

Statutory Issue Paper No. 141

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

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Type of Issue:

Common Area

SUMMARY OF ISSUE:

1. In June 2009, the Financial Accounting Standards Board (FASB) issued *FAS 166, Accounting for Transfers of Financial Assets* (FAS 166) to improve the relevance, representational faithfulness and comparability of the information that a reporting entity provides in its financial reports about a transfer of financial assets; the effects of a transfer on its financial position, financial performance, and cash flows; and a transferor's continuing involvement in transferred financial assets. FAS 166 is effective as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009, for interim periods within the first annual reporting period and for interim and annual reporting periods thereafter. Earlier application is prohibited.

2. The issuance of FAS 166 amended *FASB Statement No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (FAS 140) as follows:

- a. Removes the concept of a qualifying special-purpose entity and removes the exception that requires consolidation from applying *FASB Interpretation No. 46-Revised, Consolidation of Variable Interest Entities* (FIN 46R), to variable interest entities that are qualifying special-purpose entities.
- b. Modifies the financial-components approach used in FAS 140 and limits the circumstances in which a transferor derecognizes a portion or component of a financial asset when the transferor has not transferred the original financial asset to an entity that is not consolidated with the transferor in the financial statements being presented and/or when the transferor has continuing involvement with the financial asset.
- c. Establishes the following conditions for reporting a transfer of a portion (or portions) of a financial asset as a sale:
 - i. The transferred portion (or portions) and any portion that continues to be held by the transferor must be participating interests.
 - ii. The transfer of the participating interest (or participating interests) must meet the conditions for surrender of control.

If the transfer does not meet these conditions, sale accounting can be achieved only by transferring an entire financial asset or group of entire financial assets in a transaction that meets the sale accounting conditions.

- d. Defines a participating interest as a portion of a financial asset that:

- i. Conveys proportionate ownership rights with equal priority to each participating interest holder.
 - ii. Involves no recourse (other than standard representations and warranties) to, or subordination by, any participating interest holder.
 - iii. Does not entitle any participating interest holder to receive cash before any other participating interest holder.
 - e. Clarifies that an entity must consider all arrangements, or agreements made contemporaneously with, or in contemplation of, a transfer, even if not entered into at the time of the transfer, when applying the condition for sale accounting. In addition, it explicitly clarifies that the application of the conditions for sale accounting must consider the transferor's continuing involvement with the transferred financial assets.
 - f. Clarifies the isolation analysis to ensure that the financial asset has been put beyond the reach of the transferor, any of its consolidated affiliates (that are not entities designed to make remote the possibility that they would enter bankruptcy or other receivership) included in the financial statements being presented, and its creditors.
 - g. Removes the exception for sale accounting for transfers to qualifying special-purpose entities. It requires that a transferor, in a transfer to an entity whose sole purpose is to engage in securitization or asset-backed financing activities, determine whether each third-party holder of a beneficial interest in that entity has the right to pledge or exchange its beneficial interest and that no condition both:
 - i. Constrains the third-party beneficial interest holder from taking advantage of its right to pledge or exchange; and
 - ii. Provides more than a trivial-benefit to the transferor.
 - h. Clarifies the principle for sale accounting that the transferor must evaluate whether it, its consolidated affiliates included in the financial statements being presented, or its agents effectively control the transferred financial asset directly or indirectly.
 - i. Requires that a transferor recognize and initially measure at fair value all assets obtained (including a transferor's beneficial interest) and liabilities incurred as a result of a transfer of an entire financial asset or a group of financial assets accounted for as a sale.
 - j. Removes the special provisions in FAS 140 and FASB Statement No. 65, Accounting for Certain Mortgage Banking Activities (FAS 65), for guaranteed mortgage securitizations to require them to be treated the same, as any other transfer of financial assets within the scope of FAS 140. If such a transfer does not meet the conditions for sale accounting, the securitized mortgage loans shall continue to be classified as loans.
 - k. Removes the fair value practicability exception from measuring the proceeds received by a transferor in a transfer that meets the conditions for sale accounting at fair value.
 - l. Requires enhanced disclosures to provide financial statement users with greater transparency about transfers of financial assets and a transferor's continuing involvement with transfers of financial assets accounted for as sales.
3. In addition to the modifications to FAS 140, the issuance of FAS 166 also incorporated revisions to the following GAAP guidance:

- a. Superseded *FSP FAS 140-2, Clarification of the Application of Paragraphs 40(b) and 40(c) of FASB Statement No. 140* (FSP FAS 140-2) and *FSP FAS 140-4 and FIN 46(R)-8, Disclosures by Public Entities (Enterprises) about Transfers of Financial Assets and Interests in Variable Interest Entities* (FSP FAS 140-4 and FIN 46(R)-8). Neither of these GAAP statements were previously adopted for statutory accounting.
 - b. Amended *FAS No. 65, Accounting for Certain Mortgage Banking Activities* (FAS 65). This GAAP statement was previously deemed not applicable for statutory accounting.
 - c. Amended *FAS 155, Accounting for Certain Hybrid Financial Instruments* (FAS 155). This GAAP statement is still pending review for statutory accounting.
 - d. Amended *FAS 156, Accounting for Servicing of Financial Assets* (FAS 156). This GAAP statement was previously adopted, with modification, for statutory accounting. In accordance with the previous adoption, with modification of FAS 156, for statutory accounting, subsequent measurement of servicing assets and servicing liabilities shall be at fair value.
 - e. Removed reference to FAS 140 from *FAS No. 157, Fair Value Measurements* (FAS 157).
 - f. Amended *FASB Interpretation No. 46 Revised, Consolidation of Variable Interest Entities* (FIN 46R). This GAAP statement is still review pending for statutory accounting.
 - g. Amended *FASB Technical Bulletin, Accounting for Mortgage Servicing Fees and Rights* (TB 87-3). This GAAP statement was previously deemed not applicable for statutory accounting.
 - h. Amended *Statement 133 Implementation Issues No. D1, Application of Statement 133 to Beneficial Interests in Securitized Financial Assets* (FAS 133 Issue No. D1) and *Issue No. F8, Hedging Mortgage Service Right Assets Using Preset Hedge Coverage Ratios* (FAS 133 Issue No. F8). Pursuant to previous decisions of the Statutory Accounting Principles (E) Working Group, FAS 133 Implementation Issues are not reviewed for statutory accounting unless considered significant or relevant to statutory accounting and specifically requested for review as part of the maintenance process, or in accordance with future projects in which review of a specific FAS 133 Implementation Issue would be considered beneficial.
4. This issue paper proposes adoption, with modification, of FAS 166 and the corresponding amendments to FAS 140 and FAS 156, including the revised FAS 140 glossary and illustrations. Statutory modifications from the adoption of amendments to FAS 140 and FAS 156 reflected in FAS 166 include:
- a. Rejects the GAAP consideration for “consolidated affiliates” as the concept of consolidation has not been adopted for statutory accounting.
 - b. Rejects reference to GAAP standards and GAAP methods not adopted for statutory as well as concepts that are not pertinent for insurers. For example, references to investments “held-to-maturity”, “available for sale” or “trading” and reference to FASB standards were removed and replaced with statutory terms and references to statutory standards.
 - c. Rejects GAAP reference and guidance regarding “Revolving-Period Securitizations” as this GAAP guidance is not applicable to statutory accounting. This concept was also deemed not applicable to statutory accounting under SSAP No. 91R.

- d. Rejects GAAP guidance for “Sale-Type and Direct-Financing Lease Receivables” as leases shall be accounted for in accordance with *SSAP No. 22—Leases* (SSAP No. 22). This conclusion is consistent with SSAP No. 91R.
- e. Rejects GAAP guidance for “Banker’s Acceptances and Risk Participations in Them,” as not applicable for statutory accounting. This GAAP guidance was also deemed not applicable to statutory accounting under SSAP No. 91R.
- f. Rejects GAAP guidance for “Removal of Account Provisions” that allows recognition of sale accounting. For statutory, transfers that would empower the transferor to reclaim assets under certain conditions (considered “removal-of-accounts provisions”) are precluded from being accounted for as sales. This conclusion is consistent with SSAP No. 91R.
- g. Rejects GAAP guidance for “Transfers of Receivables with Recourse” that allows transfers of receivables in their entirety with recourse to be accounted for as sales. For statutory, a transfer of receivables with recourse shall be accounted for as a secured borrowing. This conclusion is consistent with SSAP No. 91R.
- h. Rejects illustrations for transactions involving transfers of lease financing receivables with residual values and banker’s acceptances with a risk participation as the GAAP guidance in FAS 166 related to these topics has been rejected for statutory accounting.
- i. Incorporates additional disclosure requirements for collateral requirements when the reporting entity is not permitted by contract or custom to sell or repledge.
- j. Incorporates guidance previously included in SSAP No. 91R specific to insurance entities, and guidance that was adopted from GAAP guidance not revised through the issuance of FAS 166. Items incorporated include:
 - i. Clarification that transfers of financial assets that are in substance real estate shall be accounted for in accordance with *SSAP No. 40—Real Estate Investments*.
 - ii. Clarification that transactions between related parties or affiliates are accounted for in accordance with *SSAP No. 25—Accounting For and Disclosures About Transactions with Affiliates and Other Related Parties*.
 - iii. Clarification that the guidance does not address the securitization of mortality or morbidity risk.
 - iv. Guidance on the accounting of sale transactions for entities required to maintain an interest maintenance reserve (IMR).
 - v. Clarification of when servicing assets and servicing liabilities shall be recognized as well as measurement of these items. This guidance continues the adoption, with modification, of FAS 156, including the requirement to subsequently measure servicing assets and servicing liabilities at fair value. Furthermore, continues the prior decision that servicing assets shall be nonadmitted.
 - vi. Guidance on the accounting for 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.

- vii. Disclosures on loaned securities; securities underlying repurchase and reverse repurchase agreements, dollar repurchase and dollar reverse repurchase agreements; receivables with recourse; and wash sales.
 - viii. Guidance on the sales of future revenues.
 - ix. Guidance on collateral requirements for securities lending transactions that requires collateral of 102 percent (105 percent for foreign securities) of the fair value of the loaned securities. Guidance recently adopted by the Statutory Accounting Principles (E) Working Group related to collateral received for securities lending transactions has been reflected within the proposed issue paper.
 - x. Disclosures on securities lending transactions specific to aggregate open positions and aggregate positions under 30-day, 60-day and 90-day terms, disclosures for collateral that extend beyond one year from the reporting date, and detail of loaned securities within the separate account and if the policies and procedures differ from the general account.
 - xi. Clarification that 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 guidance.
 - xii. Guidance on Repurchase Agreements. This guidance retains recent revisions to SSAP No. 91R that ensured the proper terms are being utilized for the proper scenario. This guidance retains the recently adopted guidance from *FSP FAS 140-3, Accounting for Transfers of Financial Assets and Repurchase Financing Transactions* (FSP FAS 140-3). This GAAP guidance was not revised with the issuance of FAS 166.
 - xiii. Guidance on Reverse Repurchase Agreements. This guidance retains recent revisions to SSAP No. 91R that ensured the proper terms are being utilized for the proper scenario.
 - xiv. Guidance on Collateral for Reverse and Repurchase Agreements. This guidance retains recent revisions to SSAP No. 91R that ensured the proper terms are being utilized for the proper scenario.
 - xv. Guidance on Dollar Repurchase Agreements. This guidance retains recent revisions to SSAP No. 91R that ensured the proper terms are being utilized for the proper scenario.
 - xvi. Guidance for Separate Transactions.
 - xvii. Guidance for Offsetting.
 - xviii. Guidance for Transfers of Receivables with Recourse.
5. With the exception of INT 99-07, INT 99-08, INT 99-14 and INT 99-21, as discussed below, this issue paper will be interpreted by the statutory interpretations to SSAP No. 91R:
- a. *INT 99-07: EITF 97-3: Accounting for Fees and Costs Associated with Loan Syndications and Loan Participations after the Issuance of FASB Statement No. 125 (INT 99-07)* – As this interpretation rejected EITF 97-3 for statutory accounting, there is no impact to this interpretation from adoption of FAS 166. As this interpretation is now

- included in *INT 99-00—Compilation of Rejected EITFs* (INT 99-00), the reference to INT 99-00, and not INT 99-07, will be referenced in the new SSAP to supersede SSAP No. 91R.
- b. *INT 99-08: EITF 97-6: Application of Issue No. 96-20 to Qualifying Special-Purpose Entities Received Transferred Financial Assets Prior to the Effective Date of FASB Statement No. 125* (INT 99-08) – As this interpretation rejected EITF 96-20 for statutory accounting, there is no impact to this interpretation from adoption of FAS 166. As this interpretation is now included in *INT 99-00—Compilation of Rejected EITFs* (INT 99-00), the reference to INT 99-00, and not INT 99-07, will be referenced in the new SSAP to supersede SSAP No. 91R.
- c. *INT 99-14: EITF 96-19: Debtor’s Accounting for a Modification or Exchange of Debt Instruments* (INT 99-14) – This interpretation adopted EITF 99-14 for statutory accounting. As such, an exchange of debt instruments with substantially different terms is considered a debt extinguishment. This guidance also clarifies that if 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, then the exchange of debt instruments are considered substantially different. The GAAP status of EITF 96-19 was updated to identify that FAS 166 amended FAS 140 without reconsideration. As such, there is no impact to the statutory interpretation from the adoption of FAS 166. However, pursuant to a project to incorporate guidance from statutory INTs into the related SSAPs, the guidance from this INT is proposed to be included within SSAP No. 91R, as well as the proposed SSAP to supersede SSAP No. 91R. This guidance has been included in paragraph 126 of this issue paper.
- d. *INT 99-21: EITF 98-7: Accounting for Exchanges of Similar Equity Method Investments* (INT 99-21) – This interpretation was nullified with the issuance of *SSAP No. 95—Exchanges of Nonmonetary Assets, A Replacement of SSAP No. 28—Nonmonetary Transactions* (SSAP No. 95). With the issuance of a new SSAP, there will be no future reference to this interpretation.
- e. *INT 99-22: EITF 98-8: Accounting for Transfers of Investments That Are in Substance Real Estate* (INT 99-22) – This interpretation adopted EITF 98-8 indicating that transfers of financial assets that are in substance real estate shall be accounted for in accordance with *SSAP No. 40—Real Estate Investments* (SSAP No. 40). The GAAP status of EITF 96-19 was updated to delete the effective date reference and identify that FAS 166 amended FAS 140 without reconsideration. As such, there is no impact to the statutory interpretation from the adoption of FAS 166. However, pursuant to a project to incorporate guidance from statutory INTs into the related SSAPs, the guidance from this INT is proposed to be included within SSAP No. 91R as well as the proposed SSAP to supersede SSAP No. 91R. This guidance has been included in paragraph 6 of this issue paper.
- f. *INT 00-11: EITF 98-15: Structured Notes Acquired for a Specified Investment Strategy* (INT 00-11) – This interpretation rejected the consensus position in EITF 98-15 pursuant to a recommendation from the Invested Assets (E) Working Group. It was noted that any attempt on the part of the Emerging Accounting Issues (E) Working Group to promulgate EITF 95-18 into accounting guidance (bonds accounted for at fair value rather than amortized cost) will require the Valuation of Securities (E) Task Force to change the mission of the Securities Valuation Office. The issuance of FAS 166 incorporated guidance to EITF 98-15 to identify that paragraph 11 of FAS 166 (accounting for transfers of entire financial assets or groups of entire financial assets that qualify as sales) shall be applied to each structured note upon transfer. This update is proposed for

inclusion within INT 00-11, but as there is no proposed change to the previous statutory conclusion, there will be no impact to this interpretation as a result of adopting FAS 166.

- g. *INT 01-31: Assets Pledged as Collateral* (INT 01-31) – This interpretation provides guidance on whether assets pledged as collateral shall be considered admitted assets. There is no impact to this interpretation conclusion from the adoption of FAS 166. (References to SSAP No. 91R will be replaced with references to the new SSAP.)
- h. *INT 03-05: EITF 01-7: Creditor's Accounting for a Modification or Exchange of Debt Instruments* (INT 03-05) – This interpretation adopts the consensus position of EITF 01-7. This EITF clarifies that a debt instrument modification should be considered more than minor 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. This EITF also concludes that the guidance in EITF 96-19 (adopted within INT 99-14) should be used to calculate the present value of cash flows for purposes of applying the 10 percent test. There is no impact to this interpretation from the adoption of FAS 166.
- i. *INT 04-21: EITF 02-9: Accounting for Changes that Result in a Transferor Regaining Control of Financial Assets Sold* (INT 04-21) – This interpretation adopts EITF 02-9 with modification for statutory terms and references. Pursuant to this adoption, a transferred asset that has been accounted for as sold is to be accounted for as “re-purchased” if the basis for that sale accounting subsequently becomes invalid. With the issuance of FAS 166, guidance in EITF 02-9 was updated to reflect the revised terminology in FAS 166 as well as delete the issue and conclusion pertaining to qualified special purpose entities as the concept of a QSPE is no longer captured within FAS 166. Although there is no impact to the statutory conclusion to adopt this EITF with modifications for statutory references, the guidance in INT 04-21 will be revised to reflect the revisions adopted from FAS 166.
- j. *INT 09-08: Accounting for Loans Received under the Federal TALF Program* (INT 99-08). This interpretation provides statutory guidance on whether TALF loans received and the corresponding collateral provided by the reporting entity shall be reported net within the statutory financial statements. With the exception of updating references from SSAP No. 91R to the new SSAP, there is no anticipated change proposed to this interpretation.

