u>	<u>\$ 1,000</u>

Gain on Sale

Net proceeds	\$1,000
Less: Carrying amount of loans sold	(909)
Gain on sale	<u>\$ 91</u>

Loans Sold

Carrying Amount of Loans	\$1,000
Less: Allocated carrying amount of interest that continues to be held by the transferor	(91)
Loans Sold	<u>\$ 909</u>

Journal Entries

Cash	900	
Call option	70	
Servicing Asset	90	
Loans		909
Recourse obligation		60
Gain on sale		91
To record transfer and to recognize servicing asset, call option and recourse obligation		

Illustration—Recording Transfers If It Is Not Practicable to Estimate a Fair Value

5. Company E sells loans with a carrying amount of \$1,000 to another entity for cash proceeds of \$1,050 plus a call option to purchase loans similar to the loans sold (which are readily obtainable in the marketplace) and incurs a limited recourse obligation to repurchase any delinquent loans. Company E undertakes an obligation to service the transferred assets for the other entity. In Case 1, Company E finds it impracticable to estimate the fair value of the servicing contract, although it is confident that servicing revenues will be more than adequate compensation for performing the servicing. In Case 2, Company E finds it impracticable to estimate the fair value of the recourse obligation.

<u>Fair Values</u>	<u>Case 1</u>	<u>Case 2</u>
Cash proceeds	\$1,050	\$1,050
Servicing asset	XX*	40
Call option	70	70
Recourse obligation	<u>60</u>	<u>XX*</u>
Fair value of loans transferred	1,100	1,100

* Not practicable to estimate fair value

<u>Net Proceeds</u>	<u>Case 1</u>	<u>Case 2</u>
Cash received	\$1,050	\$1,050
Plus: Servicing Asset	XX*	40
Plus: Call option	70	70
Less: Recourse obligation	<u>(60)</u>	<u>XX</u>
Net proceeds	<u>\$1,060</u>	<u>\$1,160</u>

<u>Gain on Sale</u>	<u>Case 1</u>	<u>Case 2</u>
Cash received	\$1,060	\$1,060
Carrying Amount of Loans	1,000	1,000
Less: Recourse obligation	<u>0</u>	<u>(160)</u>
Gain on Sale	<u>\$ 60</u>	<u>\$ 0</u>

<u>Journal Entries</u>	<u>Case 1</u>	<u>Case 2</u>
Cash	1,050	1,050
Servicing asset	0*	40
Call option	70	70
Loans	1,000	1,000
Recourse obligation	60	160†
Gain on sale	60	0
To record transfer		

* Assets shall be recorded at zero if an estimate of the fair value of the assets is not practicable.

† The amount recorded as a liability in this example equals the sum of the known assets less the fair value of the known liabilities, that is, the amount that results in no gain or loss.

Illustration—Secured Borrowing

6. The following example illustrates the accounting for a securities lending transaction treated as a secured borrowing, in which the securities borrower sells the securities upon receipt and later buys similar securities to return to the securities lender:

Facts

Transferor's carrying amount and fair value of security loaned	\$1,000
Cash "collateral"	1,020
Transferor's return from investing cash collateral at a 5 percent annual rate	5
Transferor's rebate to the securities borrower at a 4 percent annual rate	4

For simplicity, the fair value of the security is assumed not to change during the 35-day term of the transaction.

Journal Entries for the Transferor

At inception:

Cash	1,020	
Payable under securities loan agreements		1,020

To record the receipt of cash collateral

Securities pledged to creditors	1,000	
Securities		1,000

To reclassify loaned securities that the secured party has the right to sell or repledge

Money market instrument	1,020	
Cash		1,020

To record investment of cash collateral

At conclusion:

Cash	1,025	
Interest		5
Money market instrument		1,020

To record results of investment

Securities	1,000	
Securities pledged to creditors		1,000

To record return of security

Payable under securities loan agreements	1,020	
Interest ("rebate")	4	
Cash		1,024

To record repayment of cash collateral plus interest

Journal Entries for the Transferee

At inception:

Receivable under securities loan agreements	1,020	
Cash		1,020

To record transfer of cash collateral

Cash	1,000	
Obligation to return borrowed securities		1,000

To record sale of borrowed securities to a third party and the resulting obligation to return securities that it no longer holds

At conclusion:

Obligation to return borrowed securities	1,000	
Cash		1,000
To record the repurchase of securities borrowed		
Cash	1,024	
Receivable under securities loan agreements		1,020
Interest revenue (“rebate”)		4
To record the receipt of cash collateral and rebate interest		

Illustration—Initial Transfer and Repurchase Financing

7. The following diagram is an example of an initial transfer of a financial asset and a subsequent repurchase financing, as described in paragraphs 74 and 75, which should be analyzed using the provisions in paragraphs 76-79. The purpose of this example is to illustrate the characteristics of the transaction and to prevent an inappropriate analogy to other financing transactions that are outside the scope of this SSAP.