SCOPE OF STATEMENT

5A. Transfers of financial assets take many forms. Accounting for transfers in which the transferor has no continuing involvement with the transferred financial assets or with the transferee are generally straightforward. However, transfers of financial assets often occur in which the transferor has some continuing involvement either with the assets transferred or with the transferee. Examples of continuing involvement include, but are not limited to, servicing arrangements, recourse or guarantee arrangements, agreements to purchase or redeem transferred financial assets, options written or held, derivative financial instruments that are entered into contemporaneously with, or in contemplation of the transfer, arrangements to provide financial support, pledges of collateral, and the transferor's beneficial interests in the transferred financial assets. Transfers of financial assets with continuing involvement raise issues about the circumstances under which the transfers should be considered as sales of all or part of the assets or as secured borrowings. An objective in accounting for transfers of financial assets is for each reporting entity that is a party to the transaction to recognize only assets it controls and liabilities it has incurred, to **derecognize** assets only when control has been surrendered, and to derecognize liabilities only when they have been extinguished. Sales and other transfers may frequently result in a disaggregation of financial assets and liabilities into components, which become separate assets and liabilities.

6. This issue paper focuses on the issues of accounting for **transfers**¹ and servicing of **financial assets** and extinguishments of liabilities. This issue paper 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, repurchase financing 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). 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. Transfers of financial assets that are in substance real estate shall be accounted for in accordance with *SSAP No. 40—Real Estate Investments*. Additionally, retained beneficial interests from the sale of loan-backed or structured securities are to be accounted for in accordance with *SSAP No. 43R—Loan-Backed and Structured Securities, Revised*.

7. *SSAP No. 25—Accounting for and Disclosures about Transactions with Affiliates and Other Related Parties* (SSAP No. 25) shall be followed for accounting and disclosure requirements for all related party transactions.

8. *SSAP No. 91R—Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (SSAP No. 91R) has been superseded by this statement.

9. This issue paper 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 an issue paper will be considered.

SUMMARY CONCLUSION

Accounting for Transfers and Servicing of Financial Assets

10. The objective of paragraph 12 and related implementation guidance is to determine whether a **transferor** has surrendered control over transferred financial assets. This determination must consider the transferor's **continuing involvement** in the transferred financial assets and requires the use of judgment that must consider all arrangements or agreements made contemporaneously with, or in contemplation of, the transfer, even if they were not entered into at the time of the transfer.

11. The requirements of paragraph 12 apply to transfers of an entire financial asset, transfers of a group of entire financial assets, and transfers of a **participating interest** in an entire financial asset (all of which are referred to collectively in this issue paper as transferred financial assets). A participating interest has all of the following characteristics:

- a. From the date of the transfer, it represents a proportionate (pro rata) ownership interest in an entire financial asset. The percentage of ownership interests held by the transferor in the entire financial asset may vary over time, while the entire financial asset remains outstanding as long as the resulting portions held by the transferor (including any participating interest retained by the transferor or its **agents**) and the **transferee(s)** meet the other characteristics of a participating interest. For example, if the transferor's interest in an entire financial asset changes because it subsequently sells another interest in the entire financial asset, the interest held initially and subsequently by the transferor must meet the definition of a participating interest.

¹ Terms defined in the glossary to this issue paper are set in boldface type the first time they appear.

- b. From the date of the transfer, all cash flows received from the entire financial asset are divided proportionately among the participating interest holders in an amount equal to their share of ownership. Cash flows allocated as compensation for services performed, if any, shall not be included in that determination provided those cash flows are not subordinate to the proportionate cash flows of the participating interest and are not significantly above an amount that would fairly compensate a substitute service provider, should one be required, which includes the profit that would be demanded in the marketplace. In addition, any cash flows received by the transferor as **proceeds** of the transfer of the participating interest shall be excluded from the determination of proportionate cash flows provided that the transfer does not result in the transferor receiving an ownership interest in the financial asset that permits it to receive disproportionate cash flows.
- c. The rights of each participating interest holder (including the transferor in its role as a participating interest holder) have the same priority, and no participating interest holder's interest is subordinated to the interest of another participating interest holder. That priority does not change in the event of bankruptcy or other receivership of the transferor, the original debtor, or any other participating interest holder. Participating interest holders have no **recourse** to the transferor, its agents or to each other, other than **standard representations and warranties**, ongoing contractual obligations to service the entire financial asset and administer the transfer contract, and contractual obligations to share in any set-off benefits received by any participating interest holder. That is, no participating interest holder is entitled to receive cash before any other participating interest holder under its contractual rights as a participating interest holder. For example, if a participating interest holder also is the servicer of the entire financial asset and receives cash in its role as servicer, that arrangement would not violate this requirement.
- d. No party has the right to pledge or exchange the entire financial asset unless all participating interest holders agree to pledge or exchange the entire financial asset.

If a transfer of a portion of an entire financial asset meets the definition of a participating interest, the transferor shall apply the guidance in paragraph 12. If a transfer of a portion of a financial asset does not meet the definition of a participating interest, the transferor and transferee shall account for the transfer in accordance with the guidance in paragraph 18 as a secured borrowing. However, if the transferor transfers an entire financial asset in portions that do not individually meet the participating interest definition, paragraph 12 shall be applied to the entire financial asset once all portions have been transferred.

12. A transfer of an entire financial asset, a group of entire financial assets, or a participating interest in an entire financial asset in which the transferor surrenders control over those financial assets shall be accounted for as a sale if, and only if, all of the following conditions are met:

- a. The transferred financial assets have been isolated from the transferor—put presumptively beyond the reach of the transferor and its creditors, even in bankruptcy or other receivership. Transferred financial assets are isolated in bankruptcy or other receivership only if the transferred financial assets would be beyond the reach of the powers of a bankruptcy trustee or other receiver for the transferor.
- b. Each transferee (or, if the transferee is an entity whose sole purpose is to engage in securitization or asset-backed financing activities and that entity is constrained from pledging or exchanging the assets it receives, each third-party holder of its **beneficial interests**) has the right to pledge or exchange the assets (or beneficial interests) it received, and no condition both constrains the transferee (or third-party holder of its beneficial interests) from taking advantage of its right to pledge or exchange and provides more than a trivial benefit to the transferor (paragraphs 46-49).

- c. The transferor or its agents do not maintain effective control over the transferred financial assets or third-party beneficial interests related to those transferred assets (paragraph 53). Examples of a transferor's effective control over the transferred financial assets include, but are not limited to (1) an agreement that both entitles and obligates the transferor to repurchase or redeem them before their maturity (paragraphs 54-56), (2) an agreement that provides the transferor with both the **unilateral ability** to cause the holder to return specific financial assets and a more-than-trivial benefit attributable to that ability, other than through a **cleanup call** (paragraphs 57-61), or (3) an agreement that permits the transferee to require the transferor to repurchase the transferred financial assets at a price that is so favorable to the transferee that it is probable that the transferee will require the transferor to repurchase them (paragraph 62).

Accounting for Transfers of Participating Interests

13. Upon completion of a transfer of a participating interest that satisfies the conditions to be accounted for as a sale (paragraph 12), the transferor (**seller**) shall:

- a. Allocate the previous carrying amount of the entire financial asset between the participating interests sold and the participating interest that continues to be held by the transferor on the basis of their relative fair values at the date of the transfer (paragraph 65).
- b. **Derecognize** the participating interest(s) sold.
- c. Recognize and initially measure at fair value **servicing assets, servicing liabilities**, and any other assets obtained and liabilities incurred in the sale (such as cash) (paragraphs 66-70).
- d. Recognize in earnings any gain or loss on the sale.
- e. Report any participating interest or interests that continue to be held by the transferor as the difference between the previous carrying amount of the entire financial asset and the amount derecognized.

The transferee shall recognize the participating interest(s) obtained, other assets obtained, and any liabilities incurred and initially measure them at fair value.

14. Upon completion of a transfer of participating interests that does not satisfy the conditions to be accounted for as a sale, the guidance in paragraph 18 shall be applied.

Accounting for Transfers of an Entire Financial Asset or Group of Entire Financial Assets

15. Upon completion of a transfer of an entire financial assets or a group of entire financial assets that satisfies the conditions to be accounted for as a sale (see paragraph 12), the transferor (seller) shall:

- a. Derecognize the transferred financial assets;
- b. Recognize and initially measure at fair value servicing assets, servicing liabilities, and any other assets obtained (including a transferor's beneficial interest in the transferred financial assets) and liabilities incurred² in the sale (paragraphs 64 and 66-70).

² Some assets that might be obtained and liabilities that might be incurred include cash, put or call options that are held or written (for example, guarantee or recourse obligations), forward commitments (for example, commitments to deliver additional

- c. For reporting entities required to maintain an Interest Maintenance Reserve (IMR), the accounting for realized and unrealized capital gains and losses shall be determined per the guidance in the SSAP for the specific type of investment (e.g., SSAP No. 43R for loan-backed and structured securities), or if not specifically stated in the related SSAP, 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).

The transferee shall recognize all assets obtained and any liabilities incurred, and initially measure them at fair value.

16. Repurchase agreements, reverse repurchase agreements, repurchase financing, **collateral** requirements and dollar repurchase agreements are described in paragraphs 97-113. 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 91-96 and disclosed as required by paragraph 31. Unless there is a concurrent contract to repurchase or redeem the transferred financial assets from the transferee, the transferor does not maintain effective control over the transferred financial assets.

17. Upon completion of a transfer of an entire financial asset or a group of entire financial assets that does not satisfy the conditions to be accounted for as a sale in its entirety, the guidance in paragraph 18 shall be applied.

Secured Borrowing

18. If a transfer of an entire financial asset, a group of entire financial assets, or a participating interest in an entire financial asset does not meet the conditions for a sale in paragraph 12, or if a transfer of a portion of an entire financial asset does not meet the definition of a participating interest (paragraph 11), the transferor and transferee shall account for the transfer as a secured borrowing with pledge of collateral (paragraph 23). The transferor shall continue to report the transferred financial assets in its statement of financial position with no change in their measurement (that is, basis of accounting).

Recognition and Measurement of Servicing Assets and Liabilities

19. An entity shall recognize and initially measure at fair value, a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract in either of the following situations:

- a. A servicer's transfer of an entire financial asset, a group of entire financial assets, or a participating interest in an entire financial asset that meets the requirements for sale accounting; or
- b. An acquisition or assumption of a servicing obligation that does not relate to financial assets of the servicer.

An entity that transfers its financial assets to an entity in a transfer that qualifies as a sale in which the transferor obtains the resulting securities and classifies them as debt securities shall separately recognize its servicing assets or servicing liabilities.

receivables during the revolving periods of some securitizations) and swaps (for example, provisions that convert interest rates from fixed to variable).

20. 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.

21. 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 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.

Financial Assets Subject to Prepayment

22. Financial assets, except for instruments that are within the scope of SSAP No. 86, that can contractually be prepaid or otherwise settled in such a way that the holder would not recover substantially all of its recorded investment shall be subsequently measured like investments in debt securities and loan-backed and structured securities in accordance with SSAP No. 43R. Examples of such financial assets include, but are not limited to, **interest-only strips**, other beneficial interests, loans, or other receivables.

Secured Borrowings and Collateral

23. A debtor may grant a **security interest** in certain assets to a lender (the secured party) to serve as collateral for its obligation under a borrowing, with or without recourse to other assets of the debtor. An obligor under other kinds of current or potential obligations, for example, interest rate swaps, also may grant a security interest in certain assets to a secured party. If collateral is transferred to the secured party, the custodial arrangement is commonly referred to as a pledge. Secured parties sometimes are permitted to sell or repledge (or otherwise transfer) collateral held under a pledge. The same relationships occur, under different names, in transfers documented as sales that are accounted for as secured borrowings (paragraph 18 secured borrowing). The accounting for noncash³ 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 issue paper.
- 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.

³ 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.

- d. Except as provided in paragraph 23.c., the debtor (transferor) shall continue to carry the collateral as its asset, and the secured party (transferee) shall not recognize the pledged asset.

24. 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. 5—Liabilities, Contingencies and Impairments of Assets* (SSAP No. 5), 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 23 above 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.

Extinguishments of Liabilities

25. 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 released⁴ from being the primary obligor under the liability, either judicially or by the creditor.

Disclosures

26. The principal objectives of the disclosures required by this issue paper are to provide users of the financial statements with an understanding of all of the following:

- a. A transferor's continuing involvement (as defined in the glossary of this issue paper), if any, with transferred financial assets.
- b. The nature of any restrictions on assets reported by an entity in its statement of financial position that relate to a transferred financial asset, including the carrying amounts of those assets.
- c. How servicing assets and servicing liabilities are reported under this issue paper.
- d. For transfers accounted for as sales when a transferor has continuing involvement with the transferred financial assets and for transfers of financial assets accounted for as

⁴ If nonrecourse debt (such as certain mortgage loans) is assumed by a third party in conjunction with the sale of an asset that serves as sole collateral for that debt, the sale and related assumption effectively accomplish a legal release of the seller-debtor for purposes of applying this statement.

secured borrowings, how the transfer of financial assets affects a transferor's financial position, financial performance, and cash flows.

Those objectives apply regardless of whether this issue paper requires specific disclosures. The specific disclosures required by this issue paper are minimum requirements and an entity may need to supplement the required disclosures specified in paragraph 31 depending on the facts and circumstances of a transfer, the nature of an entity's continuing involvement with the transferred financial assets, and the effect of an entity's continuing involvement on the transferor's financial position, financial performance, and cash flows. Disclosures required by other Statement of Statutory Accounting Principles (SSAPs) for a particular form of continuing involvement shall be considered when determining whether the disclosure objectives of this issue paper have been met.

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

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

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

29. The disclosures in paragraph 31.f. of this issue paper apply to transfers accounted for as sales when the transferor has continuing involvement with transferred financial assets as a result of a securitization, asset-backed financing arrangement, or a similar transfer. If specific disclosures are required for a particular form of the transferor's continuing involvement by other SSAPs, the transferor shall provide the information required in paragraphs 31.f.i.(a) and 31.f.ii.(a) of this issue paper with a cross-reference to the separate notes to financial statements so a financial statement user can understand the risks retained in the transfer. The entity need not provide each specific disclosure required in paragraphs 31.f.i.(b), 31.f.ii.(a)(1)–(4), and 31.f.ii.(b)–(e) if the disclosure is not required by other SSAPs and the objectives of paragraph 26 are met. For example, if the transferor's only form of continuing involvement is a derivative, the entity shall provide the disclosures required in paragraphs 31.f.i.(a) and 31.f.ii.(a) of this issue paper and the disclosures about derivatives required by applicable SSAPs. In addition, the entity would evaluate whether the other disclosures in paragraph 31.f. are necessary for the entity to meet the objectives in paragraph 26.

30. To apply the disclosures in paragraph 31, an entity shall consider all involvements by the transferor or its agents to be involvements by the transferor.

31. A reporting entity shall disclose the following:

- a. For collateral:
 - i. If the entity has entered into repurchase agreements or securities lending transactions, its policy for requiring collateral or other security and the fair value of the loaned security;
 - ii. If the entity has pledged any of its assets as collateral that are not reclassified and separately reported in the statement of financial position pursuant to paragraph 23. a, the carrying amounts and classifications of both those assets and associated liabilities as of the date of the latest statement of financial position presented, including qualitative information about the relationship(s) between those assets and associated liabilities. For example, if assets are restricted solely to satisfy a specific obligation, the carrying amounts of those assets and associated liabilities, including a description of the nature of restrictions placed on the assets, shall be disclosed.
 - iii. If the entity or its agent has accepted collateral that it is permitted by contract or custom to sell or repledge, the fair value as of the date of each statement of financial position presented of that collateral and of the portion of that collateral that it has sold or repledged, and information about the sources and uses of that collateral. Additionally, the reporting entity shall disclose the aggregate amount of contractually obligated open collateral positions (aggregate amount of securities at current fair value or cash received for which the borrower may request the return of on demand) and the aggregate amount of contractually obligated collateral positions under 30-day, 60-day, 90-day, and greater than 90-day terms.
 - iv. If the entity has accepted collateral that it is not permitted by contract or custom to sell or repledge, provide detail on these transactions, including the terms of the contract, and the current fair value of the collateral.
 - v. For all securities lending transactions, disclose collateral for transactions that extend beyond one year from the reporting date; and
 - vi. For securities lending transactions administered by an affiliated agent in which “one-line” reporting (per paragraph 87.a.) of the reinvested collateral per paragraph 87.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 87.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
 - vii. For securities lending transactions, include separately, the amount of any loaned securities within the separate account and if the policy and procedures for the separate account differ from the general account.
- b. The reporting entity shall provide the following information by type of program (repurchase agreement, securities lending or dollar repurchase agreement) with respect to

the reinvestment of the cash collateral and any securities which it or its agent receives as collateral that can be sold or repledged.

- i. The aggregate amount of the reinvested cash collateral (amortized cost and fair value). Reinvested cash collateral shall be broken down by the maturity date of the invested asset – under 30-day, 60-day, 90-day, 120-day, 180-day, less than 1 year, 1-2 years, 2-3 years and greater than 3 years.
 - ii. To the extent that the maturity dates of the liability (collateral to be returned) does not match the invested assets, the reporting entity shall explain the additional sources of liquidity to manage those mismatches.
- c. For in-substance defeasance of debt
- i. 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 each the period so long as that debt remains outstanding.
- d. For all servicing assets and servicing liabilities:
- i. A description of the risks inherent in servicing assets and servicing liabilities and, if applicable, the instruments used to mitigate the income statement effect of changes in fair value to the servicing assets and servicing liabilities. (Disclosure of quantitative information about the instruments used to manage the risks inherent in servicing assets and servicing liabilities is encouraged but not required.)
 - ii. The amount of contractually specified servicing fees, late fees and ancillary fees earned for each period for which results of operations are presented, including a description of where each amount is reported in the statement of income.
 - iii. Quantitative and qualitative information about the assumptions used to estimate the fair value (for example, discount rates, anticipated credit losses, and prepayment speeds). (An entity that provides quantitative information about the instruments used to manage the risks inherent in the servicing assets and servicing liabilities, as encouraged by paragraph 31.d.i., also is encouraged, but not required to disclose the quantitative and qualitative information about the assumptions used to estimate the fair value of those instruments.
- e. When servicing assets and servicing liabilities are subsequently measured at fair value:
- i. For each class of servicing assets and servicing liabilities, the activity in the balance of servicing assets and the activity in the balance of servicing liabilities (including a description of where changes in fair value are reported in the statement of income for each period for which results of operations are presented), including, but not limited to, the following:
 - (a) The beginning and ending balances
 - (b) Additions (through purchases of servicing assets, assumptions of servicing obligations, and recognition of servicing obligations that result from transfers of financial assets)
 - (c) Disposals

- ii. For each statement of financial position presented, regardless of when the transfer occurred:
 - (a) Qualitative and quantitative information about the transferor's continuing involvement with transferred financial assets that provides financial statement users with sufficient information to assess the reasons for the continuing involvement and the risks related to the transferred financial assets to which the transferor continues to be exposed after the transfer and the extent that the transferor's risk profile has changed as a result of the transfer (including, but not limited to, credit risk, interest rate risk, and other risks), including:
 - (1) The total principal amount outstanding, the amount that has been derecognized, and the amount that continues to be recognized in the statement of financial position.
 - (2) The terms of any arrangements that could require the transferor to provide financial support (for example, liquidity arrangements and obligations to purchase assets) to the transferee or its beneficial interest holders, including a description of any events or circumstances that could expose the transferor to loss and the amount of the maximum exposure to loss.
 - (3) Whether the transferor has provided financial or other support during the periods presented that it was not previously contractually required to provide to the transferee or its beneficial interest holders, including when the transferor assisted the transferee or its beneficial interest holders in obtaining support, including:
 - (i.) The type and amount of support
 - (ii.) The primary reasons for providing the support
 - (4) Information is encouraged about any liquidity arrangements, guarantees, and/or other commitments provided by third parties related to the transferred financial assets that may affect the transferor's exposure to loss or risk of the related transferor's interest.
 - (b) The entity's accounting policies for subsequently measuring assets and liabilities that relate to the continuing involvement with the transferred financial assets;
 - (c) The key inputs and assumptions used in measuring the fair value of assets or liabilities that relate to the transferor's continuing involvement (including, at a minimum, but not limited to, and if applicable, quantitative information about discount rates, expected prepayments including the expected weighted-average life of prepayable financial assets, and anticipated credit losses, including expected static pool losses);
 - (d) For the transferor's interests in the transferred financial assets, a sensitivity analysis or stress test showing the hypothetical effect on the

fair value of those interests (including any servicing assets or servicing liabilities) of two or more unfavorable variations from the expected levels for each key assumption that is reported under paragraph 31.f.ii.(c) 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

- (e) Information about the asset quality of transferred financial assets and any other assets that it manages together with them. This information shall be separated between assets that have been derecognized and assets that continue to be recognized in the statement of financial position. This information is intended to provide financial statement users with an understanding of the risks inherent in the transferred financial assets as well as in other assets and liabilities that it manages together with transferred financial assets. For example, information for receivables shall include, but is not limited to:
 - (i) Delinquencies at the end of the period; and
 - (ii) Credit losses, net of recoveries, during the period.
- g. Disclosure requirements for transfers of financial assets accounted for as secured borrowing:
 - i. The carrying amounts and classifications of both assets and associated liabilities recognized in the transferor's statement of financial position at the end of each period presented, including qualitative information about the relationship(s) between those assets and associated liabilities. For example, if assets are restricted solely to satisfy a specific obligation, the carrying amounts of those assets and associated liabilities, including a description of the nature of restrictions placed on the assets.
 - h. Description of any loaned securities, including the amount, a description of, and the policy for, requiring collateral, and whether or not the collateral is restricted;
 - i. A description of the securities underlying repurchase and reverse repurchase agreements, dollar repurchase and dollar reverse repurchase agreements, including book values and fair values, maturities, and weighted average interest rates for the following categories: (i) securities subject to reverse repurchase agreements; (ii) securities subject to repurchase agreements; (iii) securities subject to dollar repurchase agreements; and (iv) securities subject to dollar reverse repurchase agreements; and
 - j. A description of the terms of reverse repurchase agreements whose amounts are included in borrowed money.
 - k. Disclose any transfers of receivables with recourse.
 - l. A reporting entity shall disclose the following information for wash sales, as defined in paragraph 16, involving transactions for securities with a NAIC designation of 3 or below, or unrated:
 - i. A description of the reporting entity's objectives regarding these transactions;
 - ii. An aggregation of transactions by NAIC designation 3 or below, or unrated;

- iii. The number of transactions involved during the reporting period;
- iv. The book value of securities sold;
- v. The cost of securities repurchased; and
- vi. The realized gains/losses associated with the securities involved.

32. Refer to the preamble for further discussion regarding disclosure requirements. The disclosures required by paragraph 31 shall be made for the current quarter in the quarterly statement and for the year in the annual statement.

Appendix A – Implementation Guidance

33. This appendix describes certain provisions of this issue paper in more detail and describes how they apply to certain types of transactions. This appendix discusses generalized situations. Facts and circumstances and specific contracts need to be considered carefully in applying this issue paper. This appendix is an integral part of the standards provided in this issue paper.

34. Paragraph 10 of this issue paper states that the objective of paragraph 12 and related implementation guidance is to determine whether a transferor has surrendered control over transferred financial assets.

Unit of Account

35. Paragraph 11 establishes the unit of account to which the sale accounting conditions in paragraph 12 shall be applied. Paragraph 11 states that paragraph 12 shall be applied to transfers of an entire financial asset, transfers of a group of entire financial assets, and transfers of a participating interest in an entire financial asset. Inherent in that principle is that to be eligible for sale accounting an entire financial asset cannot be divided into components before a transfer unless all of the components meet the definition of a participating interest.

36. The legal form of the asset and what the asset conveys to its holders shall be considered in determining what constitutes an entire financial asset. The following examples illustrate the application of what constitutes an entire financial asset:

- a. A loan to one borrower in accordance with a single contract that is transferred to a securitization entity before securitization shall be considered an entire financial asset. Similarly, a beneficial interest in securitized financial assets after the securitization process has been completed shall be considered an entire financial asset. In contrast, a transferred interest in an individual loan shall not be considered an entire financial asset; however, if the transferred interest meets the definition of a participating interest, the participating interest would be eligible for sale accounting.
- b. In a transaction in which the transferor creates an interest-only strip from a loan and transfers the interest-only strip, the interest-only strip does not meet the definition of an entire financial asset (and an interest-only strip does not meet the definition of a participating interest; therefore, sale accounting would be precluded). In contrast, if an entire financial asset is transferred to a securitization entity and the transfer meets the conditions for sale accounting, the transferor may obtain an interest-only strip as proceeds from the sale. An interest-only strip received as proceeds of a sale is an entire financial asset for purposes of evaluating any future transfers that could then be eligible for sale accounting.

- c. If multiple advances are made to one borrower in accordance with a single contract (such as a line of credit, credit card loan, or a construction loan), an advance on that contract would be a separate unit of account if the advance retains its identity, does not become part of a larger loan balance, and is transferred in its entirety. However, if the transferor transfers an advance in its entirety and the advance loses its identity and becomes part of a larger loan balance, the transfer would be eligible for sale accounting only if the transfer of the advance does not result in the transferor retaining any interest in the larger balance or if the transfer results in the transferor's interest in the larger balance meeting the definition of a participating interest. Similarly, if the transferor transfers an interest in an advance that has lost its identity, the interest must be a participating interest in the larger balance to be eligible for sale accounting.

Participating Interests in an Entire Financial Asset

37. Paragraph 11.b. requires that all cash flows received from the entire financial asset be divided among the participating interest holders (including any interest retained by the transferor or its agents) in proportion to their share of ownership. That is, the participating interest definition does not allow for the allocation of specified cash flows unless each cash flow is proportionately allocated to the participating interest holders. For example, in the case of an individual loan in which the borrower is required to make a contractual payment that consists of a principal amount and interest amount on the loan, the transferor and transferee shall share in the principal and interest payments on the basis of their proportionate ownership interest in the loan. In contrast, if the transferor is entitled to receive an amount that represents the principal payments and the transferee is entitled to receive an amount that represents the interest payments on the loan, that arrangement would not be consistent with the participating interest definition because the transferor and transferee do not share proportionately in the cash flows received from the loan. In other cases, a transferor may transfer a portion of an individual loan that represents either a senior interest or a junior interest in an individual loan. In both of those cases, the transferor would account for the transfer as a secured borrowing because the senior interest or junior interest in the loan do not meet the requirements to be participating interests (see paragraph 41).

38. Paragraph 11.b. states that cash flows allocated as compensation for services performed, if any, shall not be included in that determination provided that those cash flows are not subordinate to the proportionate cash flows of the participating interest and are not significantly above an amount that would fairly compensate a substitute service provider, should one be required, including any profit that would be demanded in the marketplace. Cash flows allocated as compensation for services performed that are significantly above an amount that would fairly compensate a substitute service provider would result in a disproportionate division of cash flows of the entire financial asset among the participating interest holders and, therefore, would preclude the portion of a transferred financial asset from meeting the definition of a participating interest. Examples of cash flows that are compensation for services performed include loan origination fees paid by the borrower to the transferor, fees necessary to arrange and complete the transfer paid by the transferee to the transferor, and fees for servicing the financial asset.

39. The transfer of a portion of an entire financial asset may result in a gain or loss on the transfer when the contractual interest rate on the entire financial asset differs from the market rate at the time of transfer. Paragraph 11.b. states that any cash flows received by the transferor as proceeds of a transfer of a participating interest shall be excluded from the determination of whether the cash flows of the participating interest are proportionate provided that the transfer does not result in the transferor receiving an ownership interest in the financial asset that permits it to receive disproportionate cash flows. For example, if the transferor transfers an interest in an entire financial asset and the transferee agrees to incorporate the excess interest (between the contractual interest rate on the financial asset and the market interest rate at the date of transfer) into the contractually specified servicing fee, the excess interest would likely result in the conveyance of an interest-only strip to the transferor from the transferee. An interest-only strip would result in a disproportionate division of cash flows of the financial asset among the

participating interest holders and would preclude the portion from meeting the definition of a participating interest.

40. Paragraph 11.c. requires that the rights of each participating interest holder (including the transferor in its role as participating interest holder) have the same priority and that no participating interest holder's interest is subordinated to the interest of another participating interest holder. In certain transfers, recourse is provided to the transferee that requires the transferor to reimburse any premium paid by the transferee if the underlying financial asset is prepaid within a defined timeframe of the transfer date. Such recourse would preclude the transferred portion from meeting the definition of a participating interest. However, once the recourse provision expires, the transferred portion shall be reevaluated to determine if it meets the participating interest definition.

41. Paragraph 11.c. also requires that participating interest holders have no recourse to the transferor (or its agents) or to each other, other than standard representations and warranties, ongoing contractual obligations to service the entire financial asset and administer the transfer contract, and contractual obligations to share in any set-off benefits. Recourse in the form of an independent third-party guarantee shall be excluded from the evaluation of whether the participating interest definition is met. Similarly, cash flows allocated to a third-party guarantor for the guarantee fee shall be excluded from the determination of whether the cash flows are divided proportionately among the participating interest holders.

Isolation Beyond the Reach of the Transferor and Its Creditors

42. The nature and extent of supporting evidence required for an assertion in financial statements that an entire financial asset, a group of entire financial assets, or a participating interest in an entire financial asset (which are referred to collectively in this issue paper as 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—depend on the facts and circumstances. All available evidence that either supports or questions an assertion shall be considered, including whether the contract or circumstances permit the transferor to revoke the transfer. It also may include consideration of the legal consequences of the transfer in the jurisdiction in which bankruptcy or other receivership would take place, whether a transfer of financial assets would likely be deemed a true sale at law (as described in paragraph 43) or otherwise isolated (as described in paragraph 44), whether the transferor is affiliated with the transferee, and other factors pertinent under applicable law. Derecognition of transferred financial assets is appropriate only if the available evidence provides reasonable assurance that the transferred financial assets would be beyond the reach of the powers of a bankruptcy trustee or other receiver for the transferor and its creditors (paragraph 78.c.). Transactions between related parties or affiliates are accounted for in accordance with SSAP No. 25.

43. In the context of U.S. bankruptcy laws, a true sale opinion from an attorney is often required to support a conclusion that transferred financial assets are isolated from the transferor, and its creditors. In addition, a nonconsolidation opinion is often required if the transfer is to an affiliated entity. In the context of U.S. bankruptcy laws:

- a. A true sale opinion is an attorney's conclusion that the transferred financial assets have been sold and are beyond the reach of the transferor's creditors and that a court would conclude that the transferred financial assets would not be included in the transferor's bankruptcy estate.
- b. A nonconsolidation opinion is an attorney's conclusion that a court would recognize that an entity holding the transferred financial assets exists separately from the transferor. Additionally, a nonconsolidation opinion is an attorney's conclusion that a court would not order the substantive consolidation of the assets and liabilities of the entity holding

the transferred financial assets and the assets and liabilities of the transferor in the event of the transferor's bankruptcy or receivership.

A legal opinion may not be required if a transferor has a reasonable basis to conclude that the appropriate legal opinion(s) would be given if requested. For example, the transferor might reach a conclusion without consulting an attorney if (1) the transfer is a routine transfer of financial assets that does not result in any continuing involvement by the transferor or (2) the transferor had experience with other transfers with similar facts and circumstances under the same applicable laws and regulations.

44. For insurers that are subject to conservatorship, or other receivership procedures, judgments about whether transferred financial assets have been isolated need to be made in relation to the powers of conservators or receivers in those jurisdictions.

45. Whether securitizations isolate transferred financial assets may depend on such factors as whether the securitization is accomplished in one step or multiple step transfers (paragraphs 75-80). Some common financial transactions, for example, typical repurchase agreements and securities lending transactions, may isolate transferred financial assets from the transferor, although they may not meet the other conditions for surrender of control (paragraph 12).

Conditions That Constrain a Transferee

46. Sale accounting is allowed under paragraph 12.b. only if each transferee (or, if the transferee is an entity whose sole purpose is to engage in securitization or asset-backed financing arrangements and that entity is constrained from pledging or exchanging the assets it receives, each third-party holder of its beneficial interests) has the right to pledge or exchange the assets or beneficial interests it received, and no condition both constrains the transferee (or third-party holder of its beneficial interests) from taking advantage of its right to pledge or exchange and provides more than a trivial benefit to the transferor. Many transferor-imposed or other conditions on a transferee's right to pledge or exchange both constrain a transferee from pledging or exchanging and, through that constraint, provide more than a trivial benefit to the transferor. Judgment is required to assess whether a particular condition results in a constraint. Judgment also is required to assess whether a constraint provides a more-than-trivial benefit to the transferor. If the transferee is an entity whose sole purpose is to engage in securitization or asset-backed financing activities, that entity may be constrained from pledging or exchanging the transferred financial assets to protect the rights of beneficial interest holders in the financial assets of the entity. Paragraph 12.b. requires that the transferor look through the constrained entity to determine whether each third-party holder of its beneficial interests has the right to pledge or exchange the beneficial interests that it holds. The considerations in paragraphs 47-50 apply to the transferee or the third-party holders of its beneficial interests in an entity that is constrained from pledging or exchanging the assets it receives and whose sole purpose is to engage in securitization or asset-backed financing activities

47. Some conditions may constrain a transferee from pledging or exchanging the financial asset and may provide the transferor with more than a trivial benefit. For example, a provision that prohibits selling or pledging a transferred loan receivable not only constrains the transferee but also provides the transferor with the more-than-trivial benefit of knowing who holds the financial asset (a prerequisite to repurchasing the financial asset) and of being able to block the financial asset from being transferred to a competitor for the loan customer's business. 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 to with the transferor, also constrain the transferee and presumptively provide the transferor with more-than-trivial benefits. In some circumstances in which the transferor has no continuing involvement with the transferred financial assets, some conditions may constrain a transferee from pledging or exchanging the financial assets. If the transferor and its agents have no continuing involvement with the transferred financial assets, the condition under paragraph 12.b. is met. For example, if a transferor receives only cash in return for the transferred financial assets and the transferor and its agents have no continuing involvement with the transferred financial assets, sale accounting is allowed under paragraph

12.b. even if the transferee entity is significantly limited in its ability to pledge or exchange the transferred assets.

48. However, some conditions may not constrain a transferee from pledging or exchanging the transferred financial asset. 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. This is because the right in itself does not enable the transferor to compel the transferee to sell the financial asset and the transferee would be in a position to receive the sum offered by exchanging the financial asset, albeit possibly from the transferor rather than the third party. Further examples of conditions that presumptively would not constrain a transferee for purposes of this issue paper 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. However, judgment is required to assess the significance of some conditions. For example, a prohibition on sale to the transferor's competitor would be a constraint if that competitor were the only potential willing buyer other than the transferor.

49. 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 or Beneficial Interests

50. Some rights or obligations to reacquire transferred financial assets or beneficial interests both constrain the transferee and provide more than a trivial benefit to the transferor, thus precluding sale accounting under paragraph 12.b.. A **freestanding call** option written by a transferee to the transferor may benefit the transferor and, if the transferred financial assets are not readily obtainable in the marketplace, is likely to constrain a transferee because the transferee might have to default if the call was exercised and the transferee had pledged or exchanged the financial assets. For example, if a transferor in a securitization transaction has a call option to repurchase third-party beneficial interests at the price paid plus a stated return, that arrangement conveys more than a trivial benefit to the transferor (paragraphs 57 and 58). If the third-party holders of its beneficial interests are constrained from pledging or exchanging their beneficial interests due to that call option, the transferor would be precluded from accounting for the transfer of financial assets to the securitization entity as a sale. Similarly, a freestanding forward purchase-sale contract between the transferor and the transferee on transferred financial assets not readily obtainable in the marketplace would benefit the transferor and is likely to constrain a transferee in much the same manner. Alternatively, freestanding rights to reacquire transferred assets that are readily obtainable presumptively do not constrain the transferee from pledging or exchanging them and thus do not preclude sale accounting under paragraph 12.b.

51. Other rights or obligations to reacquire transferred financial assets, regardless of whether they constrain the transferee, may result in the transferor's maintaining effective control over the transferred financial assets, as discussed in paragraphs 53-62, thus precluding sale accounting under paragraph 12.c. 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. However, an attached call could result in the transferor's maintaining effective control over the transferred asset(s) because the attached call gives the transferor the unilateral ability to cause whoever holds that specific asset to return it.

52. The concept of qualified special-purpose entities (QSPEs) was previously included within SSAP No. 91R. With the issuance of this issue paper, this concept is no longer included within statutory accounting guidance. Although this concept has been eliminated and is no longer a factor in determining whether a transfer of assets qualifies for sale accounting, reporting entities may continue to form, conduct transfers between, or have investments in trusts or other such legal vehicles that may have previously met the conditions to be considered a QSPE. Accounting for transfers of assets between the insurer and such trusts or other legal vehicles, including whether such transfers qualify for sale accounting, are subject to the provisions of this issue paper. As noted within paragraph 7, SSAP No. 25 shall be followed for accounting and disclosure requirements for all related party transactions.

Effective Control Over Transferred Financial Assets or Beneficial Interests

53. Judgment is required to assess whether the transferor maintains effective control over transferred financial assets or third-party beneficial interests. The transferor must evaluate whether a combination of multiple arrangements maintains effective control of transferred financial assets. When the transferee issues beneficial interests in the transferred financial assets, the evaluation of whether the transferor maintains effective control over the transferred financial assets also shall consider whether the transferor maintains effective control over the transferred financial assets through its control over the third-party beneficial interests. To assess whether the transferor maintains effective control over the transferred financial assets, all continuing involvement by the transferor or its agents shall be considered continuing involvement by the transferor. When assessing effective control, the transferor only considers the involvements of an agent when the agent acts for and on behalf of the transferor. In other words, if the transferor and transferee have the same agent, the agent's activities on behalf of the transferee would not be considered in the transferor's evaluation of whether it has effective control over a transferred financial asset. For example, an investment manager may act as a fiduciary (agent) for both the transferor and the transferee; therefore, the transferor need only consider the involvements of the investment manager when it is acting on its behalf.

Agreement to Repurchase or Redeem Transferred Financial Assets

54. An agreement that both entitles and obligates the transferor to repurchase or redeem transferred financial assets from the transferee maintains the transferor's effective control over those assets as described in paragraph 12.c.(1) when all of the following conditions are met:

- a. The financial assets to be repurchased or redeemed are the same or substantially the same as those transferred (paragraph 56).
- 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 56).
- c. The agreement is to repurchase or redeem them before maturity, at a fixed or determinable price.
- d. The agreement is entered into contemporaneously with, or in contemplation of, the transfer.

55. To be substantially the same, the financial asset that was transferred and the financial 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 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.

56. To be able to repurchase or redeem financial 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 financial assets from others.

Unilateral Ability to Cause the Return of Specific Transferred Financial Assets

57. A transferor maintains effective control over transferred financial assets when the transferor has the unilateral ability to cause the holder to return specific financial assets and that ability provides more than a trivial benefit to the transferor. A cleanup call, however, is permitted as an exception to that general principle. A call on a transferred financial asset provides the transferor with effective control over that financial asset if, under its price and other terms, the call provides the transferor with the unilateral ability to reclaim the transferred financial asset and 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. A transferor's unilateral ability to cause a securitization entity to return to the transferor or otherwise dispose of specific transferred financial assets, for example, in response to its decision to exit a market or a particular activity, would provide the transferor with effective control over the transferred financial assets if it provides more than a trivial benefit to the transferor. However, a call on readily obtainable assets at fair value may not provide the transferor with more than a trivial benefit. (Paragraph 60 provides an example in which, due to the combination of arrangements, the transferor would maintain effective control.)

58. Effective control over transferred financial assets can be present even if the right to reclaim is indirect. For example, if a call allows a transferor to buy back the beneficial interests at a fixed price, the transferor may maintain effective control of the financial assets underlying those beneficial interests. If the transferee is an entity whose sole purpose is to engage in securitization or asset-backed financing activities, that entity may be constrained from choosing to pledge or exchange the transferred financial assets. In that circumstance, any call held by the transferor on third-party beneficial interests is effectively an attached call on the transferred financial assets. Depending on the price and other terms of the call, the transferor may maintain effective control over the transferred financial assets.

59. An **embedded call** would not result in the transferor's maintaining effective control because it is the issuer rather than the transferor who holds the call and the call does not provide more than a trivial benefit to the transferor. For example, a call embedded by the issuer of a callable bond or the borrower of a prepayable mortgage loan would not provide the transferor with effective control over the transferred financial asset.

60. A right to reclaim specific transferred financial assets by paying their fair value when reclaimed generally does not maintain effective control when 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 financial assets. For example, if a transferor holds the residual interest in securitized financial assets and can reclaim the transferred financial assets at termination of the

securitization entity by purchasing them in an auction, and thus at what might appear to be fair value, then sale accounting for the transfer of those financial assets it can reclaim would be precluded. Such circumstances provide the transferor with a more than trivial benefit and effective control over the financial assets, because it can pay any price it chooses in the auction and recover any excess paid over fair value through its residual interest in the transferred financial assets.

61. Removal-of-account provisions do not result in the transferor's maintaining effective control, and are thus precluded from being accounted for as sales under statutory accounting as discussed in paragraph 82.

Arrangements to Reacquire Transferred Financial Assets

62. A transferor maintains effective control over the transferred financial asset as described in paragraph 12.c.(3) through an agreement that permits the transferee to require the transferor to repurchase the transferred financial asset at a price that is so favorable to the transferee at the date of the transfer that it is probable that the transferee will require the transferor to repurchase the transferred financial asset. For example, a put option written to the transferee generally does not provide the transferor with effective control over the transferred financial asset. However, a put option that is sufficiently deep in the money when it is written would provide the transferor effective control over the transferred financial asset because it is probable that the transferee will exercise the option and the transferor will be required to repurchase the transferred financial asset. In contrast, a sufficiently out-of-the-money put option held by the transferee would not provide the transferor with effective control over the transferred financial asset if it is probable when the option is written that the option will not be exercised. Likewise, a put option held by the transferee at fair value would not provide the transferor with effective control over the transferred financial asset.

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

63. A change in law or other circumstance may result in a transferred portion of an entire financial asset no longer meeting the conditions of a participating interest (paragraph 11) or the transferor's regaining control of transferred financial assets after a transfer that was previously accounted for as a sale, because one or more of the conditions in paragraph 12 are no longer met. Such changes, unless they arise solely from the initial application of this issue paper or from a change in market prices (for example, an increase in price that moves into-the-money a freestanding call on a non-readily-obtainable transferred financial asset that was originally sufficiently out-of-the-money that it was judged not to constrain the transferee), are accounted for in the same manner as a purchase of the transferred financial assets from the former transferee(s) in exchange for liabilities assumed (paragraph 13 or 15). (This "re-purchase" premise is consistent with INT 04-21.) After that change, the transferor recognizes in its financial statements those transferred financial assets together with liabilities to the former transferee(s) or beneficial interest holders of the former transferee(s). The transferor initially measures those transferred financial assets and liabilities at fair value on the date of the change, as if the transferor purchased the transferred financial assets and assumed the liabilities on that date. The former transferee would derecognize the transferred financial assets on that date, as if it had sold the transferred financial assets in exchange for a receivable from the transferor.

Measurement of Interests Held after a Transfer of Financial Assets

Assets Obtained and Liabilities Incurred as Proceeds

64. The proceeds from a sale of financial assets consist of the cash and any other assets obtained, including beneficial interests and separately recognized servicing assets, in the transfer less any liabilities incurred, including separately recognized servicing liabilities. Any asset obtained is part of the proceeds from the sale. Any liability incurred, even if it is related to the transferred financial 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.

Participating Interests in Financial Assets That Continue to be Held by a Transferor

65. Participating interests in financial assets that continue to be held by a transferor are not part of the proceeds of the transfer, and the carrying amount of those participating interests shall be measured at the date of the transfer by allocating the previous carrying amount between the participating interests transferred and sold, and the participating interests that are not transferred and continue to be held by a transferor, based on their relative fair values.

Servicing Assets and Liabilities

66. Servicing of mortgage loans, credit card receivables, or other financial assets commonly includes, but is not limited to, collecting principal, interest, and escrow payments from borrowers; paying taxes and insurance from escrowed funds; monitoring delinquencies; executing foreclosure if necessary; temporarily investing funds pending distribution; remitting fees to guarantors, trustees, and others providing services; and accounting for and remitting principal and interest payments to the holders of beneficial interests or participating interests in the financial assets. Servicing is inherent in all financial assets; it becomes a distinct asset or liability for accounting purposes only in the circumstances described in paragraph 67. If a transferor sells a participating interest in an entire financial asset, it would recognize a servicing asset or a servicing liability only related to the participating interest sold.

67. An entity that undertakes a contract to service financial assets shall recognize either a servicing asset or a servicing liability, each time it undertakes an obligation to service a financial asset that (a) results from a servicer's transfer of an entire financial asset, a group of entire financial assets, or a participating interest in an entire financial asset that meets the requirements for sale accounting, or (b) is acquired or assumed and the servicing obligation does not relate to financial assets of the servicer. However, if the transferor transfers the assets to an entity in a transfer that qualifies as a sale in which the transferor obtains the resulting securities, and classifies them as debt securities, the servicing asset or servicing liability may be reported together with the asset being serviced and not recognized separately. A servicer of financial assets commonly receives the **benefits of servicing**—revenues from contractually specified servicing fees, a portion of the interest from the financial assets, late charges, and other ancillary sources, including "float," all of which it is entitled to receive only if it performs the servicing—and incurs the costs of servicing the financial assets. Typically, the benefits of servicing are expected to be more than **adequate compensation** to a servicer for performing the servicing, and the contract results in a servicing asset. However, if the benefits of servicing are not expected to adequately compensate a servicer for performing the servicing, the contract results in a servicing liability. (A servicing asset may become a servicing liability, or vice versa, if circumstances change, and the initial measure for servicing may be zero if the benefits of servicing are just adequate to compensate the servicer for its servicing responsibilities.) A servicer would account for its servicing contract that qualifies for separate recognition as a servicing asset or a servicing liability initially measured at its fair value regardless of whether explicit consideration was exchanged.

68. 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 financial assets remaining on the transferor's balance sheet shall not recognize a servicing asset or a servicing liability.

69. A servicer that recognizes a servicing asset or servicing liability shall account for the contract to service financial assets separately from those financial assets, as follows:

- a. Report servicing assets separately from servicing liabilities as a nonadmitted asset in the statement of financial position.

- b. Initially measure servicing assets and servicing liabilities at fair value, (paragraph 19).
- c. Account separately for rights to future interest income from the serviced assets that exceed contractually specified servicing fees. Those rights are not servicing assets; they are financial assets, effectively interest-only strips to be accounted for in accordance with paragraph 22 of this issue paper. (Interest-only strips preclude a portion of a financial asset from meeting the definition of a participating interest; see paragraph 39.)
- d. Identify classes of servicing assets and servicing liabilities based on (1) the availability of market inputs used in determining the fair value of servicing assets and servicing liabilities, (2) an entity's method for managing the risks of its servicing assets and servicing liabilities, or (3) both.
- e. Subsequently measure each class of separately recognized servicing assets and servicing liabilities at fair value. Changes in fair value should be reported as unrealized gains and losses (paragraph 21). Declines in fair value which are determined to be other-than-temporary shall be recorded as realized losses.

70. As indicated above, transferors sometimes agree to take on servicing responsibilities when the future benefits of servicing are not expected to adequately compensate them for performing that servicing. In that circumstance, the result is a servicing liability rather than a servicing asset. For example, if in the transaction illustrated in Exhibit B – Illustration 3 the transferor had agreed to service the loans without explicit compensation and it estimated the fair value of that servicing obligation at \$50, net proceeds would be reduced to \$980, gain on sale would become a loss on sale of \$20, and the transferor would report a servicing liability of \$50.

Securitizations

71. Financial assets, such as mortgage loans, are 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, and even taxi medallions also have been securitized. But securitizations of nonfinancial assets are outside the scope of this issue paper.

72. An originator of a typical securitization (the transferor) transfers a portfolio of financial assets to a securitization entity, commonly a trust. In “pass-through” and “pay-through” securitizations, receivables are transferred to the entity 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 entity.

73. Beneficial interests in the securitization entity are sold to investors and the proceeds are used to pay the transferor for the assets transferred financial assets. 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 entity.

74. Pass-through and pay-through securitizations that meet the conditions in paragraph 12 qualify for sale accounting under this issue paper. All financial assets obtained and liabilities incurred by the transferor of a securitization that qualifies as a sale shall be recognized and measured as provided in paragraphs 13 and 15; that includes the implicit forward contract to sell additional financial assets during a revolving period, which may become valuable or onerous to the transferor as interest rates and other market conditions change.

Isolation of Transferred Financial Assets in Securitizations

75. A securitization carried out in one transfer or a series of transfers may or may not isolate the transferred financial assets beyond the reach of the transferor and its creditors. Whether it does depends on the structure of the securitization transaction taken as a whole, considering such factors as the type and extent of further involvement in arrangements to protect investors from credit, and interest rate, and other risks, the availability of other financial assets, and the powers of bankruptcy courts or other receivers. The discussion in paragraphs 76-78 relates only to the isolation condition in paragraph 12.a. The conditions in paragraphs 12.b. and 12.c. also must be considered to determine whether a transferor has surrendered control over the transferred financial assets.

76. In certain securitizations, a corporation that, if it failed, would be subject to the U.S. Bankruptcy Code transfers financial assets to a securitization entity exchange for cash. The entity raises that cash by issuing to investors beneficial interests that pass through all cash received from the financial assets, and the transferor has no further involvement with the trust or the transferred financial assets. The Board understands that those securitizations generally would be judged as having isolated the assets, because, in the absence of any continuing involvement, there would be reasonable assurance that the transfer would be found to be a true sale at law that places the assets beyond the reach of the transferor, and its creditors, even in bankruptcy or other receivership.

77. In other securitizations, a similar corporation transfers financial assets to a securitization entity in exchange for cash and beneficial interests in the transferred financial assets. That entity raises the cash by issuing to investors commercial paper that gives them a senior beneficial interest in cash received from the financial assets. The beneficial interests obtained by the transferring corporation represent a junior interest to be reduced by any credit losses on the financial assets in the entity. The senior beneficial interests (commercial paper) are highly rated by credit rating agencies only if both (a) the credit enhancement from the junior interest is sufficient and (b) the transferor is highly rated. Depending on facts and circumstances, the Board understands that those “single-step” securitizations often would be judged in the United States as not having isolated the financial assets, because the nature of the continuing involvement may make it difficult to obtain reasonable assurance that the transfer would be found to be a true sale at law that places the financial assets beyond the reach of the transferor and its creditors in U.S. bankruptcy (paragraph 43). If the transferor fell into bankruptcy and the transfer was found not to be a true sale at law, investors in the transferred financial assets might be subjected to an automatic stay that would delay payments due them, and they might have to share in bankruptcy expenses and suffer further losses if the transfer was recharacterized as a secured loan.

78. Still other securitizations use multiple transfers intended to isolate transferred financial assets beyond the reach of the transferor and its creditors, even in bankruptcy. For example, in “two-step” structures:

- a. First, the corporation transfers a group of financial assets to a special-purpose corporation that, although wholly owned, is so designed that the possibility is remote that the transferor or its creditors could reclaim the financial assets. This first transfer is designed to be judged to be a true sale at law, in part because the transferor does not provide “excessive” credit or yield protection to the special-purpose corporation, and the Board understands that transferred financial assets are likely to be judged beyond the reach of the transferor or the transferor’s creditors even in bankruptcy or other receivership.
- b. Second, the special-purpose corporation transfers a group of financial assets to a trust or other legal vehicle with a sufficient increase in the credit or yield protection on the second transfer (provided by a transferor’s junior beneficial interest or other means) to merit the high credit rating sought by third-party investors who buy senior beneficial interests in the trust. Because of that aspect of its design, that second transfer might not

be judged to be a true sale at law and, thus, the transferred financial assets could at least in theory be reached by a bankruptcy trustee for the special-purpose corporation.

- c. However, the special-purpose corporation is designed to make remote the possibility that it would enter bankruptcy. For example, its charter forbids it from undertaking any other business or incurring any liabilities, so that there can be no creditors to petition to place it in bankruptcy. Furthermore, its dedication to a single purpose is intended to make it extremely unlikely, even if it somehow entered bankruptcy, that a receiver under the U.S. Bankruptcy Code could reclaim the transferred financial assets because it has no other assets to substitute for the transferred financial assets.

79. The Board understands that the “two-step” securitizations described above, taken as a whole, generally would be judged under present U.S. law as having isolated the financial assets beyond the reach of the transferor and its creditors, even in bankruptcy or other receivership. However, each entity involved in a transfer must be evaluated under the applicable accounting guidance.

80. The powers of receivers vary considerably by state of domicile, and therefore some receivers may be able to reach financial assets transferred under a particular arrangement and others may not. A securitization may isolate transferred financial assets from a transferor subject to such a receiver and its creditors even though it is accomplished by only one transfer directly to a securitization entity that issues beneficial interests to investors and the transferor provides credit or yield protection.

Sales of Future Revenues

81. 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

82. Many transfers of financial assets that involve transfers of a group of entire financial assets to an entity whose sole purpose is to engage in securitization or asset-backed financing activities empower the transferor to reclaim assets subject to certain restrictions. Such a power is sometimes called a removal-of-accounts provision (ROAP). Transfers of assets that include ROAP provisions are precluded from being accounted for as sales under statutory accounting and shall follow the guidance in paragraph 18 for secured borrowing.

Securities Lending Transactions

83. 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.

84. If the criteria conditions in paragraph 12 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 cash collateral⁹ and a forward repurchase commitment.
- 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.

85. Many securities lending transactions are accompanied by an agreement that entitles and obligates the transferor to repurchase or redeem the transferred financial assets before their maturity under which the transferor maintains effective control over those financial assets (paragraphs 54-56 maintain effective control criteria). 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 reclassified as set forth in paragraph 23.a., and any rebate paid to the transferee of securities is interest on the cash or securities the transferor is considered to have borrowed.

86. The transferor of securities being “loaned” accounts for cash received in the same way whether the transfer is accounted for as a sale or a secured borrowing. The cash received shall be recognized as the transferor’s asset—as shall investments made with that cash, even if made by agents or in pools with other securities lenders—along with the obligation to return the cash. If securities that may be sold or repledged are received, the transferor of the securities being “loaned” accounts for those securities in the same way as it would account for cash received.

87. 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 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 balance sheet, along with the obligation to return the asset¹⁰. Collateral received which may not be sold or repledged by the transferor or its agent is off balance sheet¹¹. For collateral on the balance sheet, the reporting is determined by the administration of the program.

⁹ If the “collateral” in a transaction that meets the criteria in paragraph 12 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.

¹⁰ 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.

¹¹ 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.

- 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 87. a. above) or investment schedule reporting (paragraph 87. b. above).

88. 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

89. 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.

90. 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 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"

91. 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 cash¹² 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 issue paper.

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

93. If the conditions in paragraph 12 are met, the transferor shall account for the repurchase agreement as a sale of financial assets and a forward repurchase commitment, and the transferee shall account for the agreement as a purchase of financial assets and a forward resale commitment. Other transfers that are accompanied by an agreement to repurchase the transferred financial assets that may be accounted for as sales include transfers with agreements to repurchase at maturity and transfers with repurchase agreements in which the [transferor] has not obtained collateral sufficient to fund substantially all of the cost of purchasing replacement financial assets. (Repurchase financing is addressed in paragraphs 100-105.)

94. 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 issue paper. Unless there is a concurrent contract to repurchase or redeem the transferred financial assets from the transferee, the transferor does not maintain effective control over the transferred financial assets.

95. As with securities lending transactions, under many agreements to repurchase transferred financial assets before their maturity the transferor maintains effective control over those financial assets. Repurchase agreements that do not meet all the conditions in paragraph 12 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 55) securities as those concurrently transferred is assured. Therefore, those transactions shall be accounted for as secured borrowings by both parties to the transfer.

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

Repurchase Agreements

97. 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

¹² Instead of cash, other securities or letters of credit sometimes are exchanged. Those transactions are accounted for in the same manner as securities lending transactions (paragraphs 83-89).

specified date. For securities to be substantially the same, the criteria defined in paragraph 55 (substantially the same criteria) 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.

98. For repurchase agreements that are accounted for as collateralized borrowings in accordance with paragraph 95 of this issue paper, 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.

99. 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

100. 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.

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

102. When the transferor transfer 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.

103. Repurchase financing that is entered into contemporaneously with, or in contemplation of, an initial transfer of financial asset between the same counterparties (or affiliates of either counterparty) shall not be separately accounted for as a transfer of a financial asset and a related repurchase financing unless (a) the two transactions have a valid and distinct business or economic purpose for being entered into separately and (b) the repurchase financing does not result in the initial transferor regaining control over the financial asset. Unless the provisions in paragraph 104 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 12. 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.

104. 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.)

105. In accordance with paragraph 103, an initial transfer of assets and a repurchase financing shall not be considered separate transactions unless the provisions of paragraph 104 are met. If the provisions of paragraph 104 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

106. 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 55 (substantially the same criteria) 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.

107. For reverse repurchase agreements that are accounted for as collateralized lendings in accordance with paragraph 95 of this issue paper, the underlying securities shall not be accounted for as investments owned by the reporting entity. The amount paid for the securities shall be reported as a short-term investment, and the difference between the amount paid and the amount at which the securities will be subsequently resold shall be reported as interest income, calculated on the straight-line method or the scientific interest (constant yield) method, over the term of the agreement.

Collateral Requirements – Repurchase and Reverse Repurchase Agreements

108. 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 any time the fair value of the collateral is less than 100 percent of the purchase price paid by the reporting entity, the counterparty shall be obligated to provide additional collateral, the fair value of which, together with fair value of all collateral then held in connection with the transaction, at least equals 102 percent of the purchase price.

Dollar Repurchase Agreements

109. 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 55, 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.

110. For the seller in a dollar repurchase agreement accounted for as collateralized borrowing in accordance with paragraph 95 of this issue paper, 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.

111. 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 55.

112. 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.

113. For the purchaser in a dollar reverse repurchase agreement accounted for as collateralized lending in accordance with paragraph 95 of this issue paper, 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

114. Agreements to repurchase and resell securities that do not meet the definitions in paragraphs 83-96 of this issue paper 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

115. 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.

116. 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.

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

Loan Syndications

118. 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.

119. 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 a financial asset.

Loan Participations

120. 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 interests in the loan to other entities.

121. 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.

122. If the loan participation agreement transfers a participating interest in an entire financial asset (as described in paragraph 11 of this issue paper) and the conditions in paragraph 12 are met, the transfer shall be accounted for by the transferor as a sale of a participating interest. 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 its participating interest and that constraint provides a more-than-trivial benefit to the transferor, the transferor has not relinquished control and shall account for the transfer as a secured borrowing.

Factoring Arrangements

123. Factoring arrangements are a means of discounting accounts receivable on a nonrecourse, notification basis. Accounts receivable in their entireties 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 conditions in paragraph 12 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

124. In a transfer of an entire receivable, a group of entire receivables, or a portion of an entire receivable with recourse, the transferor provides the transferee with full or limited 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 secured borrowing. (This provision is applied regardless if the transfer was comprised of the entire receivable, a group of the entire receivable, or a portion of the entire receivable.) 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*.

Extinguishments of Liabilities

125. 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.

126. An exchange of debt instruments or debt instrument modifications are considered extinguishments if the exchange or modification results with substantially different terms or is considered more than minor. If the cash flows under the terms of the new debt instrument are at least 10 percent different from the present value of the remaining cash flows under the terms of the original instrument, then the exchange of, or modification to, debt instruments is considered substantially different and/or more than minor.

Effective Date and Transition

127. After adoption of this issue paper, it is expected that the NAIC will release a Statement of Statutory Accounting Principle (SSAP) for comment. The initial draft of the SSAP will contain the adopted Summary Conclusion of this issue paper. Users of the Accounting Practices and Procedures Manual should note that issue papers are not represented in the Statutory Hierarchy (see Section IV of the Preamble) and therefore the conclusions reached in this issue paper should not be applied until the corresponding SSAP has been adopted by the Plenary of the NAIC. It is expected that the SSAP will be effective as of Jan 1, 20XX. The provisions within the adopted SSAP shall be reflected in the interim periods within that first annual reporting period, and for interim and annual reporting periods thereafter. Earlier application is prohibited. The recognition and measurement provisions of the adopted standard shall be applied to transfers that occur on or after the effective date. The disclosure provisions shall be applied to transfers that occurred both before and after the effective date of the adopted standard.

EXHIBIT A – GLOSSARY**Adequate Compensation**

The amount of benefits of servicing that would fairly compensate a substitute servicer should one be required, which includes the profit that would be demanded in the marketplace.

Agent

A party that acts for and on behalf of another party. For example, a third-party intermediary is an agent of the transferor if it acts on behalf of the transferor.

Attached Call

A call option held by the transferor of a financial asset that becomes part of and is traded with the underlying instrument. Rather than being an obligation of the transferee, an attached call is traded with and diminishes the value of the underlying instrument transferred subject to that call.

Beneficial Interests

Rights to receive all or portions of specified cash inflows to be received by a trust or other entity, including, but not limited to, 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.

Benefits of Servicing

Revenues from contractually specified servicing fees, late charges, and other ancillary sources, including “float.”

Cleanup Call

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

Collateral

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

Continuing Involvement

Any involvement with the transferred financial assets that permits the transferor to receive cash flows or other benefits that arise from the transferred financial assets or that obligates the transferor to provide additional cash flows or other assets to any party related to the transfer. All available evidence shall be considered, including, but not limited to, explicit written arrangements, communications between the transferor and the transferee or its beneficial interest holders, and unwritten arrangements customary to similar transfers. Examples of continuing involvement with the transferred financial assets include, but are not limited to, servicing arrangements, recourse or guarantee arrangements, agreements to purchase or redeem transferred financial assets, options written or held, derivative financial instruments that are entered into contemporaneously with, or in contemplation of, the transfer, arrangements to provide financial support, pledges of collateral, and the transferor’s beneficial interests in the transferred financial assets.

Contractually Specified Servicing Fees

All amounts that, per contract, are due to the servicer in exchange for servicing the financial asset and would no longer be received by a servicer if the beneficial owners of the serviced assets (or their trustees or agents) were to exercise their actual or potential authority under the contract to shift the servicing to another servicer. Depending on the servicing contract, those fees may include some or all of the difference between the interest rate collectible on the financial asset being serviced and the rate to be paid to the beneficial owners of those financial assets.

Derecognize

Remove previously recognized assets or liabilities from the statement of financial position.

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, Financial Instruments with Concentrations of Credit Risk and Disclosures about Fair Value of Financial Instruments*, paragraph 2).

Embedded Call

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 one entity a right (a) to receive cash or another financial instrument from a second entity or (b) to exchange other financial instruments on potentially favorable terms with the second entity.

Financial Liability

A contract that imposes on one entity an 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.

Freestanding Call

A call that is neither embedded in nor attached to an asset subject to that call.

Interest-Only Strip

A contractual right to receive some or all of the interest due on a bond, mortgage loan, collateralized mortgage obligation, or other interest-bearing financial asset.

Participating Interest

A participating interest has the following characteristics:

- a. From the date of the transfer, it represents a proportionate (pro rata) ownership interest in an entire financial asset. The percentage of ownership interests held by the transferor in

the entire financial asset may vary over time, while the entire financial asset remains outstanding as long as the resulting portions held by the transferor or its agents) and the transferee(s) meet the other characteristics of a participating interest. For example, if the transferor's interest in an entire financial asset changes because it subsequently sells another interest in the entire financial asset, the interest held initially and subsequently by the transferor must meet the definition of a participating interest.

- b. From the date of the transfer, all cash flows received from the entire financial asset are divided proportionately among the participating interest holders in an amount equal to their share of ownership. Cash flows allocated as compensation for services performed, if any, shall not be included in that determination provided those cash flows are not subordinate to the proportionate cash flows of the participating interest and are not significantly above an amount that would fairly compensate a substitute service provider, should one be required, which includes the profit that would be demanded in the marketplace. In addition, any cash flows received by the transferor as proceeds of the transfer of the participating interest shall be excluded from the determination of proportionate cash flows provided that the transfer does not result in the transferor receiving an ownership interest in the financial asset that permits it to receive disproportionate cash flows.
- c. The rights of each participating interest holder (including the transferor in its role as a participating interest holder) have the same priority, and no participating interest holder's interest is subordinated to the interest of another participating interest holder. That priority does not change in the event of bankruptcy or other receivership of the transferor, the original debtor, or any other participating interest holder. Participating interest holders have no recourse to the transferor, its agents or to each other, other than standard representations and warranties, ongoing contractual obligations to service the entire financial asset and administer the transfer contract, and contractual obligations to share in any set-off benefits received by any participating interest holder. That is, no participating interest holder is entitled to receive cash before any other participating interest holder under its contractual rights as a participating interest holder. For example, if a participating interest holder also is the servicer of the entire financial asset and receives cash in its role as servicer, that arrangement would not violate this requirement.
- d. No party has the right to pledge or exchange the entire financial asset unless all participating interest holders agree to pledge or exchange the entire financial asset.

Proceeds

Cash, beneficial interests, servicing assets, 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.

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 contractually specified servicing fees, late charges, and other ancillary revenues are not expected to adequately compensate the servicer for performing the servicing.

Standard Representations and Warranties

Representations and warranties that assert the financial asset being transferred is what it is purported to be at the transfer date. Examples include representations and warranties about (a) the characteristics, nature, and quality of the underlying financial asset, including characteristics of the underlying borrower and the type and nature of the collateral securing the underlying financial asset, (b) the quality, accuracy, and delivery of documentation relating to the transfer and the underlying financial asset, and (c) the accuracy of the transferor's representations in relation to the underlying financial asset.

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, an interest in a financial asset, or a group of financial assets from a transferor.

Transferor

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

Unilateral Ability (See paragraphs 57 and 58)

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 transfers entire loans with a carrying amount of \$1,000 to a subsidiary and receives proceeds with a fair value of \$1,030 and the transfer is accounted for as a sale. Company A undertakes no servicing responsibilities 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 asset	40
Recourse obligation	60

Net Proceeds

Cash received	\$1,050
Plus: Interest rate swap asset	40
Less: Recourse obligation	<u>(60)</u>
Net proceeds	<u>\$1,030</u>

Gain on Sale

Net proceeds	\$1,030
Carrying amount of loans sold	<u>1,000</u>
Gain on sale	<u>\$ 30</u>

Journal Entry

Cash	1,050	
Interest rate swap asset	40	
Loans		1,000
Recourse obligation		60
Gain on sale		30
To record transfer		

Illustration—Recording Transfers of Participating Interests

2. Company B transfers a nine-tenths participating interest in a loan with a fair value of \$1,100 and a carrying amount of \$1,000, and the transfer is accounted for as a sale. The servicing contract has a fair value of zero 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 ($\$1,100 \times 9/10$)	\$990
One-tenth interest continued to be held by the transferor ($\$1,100 \times 1/10$)	110

Allocated 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 participating interest sold ($\$1,100 \times 9/10$)	\$990	90	\$900
One-tenth participating interest continued to be held by the transferor ($\$1,100 \times 1/10$)	<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
Less: 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 transfers the entire loans to an entity and the transfer is accounted for as a sale. Company C receives as proceeds \$1,000 cash, a beneficial interest to receive 1 percent on the contractual interest on the loans (an interest-only strip receivable), and an additional 1 percent of the contractual interest as compensation for servicing the loans. 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
Interest-only strip receivable	60

Net Proceeds	\$1,100
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Gain on Sale

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

Journal Entries

Cash	1,000	
Interest-only strip receivable	60	
Servicing asset	40	
Loans		1,000
Gain on sale		100

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

Illustration—Securities Lending Transaction Treated as a Secured Borrowing

4. 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

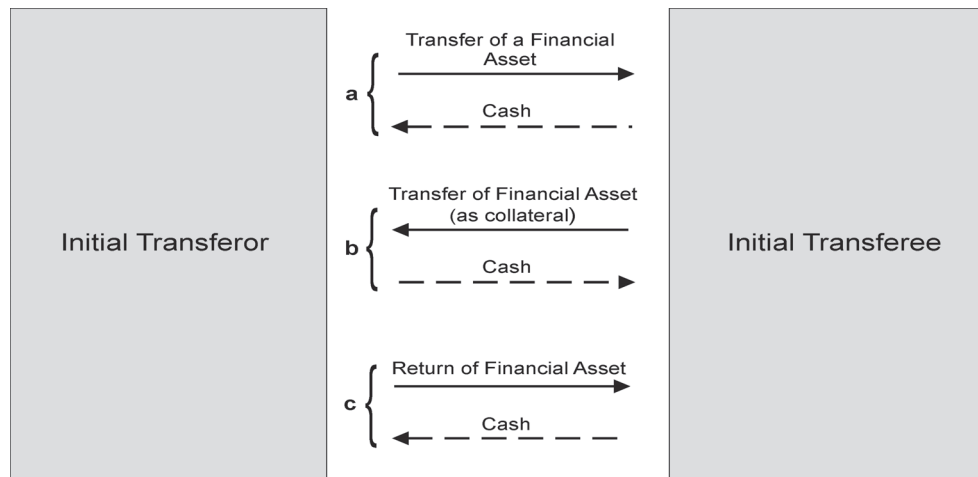
To record the repurchase of securities borrowed

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

5. The following diagram is an example of an initial transfer of a financial asset and a subsequent repurchase financing, as described in paragraphs 100-105.



DISCUSSION

Overview

128. The accounting guidance in this issue paper is consistent with the GAAP guidance for the accounting for transfers and servicing of financial assets and extinguishments of liabilities as reflected in FAS 166 with modifications deemed appropriate for statutory accounting. Previous statutory guidance within SSAP No. 91R adopted, with modification, the guidance within *FAS 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (FAS 140).

129. Revising statutory accounting by superseding SSAP No. 91R, to adopt, with modification, *FAS 166, Accounting for transfers of financial assets, an amendment to FASB Statement No. 140* (FAS 166) is considered necessary to ensure the consistent and proper application of accounting guidance for transfers of financial assets. Furthermore, the elimination of qualifying special-purpose entities, as well as the incorporation of enhanced criteria for when a transfer qualifies as a “sale” will result with statutory financial statements that are more transparent and more reflective of the reporting entity’s financial position. The need for timely revisions is further supported by the following FASB conclusions and actions:

- a. In establishing the effective date for FAS 166, the FASB identified that there is an urgent need to improve transparency related to certain entities that are off-balance sheet and certain transactions that are currently reported as sales. It was also noted that there is significant diversity and frequent application questions regarding the application of FAS 140.
- b. It is also noted that FAS 166 does not fully converge with International Financial Reporting Standards. Although the IASB and FASB have a long-term project to work on a converged standard for derecognition of financial assets, the FASB believed that the urgent need to eliminate the QSPE concept overrode the need for a convergent standard. The issuance of FAS 166 does improve convergence as the concept of a QSPE does not exist in International Financial Reporting Standards.

Sale Accounting

130. In the prior GAAP guidance, and in SSAP No. 91R, a “financial-components approach” for sale accounting had been incorporated. This approach analyzed a transfer of financial assets by examining the component assets and liabilities that existed after a transfer. Each party to the transfer recognized the assets that it controlled and the liabilities that it assumed as a result of the transfer and no longer recognized the assets and liabilities that were surrendered or extinguished in the transfer. A key component of this approach was that a transferor should no longer recognize a transferred financial asset if it had surrendered control. Although guidance was provided on when control is considered surrendered, no explicit guidance had been provided on what constitutes a portion or a component of a financial asset.

131. In accordance with the application of the FAS 140, concerns were raised about certain transfers of portions of financial assets that were being accounted for as sales. In particular, concerns were raised about sales of undivided interests in pools of financial assets because of credit support provided by affiliates of the transferor. Also, it was noted that in some cases, transferred financial assets appeared to remain under the control of the transferor while being reported as sales. This was noted with highly-structured transactions in which the transferor continued to control the transferred financial assets, as they were in the custody of the transferor and/or affiliates and the transferor had significant continuing involvements through its interests in the underlying financial assets. As noted by the FASB, it is difficult to determine whether a transferor has surrendered control over a component of a financial asset or a component of a group of financial assets if the transferor continues to maintain custody of the original asset.

132. Pursuant to the statutory accounting concept of conservatism, in assessing FAS 166, there is no identified insurance-specific rationale that would support deviation from the enhanced GAAP requirements in determining “sale” accounting, and the treatment of participating interests and beneficial interests retained or obtained from the transfers of financial assets, in a manner that would result in less-conservative, or less-restrictive, guidelines for statutory accounting. Thus, this issue paper adopts the following GAAP provisions for statutory accounting:

- a. Sale accounting is only met in a transfer of an entire financial asset, a transfer of a group of entire financial assets, or if a transfer meets all of the participating interests conditions, including the surrender of control. This guidance indicates that an entity must consider all arrangements made in contemplation of, or contemporaneously with, the transfer, consider the continuing involvement of the transferred assets, as well as consider whether the financial assets have been put beyond the reach of the transferor or creditors if the reporting entity was to enter receivership.
- b. Upon a transfer that qualifies for sale accounting, the transferor recognizes and initially measures at fair value all servicing assets, servicing liabilities, any other asset obtained, including beneficial interests, and liabilities incurred at fair value. This measurement is

considered appropriate as a clear exchange has occurred which warrants initial measurement at fair value.

- c. Participating interests in financial assets that continue to be held by a transferor are not part of the proceeds of a transfer, and the carrying amount of those participating interests shall be measured at the date of the transfer by allocating the previous carrying amount between the participating interests transferred and sold, and the participating interests that are not transferred and continued to be held by a transferor, based on their relative fair values. This measurement is considered appropriate, as the retained participating interests were not part of the transfer, and there has been no surrendering of control.

133. Mirroring the FASB conclusion, inherent in the sale accounting principle that requires transfer of an entire asset, in order to be eligible for sale accounting, an entire financial asset cannot be divided into components before the transfer unless those components meet the definition of a participating interest. Pursuant to this position, circumstances for sale accounting are limited as the conditions for surrender of control can be applied only to a transfer of an entire financial asset, a group of entire financial assets, or a participating interest in the entire financial asset.

134. In determining the participating interest criteria, the statutory accounting guidance proposes to adopt the requirements incorporated within FAS 166. In adopting the GAAP participating interest conditions, an interest-only strip received as proceeds would not meet the definition of a participating interest. The concept of a participating interest is consistently applied only when a premium, if any, is not dependent on the cash flows received from the transferred participating interest. A transferor cannot receive an interest-only strip as proceeds from a transfer of a participating interest because the future cash flows would not be proportionately shared by all participating interest holders.

135. Key aspects of the FAS 166 participating interest characteristics adopted for statutory:

- a. From the date of transfer, it represents a proportionate (pro rata) ownership interest in an entire financial asset.
- b. From the date of transfer, all cash flows received from the entire financial asset are divided proportionately among the participating interest holders in an amount equal to their share of ownership. Cash flows compensating for services are not included in this determination if those cash flows are not subordinate to the proportionate cash flows of the participating interest and are not significantly above an amount that would fairly compensate a substitute service provider. Cash flows received by the transferor as proceeds of the transfer are excluded from the determination of proportionate cash flows provided that the transfer does not result with the transferor receiving an ownership interest in the financial asset that permits it to receive disproportionate cash flows.
- c. The rights of each participating interest hold (including the transferor) have the same priority, and no holder's interest is subordinated to the interest of another interest holder. This priority cannot change in the event of bankruptcy or other receivership of the transferor, the original debtor, or any other participating interest holder. Participating interest holders have no recourse to the transferor other than standard representations and warranties. No participating interest holder can be entitled to receive cash before any other holder. Thus, if a participating interest holder is also the servicer of the financial asset and receives cash for the role as servicer, the transfer would not meet the definition of a participating interest.
- d. No party has the right to pledge or exchange the entire financial asset unless all participating interest holder agree to pledge or exchange the entire financial asset.

136. This issue paper, through the adoption of FAS 166, retains the concept from SSAP No. 91R that a transferor shall recognize assets obtained and liabilities incurred in a transfer of financial assets accounted for as a sale. As such, a transferor is allowed to obtain a beneficial interest in the transferred financial asset as proceeds from the transfer, but only if it has surrendered control over the original financial asset, thus meeting all of the conditions for sale accounting. It is noted that the “obtained” beneficial interest resulting from the transfer may be very similar to a “component” of the actual transferred asset.

137. In accordance with the continued recognition of obtained beneficial interests from a sale of financial assets, it is noted that similar assets resulting from different transactions will be accounted for differently depending on whether the transaction involves a securitization entity. This was also noted by the FASB, and can be evidenced by comparing a sale of a participating interest directly to a third party and a sale of the whole loan to an entity in which entity was to “obtain” the same participating interest as part of the proceeds from the transfer.

- a. For a sale of a participating interest directly to a third party, the retained participating interest would not be remeasured at fair value, rather its carrying value would be allocated on the basis of the relative fair value of the portion sold and portion retained.
- b. For a sale of a whole loan to an entity in which the entity was to take-back the same participating interest, the beneficial interest “obtained” as part of the sale would be measured at fair value, with a gain or loss effectively recognized on the portion retained.

Although the asset ultimately held by the entity would be the same in both these scenarios, the measurement is driven in accordance with the transaction that occurred. To address such situations, the FASB decided to add disclosures about assets obtained and liabilities incurred as a result of a transfer accounted for as a sale. Similar disclosures are proposed for statutory accounting. The inclusion of these enhanced disclosures should provide adequate information to the users of the financial statements.

138. If the sale accounting criteria is not met, the adoption of FAS 166 would retain the “secured borrowing” concept within SSAP No. 91R. It is perceived that with the more restrictive sale accounting guidelines, transactions will either be restructured accordingly to meet the enhanced sale criteria, or an increased amount of transactions will be accounted for as secured borrowings. Pursuant to the guidance for secured borrowings, the transferred financial assets will continued to be reported in the financial statements, with no change in measurement, and accordingly, no gain or loss on the result of the transfer.

139. In considering the application of the FAS 166 guidance for Re-REMIC transactions:

- a. If the entire financial asset is transferred in a sale transaction, satisfying the surrender of control, then any beneficial interests “obtained” or “taken back” as part of the proceeds of the sale would be accounted for at fair value.
- b. If a “participating interest” was transferred in a sale transaction, satisfying the surrender of control, remaining “participating interests” retained (not part of the sale transfer), would be held at an amount representing the difference between the carrying amount of the entire financial asset, and the amount derecognized — previous carrying value allocated between the participating interests sold and retained based on relative fair values at the date of the transfer. If an aspect of the transferred participating interest was “taken back” as proceeds from the transfer, it would then be accounted for at fair value.
- c. Transfers that do not meet the sale criteria would be considered secured borrowings. In such instances, the transferor would continue to report the transferred financial assets in the financial statements with no change in measurement. With secured borrowings, there is no derecognition of the transferred asset at the time of transfer.

- d. Transfers conducted among trusts or legal vehicles previously captured within the QSPE concept, are not exempt from being considered affiliated or related party transactions. Consideration must be given to the guidance within *SSAP No. 25—Accounting for and Disclosures about Transactions with Affiliates and Other Related Parties* on all transfers within the confines of this issue paper. If concluded that the transaction is a related party or affiliated transaction, then the valuation methods identified within SSAP No. 25 shall be utilized:
- i. Economic transactions shall be reported at fair value at the date of the transaction. To the extent that the related parties are affiliates under common control, the controlling reporting entity shall defer the effects of such transactions that result in gains or increases in surplus.
 - ii. Non-economic transactions shall be recorded at the lower of existing book values or fair values at the date of the transactions.
 - iii. Non-economic transactions between a reporting entity and an entity that has no significant ongoing operations other than to hold assets that are primarily for the direct or indirect benefit of the reporting entity or its affiliates, shall be recorded at the fair value at the date of the transaction; however, to the extent that the transaction results in a gain, that gain shall be deferred until such time as permanence can be verified.
 - iv. Transactions designed to avoid statutory practices shall be reported as if the reporting entity continued to own the asset or to be obligated for a liability directly.

Qualifying Special Purpose Entities (QSPE)

140. Previous GAAP and statutory accounting guidance in SSAP No. 91R provided that if there was a transfer of financial assets to a qualifying special-purpose entity (QSPE) that cannot pledge or exchange the transferred financial assets, the transferor should nevertheless generally be permitted to derecognize the transferred financial assets if (a) the holders of interests issued by that entity could pledge or exchange their interests and (b) the transfer met the other conditions for sale accounting. In the development of this guidance, it was perceived that the QSPE entity would be so passive that control would not be an issue. Accordingly, under GAAP, such entities were excluded from consolidation because (1) the entity's primary purpose was limited to passively holding financial assets on behalf of its beneficial interest holders, and (2) the understanding that no individual party would have the ability to control such an entity.

141. As noted by the FASB, in practice, the conditions specified in FAS 140, adopted within SSAP No. 91R, paragraph 25, that require a QSPE activities to be "significantly limited" and "entirely specified" were being applied more broadly than originally intended in many securitizations that were reported as sales. The practice of rollovers of beneficial interests, servicer discretion, and the inability of QSPEs to maintain their qualifying status when responding to unexpected events (i.e., modify loans to reduce risk of default), raised questions on whether the passivity conditions required for QSPEs were being met and enforced in practice. As a result of the broad QSPE application, FASB decided to remove the concept of QSPEs entirely from FAS 166.

QSPEs – Rollovers of Beneficial Interests

142. The FASB origination of the FAS 166 project began to address whether a QSPE (or its designee or agent) is permitted to establish the terms of replacement beneficial interests issued after inception of the QSPE. Also, the FASB questioned whether the existing QSPE (or its designee or agent) that

determines the beneficial interests issued after the inception of the QSPE satisfies the passivity requirements.

143. The FASB learned that QSPEs often finance long-term financial assets by issuing short-term beneficial interests in the form of commercial paper or other debt instruments that, in the aggregate, do not receive all the cash inflows from the pool of assets. When those beneficial interests mature, they are paid off from the proceeds from issuing new beneficial interest, rather than from the cash inflows from the pool of financial assets. Frequently, such entities are supported by liquidity commitments from the transferor or other parties to ensure that the obligations of the entity to redeem beneficial interests are met on a timely basis.

144. The roll-over of beneficial interests, and the combination of an entity's ability to make decisions about future refinancing and the involvement of a liquidity provider causes FASB concern with whether the limitations on QSPE activities to be "significantly limited" and "entirely specified" are being met.

QSPEs – Servicer Discretion

145. The FASB identified that questions have also been raised about the amount of discretion a servicer is permitted in servicing the financial assets of a QSPE. Requests had been made for clarification of the requirement that the activities of a QSPE be "significantly limited" and "entirely specified" in the legal documents that establish the QSPE or that create the beneficial interests in the transferred financial asset.

146. After meeting with constituents, the FASB concluded that in practice, many QSPEs hold financial assets that do not appear to be passive in nature. In addition, many entities require a servicer to exercise a level of decision making that does not appear to have been entirely pre-specified if unforeseen events occur or to engage in activities that reach beyond the requirement that the activities of a QSPE be "significantly limited".

147. In considering this situation, it was noted that the long-term nature of many QSPE transactions makes it impractical to predict all of the possible events that may occur during the life of the transferred financial asset. In addition, it is impractical to predict all of the potential responses a servicer might be required to make to protect the interests of the beneficial interest holders. As such, the FASB concluded that it would not be feasible or fruitful to define at inception the parameters required by the definition of a QSPE for many types of financial assets, most notably, financial assets with longer terms.

QSPEs – Loan Modification

148. In light of a statement from the federal financial institutions' regulatory agencies encouraging financial institutions to work constructively with residential borrowers who were unable to make their contractual payments on their home loans, consideration was given to how loan modifications, for loans not in default, but for which default would be imminent, would impact a QSPE. It was noted that the prior GAAP guidance and interpretations were ambiguous about when an entity could modify a loan without effecting the QSPE status, because the interpretative guidance stated only that the servicer is permitted to work out a loan if it become delinquent or is in default. This guidance also required that the discretion inherent in the decision be "significantly limited" and its parameters be "entirely specified" in the QSPE's legal documents.

QSPE – Conclusion

149. Due to the range of financial assets being securitized and the complexity of securitization structures and arrangements, the applicabtion of the conditions for a QSPE have been extended beyond the scope of their original intent, thus rendering the conditions no longer operational in practice. Although the FASB considered an approach that would have strengthened the passivity requirement of the

permitted assets of a QSPE, the FASB concluded that few classes of financial assets are truly passive as envisioned in the QSPE concept. As such, the concept of a QSPE has been removed from FAS 140. The removal of this concept from FAS 140, resulted with a need to remove the scope exception for such entities from consolidation requirements and complete another project (FAS 167) to reconsider the guidance in Interpretation 46R.

150. The elimination of the concept of “qualified special purpose entities” (QSPE) for statutory accounting, similar to the FASB rationale, is necessary to address concerns that the application of entities classified as QPSEs has been applied more broadly than intended. Pursuant to the FASB conclusions, it was noted that in practice, QSPEs hold financial assets that do not appear to be passive in nature. Also, with the range of financial assets being securitized and the complexity of securitization structures and arrangements, the application of the conditions for a qualifying QSPE have been extended in some cases beyond the intent of the original guidance.

151. For statutory accounting, it is presumed that insurers will continue to form, conduct transfers of assets between, and hold investments in trusts or legal vehicles that would have met the prior conditions to be considered a QSPE. The accounting for transfers between the insurer and these trusts and other legal vehicles, including whether sale accounting should be applied, will be determined in accordance with the provisions of this issue paper. Furthermore, without retaining the concept of a “QSPE”, transactions completed with entities previously captured within this term must be assessed in accordance with *SSAP No. 25—Accounting for and Disclosure about Transactions with Affiliates and Other Related Parties* (SSAP No. 25). As previously noted, if concluded that the transaction is a related party or affiliated transaction, then the valuation methods identified within SSAP No. 25 shall be utilized.

Isolation of Transferred Assets

Legal Opinions

152. This issue paper proposes adoption of the FAS 166 guidance regarding the “isolation” of transferred assets from the transferor in order to qualify for sale accounting. This guidance indicates that all evidence that supports an assertion for isolation should be considered, which includes consideration of the legal consequences of the transfer in the jurisdiction in which receivership would take place. This issue paper, similar to FAS 166, indicates that derecognition of transferred financial assets is appropriate only if the available evidence provides reasonable assurance that the transferred financial assets would be beyond the reach of the bankruptcy trustee or receiver for the transferor.

153. This issue paper incorporates information regarding legal opinions (“true sale opinions” and “nonconsolidation opinions”) to identify aspects that should be considered in reviewing evidence to support isolation assertions. The guidance identifies that a legal opinion may not be required if the transferor has a reasonable basis to conclude that the appropriate legal opinion would be given if requested. Although the legal opinion is not necessary to support an assertion in all instances, similar to GAAP, the inclusion of this guidance, is intended to reduce practice issues and provide a sense of consistency in assessing whether isolation has occurred.

Transferability

154. This issue paper concurs with the FASB conclusion that the ability of a transferee to use the financial asset it receives is an important indication that a transferor has surrendered control over the transferred financial asset. Similar to the GAAP conclusion, for instances of transfers in which beneficial interests are created and distributed, this assessment may require consideration as to whether the third-party beneficial interest holders have the ability to pledge or exchange their beneficial interests:

- a. Certain transferees issue beneficial interests of various types (debt, participations, residual interests or otherwise) as required by the transfer agreements. To issue beneficial

interests, the transferee is typically restricted from pledging or exchanging the assets it holds because it is effectively distributing ownership rights in those assets to the beneficial interest holders. This transaction is effectuated by establishing a separate legal entity that merges the contractual rights in the transferred financial assets and allocates ownership interests in them (beneficial interests). As such, a third-party holder's right to pledge or exchange beneficial interests is the counterpart of a transferee's right to pledge or exchange the transferred assets themselves. Thus, a constraint on the transferee that issues beneficial interests would not necessarily indicate that the transferor has retained control over the transferred financial assets. In considering this conclusion for cases in which (a) a financial asset is transferred to an entity whose sole purpose is to facilitate a securitization or asset-backed financing and (b) the transferee entity is constrained from pledging to exchanging the asset it receives, the transferor should evaluate whether the third-party beneficial holders have the ability to pledge or exchange their beneficial interests.

Effective Control

155. This issue paper concurs with the FASB conclusion that the transferor cannot maintain effective control over the transferred financial assets. In considering whether control exists, the transferor must consider any direct continuing involvement with the transferred financial assets as well as consider any indirect continuing involvement that could enable it to maintain effective control through an arrangement made with beneficial interest holders of the transferred financial assets.

156. This issue paper also adopts the FASB conclusion that to account for a transfer of financial assets as a sale, the transferor must surrender control over the entire financial asset, except for limited circumstances in which the transferred portion meets the definition of a participating interest. Under this guidance, it is not possible to account for a transferred financial asset partially as a sale and partially as secured borrowing in situations in which the effective control is only maintained on a portion of the transferred assets. Such transactions, unless involving participating interests, would not meet the sale criteria and would be accounted for as secured borrowings — until all of the portions have been transferred in a manner that meet the sale criteria. This is further supported by the guidance that indicates any assets obtained from the sale of an entire financial asset are to be considered proceeds from the sale. If the transferor maintained effective control over a portion of the asset it has transferred, it would be inappropriate for that portion to be considered proceeds from the sale.

Securities Lendings

157. This issue paper also proposes adoption of the FAS 166 securities lending guidance. The statutory accounting guidance for securities lending transactions previously included within SSAP No. 91R established different guidelines from GAAP for when securities lending transactions, and related collateral, should be reported within the balance sheet. This prior guidance utilized the terms “restricted” and “unrestricted” and defined those terms in accordance with whether the collateral pledged by the transferee was or was not available for “general use of the transferor”.

158. In 2008, the Statutory Accounting Principles (E) Working Group identified that various reporting entities had interpreted the security lending definitions differently, resulting with inconsistency in application and instances in which the guidance for “off-balance sheet” reporting was being applied in a broader manner than intended. It was identified that some entities had concluded the collateral requirement for “general use of the transferor” to mean that the collateral was to be considered “restricted” if the reporting entity had been prohibited from using the collateral in any form. However, although use of the collateral may have been limited in some manner, perhaps unavailable for policyholder claims, the reporting entity may still have been permitted to reinvest the collateral. The ability to reinvest the collateral, coupled with off-balance sheet reporting caused concern for regulators

due to the lack of information and transparency on the transactions that occurred, as well as the potential financial risk if the reinvested collateral was to significantly decrease in value.

159. By adopting the GAAP guidance for securities lending transactions, the collateral received in such transactions will be assessed in accordance with “sale” criteria. Thus, if the holder is permitted by contract or custom to sell or repledge, the collateral is considered proceeds of the sale of the “loaned” securities. If the collateral received is in a form that is not permitted by contract or custom to sell or repledge, the securities lending transaction would not satisfy the sale criteria and would be accounted for as a loan of securities by the transferor to the transferee.

Statutory-Specific Revisions

160. This issue paper proposes adoption, with modification to the FAS 166 guidance to further restrict sale accounting treatment for statutory accounting in specific instances in which GAAP would permit sale recognition. These revisions are proposed in accordance with the conservatism principle, as in the noted instances, the potential continuing involvement is considered significant to preclude sale accounting under statutory accounting principles. Specifically, these modifications are included for transactions with removal-of-account provisions and transfers of receivables with recourse. Modifications have also been proposed to incorporate guidance previously included in SSAP No. 91R specific to insurance entities, as well as to include guidance that was previously adopted from GAAP, and not revised through the issuance of FAS 166.

161. This issue paper proposes adoption, with modification, of FAS 166 and the corresponding amendments to FAS 140 and FAS 156, including the revised FAS 140 glossary and illustrations. Statutory modifications from the adoption of amendments to FAS 140 and FAS 156 reflected in FAS 166 include:

- a. Rejects the GAAP consideration for “consolidated affiliates” as the concept of consolidation has not been adopted for statutory accounting.
- b. Rejects reference to GAAP standards and GAAP methods not adopted for statutory as well as concepts that are not pertinent for insurers. For example references to investments ‘held-to-maturity’, ‘available for sale’ or ‘trading’ and reference to FASB standards were removed and replaced with statutory terms and references to statutory standards.
- c. Rejects GAAP reference and guidance regarding “Revolving-Period Securitizations” as this GAAP guidance is not applicable to statutory accounting. This concept was also deemed not applicable to statutory accounting under SSAP No. 91R.
- d. Rejects GAAP guidance for “Sale-Type and Direct-Financing Lease Receivables” as leases shall be accounted for in accordance with *SSAP No. 22—Leases* (SSAP No. 22). This conclusion is consistent with SSAP No. 91R.
- e. Rejects GAAP guidance for “Banker’s Acceptances and Risk Participations in Them” as not applicable for statutory accounting. This GAAP guidance was also deemed not applicable to statutory accounting under SSAP No. 91R.
- f. Rejects GAAP guidance for “Removal of Account Provisions” that allows recognition of sale accounting. For statutory, transfers that would empower the transferor to reclaim assets under certain conditions (considered ‘removal-of-accounts provisions’) are precluded from being accounted for as sales. This conclusion is consistent with SSAP No. 91R.
- g. Rejects GAAP guidance for “Transfers of Receivables with Recourse” that allows transfers of receivables in their entirety with recourse to be accounted for as sales. For

- statutory, a transfer of receivables with recourse shall be accounted for as a secured borrowing. This conclusion is consistent with SSAP No. 91R.
- h. Rejects illustrations for transactions involving transfers of lease financing receivables with residual values and banker's acceptances with a risk participation as the GAAP guidance in FAS 166 related to these topics has been rejected for statutory accounting.
 - i. Incorporates additional disclosure requirements for collateral requirements when the reporting entity is not permitted by contract or custom to sell or repledge.
 - j. Incorporates guidance previously included in SSAP No. 91R specific to insurance entities, and guidance that was adopted from GAAP guidance not revised through the issuance of FAS 166. Items incorporated include:
 - i. Clarification that transfers of financial assets that are in substance real estate shall be accounted for in accordance with *SSAP No. 40—Real Estate Investments*.
 - ii. Clarification that transactions between related parties or affiliates are accounted for in accordance with *SSAP No. 25—Accounting For and Disclosures About Transactions with Affiliates and Other Related Parties*.
 - iii. Clarification that the guidance does not address the securitization of mortality or morbidity risk.
 - iv. Guidance on the accounting of sale transactions for entities required to maintain an interest maintenance reserve (IMR).
 - v. Clarification of when servicing assets and servicing liabilities shall be recognized as well as measurement of these items. This guidance continues the adoption, with modification, of FAS 156, including the requirement to subsequently measure servicing assets and servicing liabilities at fair value. Furthermore, continues the prior decision that servicing assets shall be nonadmitted.
 - vi. Guidance on the accounting for 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.
 - vii. Disclosures on loaned securities; securities underlying repurchase and reverse repurchase agreements, dollar repurchase and dollar reverse repurchase agreements; receivables with recourse; and wash sales.
 - viii. Guidance on the sales of future revenues.
 - ix. Guidance on collateral requirements for securities lending transactions that requires collateral of 102 percent (105 percent for foreign securities) of the fair value of the loaned securities. Guidance recently adopted by the Statutory Accounting Principles (E) Working Group related to collateral received for securities lending transactions has been reflected within the proposed issue paper.
 - x. Disclosures on securities lending transactions specific to aggregate open positions and aggregate positions under 30-day, 60-day and 90-day terms, disclosures for collateral that extend beyond one year from the reporting date, and detail of loaned securities within the separate account and if the policies and procedures differ from the general account.

- xi. Clarification that 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 guidance.
- xii. Guidance on Repurchase Agreements. This guidance retains recent revisions to SSAP No. 91R that ensured the proper terms are being utilized for the proper scenario. This guidance retains the recently adopted guidance from FSP FAS 140-3, Accounting for Transfers of Financial Assets and Repurchase Financing Transactions (FSP FAS 140-3). This GAAP guidance was not revised with the issuance of FAS 166.
- xiii. Guidance on Reverse Repurchase Agreements. This guidance retains recent revisions to SSAP No. 91R that ensured the proper terms are being utilized for the proper scenario.
- xiv. Guidance on Collateral for Reverse and Repurchase Agreements. This guidance retains recent revisions to SSAP No. 91R that ensured the proper terms are being utilized for the proper scenario..
- xv. Guidance on Dollar Repurchase Agreements. This guidance retains recent revisions to SSAP No. 91R that ensured the proper terms are being utilized for the proper scenario.
- xvi. Guidance for Separate Transactions.
- xvii. Guidance for Offsetting.
- xviii. Guidance for Transfers of Receivables with Recourse.

162. With the exception of INT 99-21, as discussed below, this issue paper will be interpreted by the statutory interpretations to SSAP No. 91R:

- a. *INT 99-07: EITF 97-3: Accounting for Fees and Costs Associated with Loan Syndications and Loan Participations after the Issuance of FASB Statement No. 125 (INT 99-07)* – As this interpretation rejected EITF 97-3 for statutory accounting, there is no impact to this interpretation from adoption of FAS 166.
- b. *INT 99-08: EITF 97-6: Application of Issue No. 96-20 to Qualifying Special-Purpose Entities Received Transferred Financial Assets Prior to the Effective Date of FASB Statement No. 125 (INT 99-08)* – As this interpretation rejected EITF 96-20 for statutory accounting, there is no impact to this interpretation from adoption of FAS 166.
- c. *INT 99-14: EITF 96-19: Debtor’s Accounting for a Modification or Exchange of Debt Instruments (INT 99-14)* – This interpretation adopted EITF 99-14 for statutory accounting. As such, an exchange of debt instruments with substantially different terms is considered a debt extinguishment. This guidance also clarifies that if 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, then the exchange of debt instruments are considered substantially different. There is no impact to this interpretation from the adoption of FAS 166.
- d. *INT 99-21: EITF 98-7: Accounting for Exchanges of Similar Equity Method Investments (INT 99-21)* – This interpretation was nullified with the issuance of *SSAP No. 95—Exchanges of Nonmonetary Assets, A Replacement of SSAP No. 28—Nonmonetary*

Transactions (SSAP No. 95). With the issuance of a new SSAP, there will be no future reference to this interpretation.

- e. *INT 99-22: EITF 98-8: Accounting for Transfers of Investments That Are in Substance Real Estate* (INT 99-22) – This interpretation adopted EITF 98-8 indicating that transfers of financial assets that are in substance real estate shall be accounted for in accordance with *SSAP No. 40—Real Estate Investments* (SSAP No. 40). There is no impact to this interpretation from the adoption of FAS 166.
- f. *INT 00-11: EITF 98-15: Structured Notes Acquired for a Specified Investment Strategy* (INT 00-11) – This interpretation rejected the consensus position in EITF 98-15 pursuant to a recommendation from the Invested Assets (E) Working Group. It was noted that any attempt on the part of the Emerging Accounting Issues (E) Working Group to promulgate EITF 95-18 into accounting guidance will require the Valuation of Securities (E) Task Force to change the mission of the Securities Valuation Office. As such, there will be no impact to this interpretation as a result of adopting FAS 166.
- g. *INT 01-31: Assets Pledged as Collateral* (INT 01-31) – This interpretation provides guidance on whether assets pledged as collateral shall be considered admitted assets. There is no impact to this interpretation from the adoption of FAS 166.
- h. *INT 03-05: EITF 01-7: Creditor’s Accounting for a Modification or Exchange of Debt Instruments* (INT 03-05) – This interpretation adopts the consensus position of EITF 01-7. This EITF clarifies that a debt instrument modification should be considered more than minor 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. This EITF also concludes that the guidance in EITF 96-19 (adopted within INT 99-14) should be used to calculate the present value of cash flows for purposes of applying the 10 percent test. There is no impact to this interpretation from the adoption of FAS 166.
- i. *INT 04-21: EITF 02-9: Accounting for Changes that Result in a Transferor Regaining Control of Financial Assets Sold* (INT 04-21) – This interpretation adopts EITF 02-9 with modification for statutory terms and references. Pursuant to this adoption, a transferred asset that has been accounted for as sold is to be accounted for as “re-purchased” if the basis for that sale accounting subsequently becomes invalid. There is no impact to this interpretation from the adoption of FAS 166.

Drafting Notes/Comments

163. None

RELEVANT STATUTORY ACCOUNTING AND GAAP GUIDANCE

Statutory Accounting

164. SSAP No. 91R provides the following guidance: **(This has been updated to include the SSAP No. 91R revisions adopted in May 2010 for securities lending transactions.)**

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). 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 (E) 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 56 and 97, 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 17 and 18);
 - b. Either (i) each transferee obtains the right, free of conditions that constrain it from taking advantage of that right (see paragraphs 19-23), to pledge or exchange the transferred assets or (ii) the transferee is a qualifying special-purpose entity as defined in paragraph 25 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 24), 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 38-40) or (ii)

the ability to unilaterally cause the holder to return specific assets, other than through a cleanup call (see paragraphs 22-23 and 41-45).

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 50);
 - 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 48 and 49); 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 7c., 48 and 49).

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 (excluding 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 50); 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 64-86. 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 67-69 and disclosed as required by paragraph 100. 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 97); 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.

Footnote 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.

- 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 above), 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. 5—Liabilities, Contingencies and Impairments of Assets* (SSAP No. 5), 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 above 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.

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. 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

17. 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.
18. 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

19. 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.

20. 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.
21. 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

22. 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.
23. 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 38-45, thus precluding sale accounting under paragraph 5.

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

24. The considerations in paragraphs 19-23, 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

25. 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 26 and 27);
 - 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 28 and 29).
 - c. It shall hold only:
 - i. Financial assets transferred to it that are passive in nature (paragraph 30);
 - 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 30 and 31);
 - 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 32);
 - 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 33 and 34.)
 - 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 35);
 - 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 41-45);
 - 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 36).

Need to Be Demonstrably Distinct from the Transferor

26. 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.
27. 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

28. The powers of the SPE must be limited to those activities allowed by paragraph 25 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.
29. 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 5b. are then met by the SPE itself and the conditions in paragraphs 5a. and 5c. continue to be met, that change would bring the transferred assets held in the SPE back under the control of the transferor (paragraph 46).

Limits on What a Qualifying SPE May Hold

30. 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% of 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.
31. 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.
32. 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

33. 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.
34. 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).
35. 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.
36. 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

37. 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

38. 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 39);
 - 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 40);
 - 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.
39. 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.
40. 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

41. 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.

42. If the transferee is a qualifying SPE, it has met the conditions in paragraph 25 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.
43. 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.
44. 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.
45. 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 33.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 35.b.), because the transferor could not cause that reacquisition unilaterally.

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

46. 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 29). 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

47. 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

48. 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 47.
49. 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

50. 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. 5.

Securitizations

51. 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.
52. 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.
53. 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.
54. 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

55. 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

56. 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

57. 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.
58. 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 38-40 maintain effective control criteria). 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.
59. If the criteria 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.

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.

60. 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 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 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 60 a. above) or investment schedule reporting (paragraph 60 b. above).
61. 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

62. 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

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.

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.

63. 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 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"

64. 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.
65. 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.
66. If the conditions in paragraph 5 are met, including the criterion in paragraph 5c., 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 73-78.)
67. 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

⁵ Instead of cash, other securities or letters of credit sometimes are exchanged. Those transactions are accounted for in the same manner as securities lending transactions (paragraphs 82-87).

- 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.
68. 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 39 substantially the same criteria) securities as those concurrently transferred is assured. Therefore, those transactions shall be accounted for as secured borrowings by both parties to the transfer.
69. 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

70. 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 39 (substantially the same criteria) 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.
71. For repurchase agreements that are accounted for as collateralized borrowings in accordance with paragraph 68 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.
72. 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

73. 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.
74. A repurchase financing involves the transfer of a previously transferred financial asset back to the initial transferor as collateral for a financing between the initial transferee (the borrower) and the initial transferor (the lender). A repurchase financing also typically involves the initial transferor returning the transferred financial asset (or substantially the same asset) to the initial transferee when the financing is repaid on a state date. A repurchase financing is entered into in contemplation of the initial transfer if both transactions are considered together at the execution of the initial transfer.
75. 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.
76. 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 paragraphs 77 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.
77. 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.)
78. 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 77 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

79. 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 39 (substantially the same criteria) 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.
80. For reverse repurchase agreements that are accounted for as collateralized lendings in accordance with paragraph 68 of this statement, the underlying securities shall not be accounted for as investments owned by the reporting entity. The amount paid for the securities shall be reported as a short-term investment, and the difference between the amount paid and the amount at which the securities will be subsequently resold shall be reported as interest income, calculated on the straight-line method or the scientific interest (constant yield) method, over the term of the agreement.

Collateral Requirements

81. 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 any time the fair value of the collateral is less than 100 percent of the purchase price paid by the reporting entity, the counterparty shall be obligated to provide additional collateral, the fair value of which, together with fair value of all collateral then held in connection with the transaction, at least equals 102 percent of the purchase price. Dollar Repurchase Agreements

82. 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 39, 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.

83. For the seller in a dollar reverse repurchase agreement accounted for as collateralized borrowing in accordance with paragraph 68 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.
84. 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 39.
85. 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.
86. For the purchaser in a dollar repurchase agreement accounted for as collateralized lending in accordance with paragraph 68 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

87. Agreements to repurchase and resell securities that do not meet the definitions in paragraphs 58 and 64 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

88. 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.
89. 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*; 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.
90. Otherwise, separate assets and liabilities shall be recognized.

Loan Syndications

91. 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.
92. 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

93. 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.
94. 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.
95. 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

96. 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

97. 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

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

- ii. To the extent that the maturity dates of the liability (collateral to be returned) does not match the invested assets, the reporting entity shall explain the additional sources of liquidity to manage those mismatches.
- 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 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, maturities, and weighted average interest rates 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.
99. Disclose any transfers of receivables with recourse.
100. A reporting entity shall disclose the following information for wash sales, as defined in paragraph 9 above, 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;

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

- 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.
101. Refer to the preamble for further discussion regarding disclosure requirements. The disclosures required by paragraph 100 above (wash sales) shall be made for the current quarter in the quarterly statement and for the year in the annual statement.

Relevant Literature

102. 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).
103. 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.
104. 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.
105. 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*.
106. 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

107. 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, 98f, 104 and Exhibit B illustrations are effective January 1, 2009. Substantive revisions in paragraphs 13, 14, 57-81, 98-101 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*.
108. 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

- *SSAP No. 18—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*
- *SSAP No. 33—Securitization*

- *SSAP 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—Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities - Revised*

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 41 and 43)

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 41 and 42)

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	\$99
One-tenth interest continued to be held by the transferor $[(\$990 \div 9/10) \times 1/10]$	110

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	60	5.4	54.50
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

- 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>\$1,00</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	\$1,00
Less: Carrying amount of loans sold	(909)
Gain on sale	<u>\$ 91</u>

Loans Sold

Carrying Amount of Loans	\$1,00
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</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</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

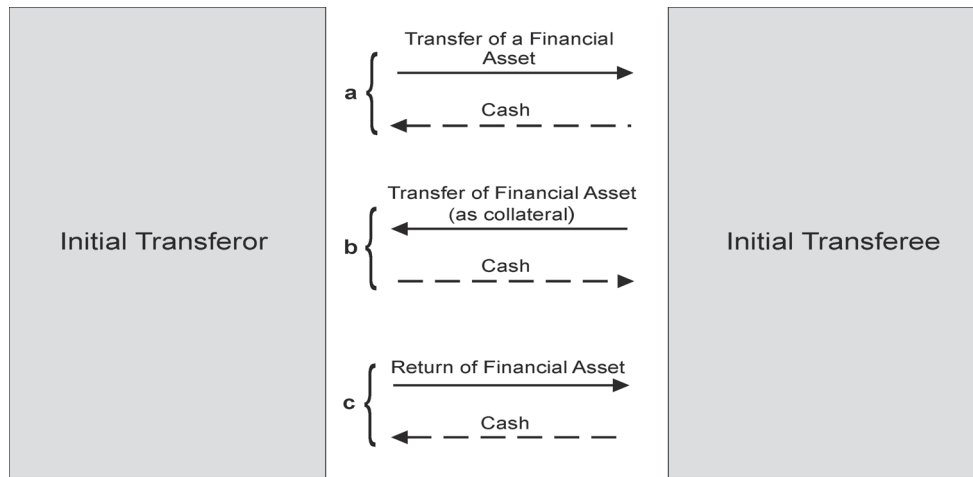
Cash	1,000	
Obligation to return borrowed securities		1,000

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

<i>At conclusion:</i>			
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 73 and 74, which should be analyzed using the provisions in paragraphs 75-78. 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.



Generally Accepted Accounting Principles

The GAAP guidance has not been reproduced in this issue paper. Please refer to FAS 166, *FAS 166, Accounting for Transfers of Financial Assets* (FAS 166).

RELEVANT LITERATURE

Statutory Accounting

Generally Accepted Accounting Principles

State Regulations

- No additional guidance obtained from state statutes or regulations.

APPENDIX A – ILLUSTRATION OF REVISIONS TO INTS

NOTE: THIS APPENDIX WAS INCLUDED IN THE EXPOSED SSAP NO. 103 TO IDENTIFY REVISIONS TO INTS THAT WILL BE INCORPORATED ONCE THE SSAP IS ADOPTED.

SSAP NO. 103—ACCOUNTING FOR TRANSFERS AND SERVICING OF FINANCIAL ASSETS AND EXTINGUISHMENTS OF LIABILITIES WAS ADOPTED AT THE SPRING 2012 NATIONAL MEETING. UPON ADOPTION, THE WORKING GROUP DIRECTED FOR THIS APPENDIX TO BE INCLUDED IN ISSUE PAPER NO. 141 FOR HISTORICAL PURPOSES.

Issue Paper No. 141 identified the statutory INTs that will interpret this new SSAP, noting whether there would be a change from the previous conclusion noted in SSAP No. 91R. Although these original conclusions are considered accurate, it was noted that INT 00-11 (rejecting EITF 98-15) and INT 04-21(adopting with modification EITF 02-9) should reflect the GAAP revisions from FAS 166. Furthermore, since the development of the INT, initiatives have occurred to reference non-applicable INTs into INT 99-00, as well as to incorporate INT guidance in to specific SSAPs.

This Appendix proposes revisions to the related INT's to reflect the FAS 166 revisions. **It is recommended that these revisions be adopted into the related interpretations, but that this appendix not be retained within the adopted SSAP. This appendix will be incorporated within Issue Paper No. 141 for historical purposes.**

Proposed Revisions to Issue Paper No. 141, paragraph 5

5. With the exception of INT 99-07, INT 99-08, INT 99-14, and INT 99-21, as discussed below, this issue paper will be interpreted by the statutory interpretations to SSAP No. 91R:
 - a. INT 99-07: EITF 97-3: Accounting for Fees and Costs Associated with Loan Syndications and Loan Participations after the Issuance of FASB Statement No. 125 (INT 99-07) – As this interpretation rejected EITF 97-3 for statutory accounting, there is no impact to this interpretation from adoption of FAS 166. As this interpretation is now included in INT 99-00—Compilation of Rejected EITFs (INT 99-00), the reference to INT 99-00, and not INT 99-07, will be referenced in the new SSAP to supersede SSAP No. 91R.
 - b. INT 99-08: EITF 97-6: Application of Issue No. 96-20 to Qualifying Special-Purpose Entities Received Transferred Financial Assets Prior to the Effective Date of FASB Statement No. 125 (INT 99-08) – As this interpretation rejected EITF 96-20 for statutory accounting, there is no impact to this interpretation from adoption of FAS 166. As this interpretation is now included in INT 99-00—Compilation of Rejected EITFs (INT 99-00), the reference to INT 99-00, and not INT 99-08, will be referenced in the new SSAP to supersede SSAP No. 91R.
 - c. INT 99-14: EITF 96-19: Debtor's Accounting for a Modification or Exchange of Debt Instruments (INT 99-14) – This interpretation adopted EITF 99-14 for statutory accounting. As such, an exchange of debt instruments with substantially different terms is considered a debt extinguishment. This guidance also clarifies that if the cash flows under the terms of the new debt instrument are at least 10 percent different from the present value of the remaining cash flows under the terms of the original instrument, then the exchange of debt instruments are considered substantially different. The GAAP status of EITF 96-19 was updated to identify that FAS 166 amended FAS 140 without reconsideration. As such, there is no impact to this the statutory interpretation from the adoption of FAS 166. However, pursuant to a project to incorporate guidance from statutory INTs into the related SSAPs, the guidance from this INT is proposed to be included within SSAP No. 91R, as well as the proposed SSAP to supersede

SSAP No. 91R. This guidance has been included in paragraph 126 of this issue paper.

- d. *INT 99-21: EITF 98-7: Accounting for Exchanges of Similar Equity Method Investments* (INT 99-21) – This interpretation was nullified with the issuance of *SSAP No. 95—Exchanges of Nonmonetary Assets, A Replacement of SSAP No. 28—Nonmonetary Transactions* (SSAP No. 95). With the issuance of a new SSAP, there will be no future reference to this interpretation.

Staff Note: EITF 98-7 was not revised in FAS 166.

- e. *INT 99-22: EITF 98-8: Accounting for Transfers of Investments That Are in Substance Real Estate* (INT 99-22) – This interpretation adopted EITF 98-8 indicating that transfers of financial assets that are in substance real estate shall be accounted for in accordance with *SSAP No. 40—Real Estate Investments* (SSAP No. 40). The GAAP status of EITF 96-19 was updated to deleted the effective date reference and identify that FAS 166 amended FAS 140 without reconsideration. As such, there is no impact to this statutory interpretation from the adoption of FAS 166. However, pursuant to a project to incorporate guidance from statutory INTs into the related SSAPs, the guidance from this INT is proposed to be included within SSAP No. 91R, as well as the proposed SSAP to supersede SSAP No. 91R. This guidance has been included in paragraph 6 of this issue paper.

- f. *INT 00-11: EITF 98-15: Structured Notes Acquired for a Specified Investment Strategy* (INT 00-11) – This interpretation rejected the consensus position in EITF 98-15 pursuant to a recommendation from the Invested Assets (E) Working Group. It was noted that any attempt on the part of the Emerging Accounting Issues (E) Working Group to promulgate EITF 95-18 into accounting guidance (bonds accounted for at fair value rather than amortized cost) will require the Valuation of Securities (E) Task Force to change the mission of the Securities Valuation Office. The issuance of FAS 166 incorporated guidance to EITF 98-15 to identify that paragraph 11 of FAS 166 (accounting for transfers of entire financial assets or groups of entire financial assets that qualify as sales) shall be applied to each structured note upon transfer. This update is proposed for inclusion within INT 00-11, but as there is no proposed change to the previous statutory conclusion, As such, there will be no impact to this interpretation as a result of adopting FAS 166.

- g. *INT 01-31: Assets Pledged as Collateral* (INT 01-31) – This interpretation provides guidance on whether assets pledged as collateral shall be considered admitted assets. There is no impact to this interpretation conclusion from the adoption of FAS 166. (References to SSAP No. 91R will be replaced with references to the new SSAP.)

Staff Note: This INT does not relate to a GAAP EITF, therefore no changes from FAS 166.

- h. *INT 03-05: EITF 01-7: Creditor's Accounting for a Modification or Exchange of Debt Instruments* (INT 03-05) – This interpretation adopts the consensus position of EITF 01-7. This EITF clarifies that a debt instrument modification should be considered more than minor 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. This EITF also concludes that the guidance in EITF 96-19 (adopted within INT 99-14) should be used to calculate the present value of cash flows for purposes of applying the 10 percent test. There is no impact to this interpretation from the adoption of FAS 166.

Staff Note: EITF 01-7 was not revised in FAS 166.

- i. *INT 04-21: EITF 02-9: Accounting for Changes that Result in a Transferor Regaining Control of Financial Assets Sold (INT 04-21) – This interpretation adopts EITF 02-9 with modification for statutory terms and references. Pursuant to this adoption, a transferred asset that has been accounted for as sold is to be accounted for as “re-purchased” if the basis for that sale accounting subsequently becomes invalid. With the issuance of FAS 166, guidance in EITF 02-9 was updated to reflect the revised terminology in FAS 166 as well as delete the issue and conclusion pertaining to qualified special purpose entities as the concept of a QSPE is no longer captured within FAS 166. Although there is no impact to the statutory conclusion to adopt this EITF with modifications for statutory references, the guidance in INT 04-21 will be revised to reflect the revisions adopted from FAS 166. There is no impact to this interpretation from the adoption of FAS 166.*
- j. *INT 09-08: Accounting for Loans Received under the Federal TALF Program. This interpretation provides statutory guidance on whether TALF loans received and the corresponding collateral provided by the reporting entity shall be reported net within the statutory financial statements. With the exception of updating references from SSAP No. 91R to the new SSAP, there is no anticipated change proposed to this interpretation.*

Proposed Revisions to Interpretations: (To be included in an Exhibit to Issue Paper No. 141)

This Exhibit identifies the revisions proposed to interpretations as a result of adopting, with modification, FAS 166 in a new SSAP to supersede SSAP No. 91R. (All interpretations identified in SSAP No. 91R are discussed below.)

1. *INT 99-07—EITF 97-3: Accounting for Fees and Costs Associated with Loan Syndications and Loan Participations after the Issuance of FASB Statement No. 125*

Proposed Changes: No changes are proposed to this INT as it is no longer captured in the AP&P Manual, but is instead referenced as rejected in INT 99-00. A change will occur to INT 99-00 to reference the new SSAP instead of SSAP No. 91R.
2. *INT 99-08—EITF 97-6: Application of Issue No. 96-20 to Qualifying Special-Purpose Entities Received Transferred Financial Assets Prior to the Effective Date of FASB Statement No. 125*

Proposed Changes: No changes are proposed to this INT as it is no longer captured in the AP&P Manual, but is instead referenced as rejected in INT 99-00. A change will occur to INT 99-00 to reference the new SSAP instead of SSAP No. 91R.
3. *INT 99-14—EITF 96-19: Debtor’s Accounting for a Modification or Exchange of Debt Instruments*

Proposed Changes: No changes are proposed to this INT as it is no longer captured within the authoritative guidance of the AP&P Manual. This INT has been nullified, with the guidance reflected in the underlying SSAP (SSAP No. 91R). These revisions are also reflected in the proposed SSAP to supersede SSAP No. 91R in paragraph 22.
4. *INT 99-21: EITF 98-7: Accounting for Exchanges of Similar Equity Method Investments*

Proposed Changes: No changes are proposed to this INT as it was nullified with the issuance of SSAP No. 95—*Exchanges of Nonmonetary Assets, A Replacement of SSAP No. 28—Nonmonetary Transactions* (SSAP No. 95).

5. *INT 99-22—EITF 98-8: Accounting for Transfers of Investments That Are in Substance Real Estate*

Proposed Changes: No changes are proposed to this INT as it is no longer captured within the authoritative guidance of the AP&P Manual. This INT has been nullified, with the guidance reflected in the underlying SSAP (SSAP No. 91R). These revisions are also reflected in the proposed SSAP to supersede SSAP No. 91R in paragraph 2.

6. *INT 00-11—EITF 98-15: Structured Notes Acquired for a Specified Investment Strategy*

Proposed Changes: Revisions are proposed to update the reference and status section of this INT:

INT 00-11 References

SSAP No. 43R—Loan-Backed and Structured Securities (SSAP No. 43R)

SSAP No. 45—Repurchase Agreements, Reverse Repurchase Agreements and Dollar Repurchase Agreements (SSAP No. 45)

SSAP No. 91R—Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities (SSAP No. 91R) (Add Shading)

SSAP No. 103—Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities (Add new SSAP reference)

SSAP No. 98—Treatment of Cash Flows When Quantifying Changes in Valuation and Impairments, an Amendment of SSAP No. 43—Loan-Backed and Structured Securities (SSAP No. 98)

INT 00-11 Status

4. In 2009, FAS 166, Accounting for Transfers of Financial Assets, an Amendment of FAS 140, was issued. In addition to amending FAS 140, it also amended FASB EITF 98-15 to clarify that paragraph 11 (Accounting for Transfers of an Entire Financial Asset or Group of Entire Financial Assets) of FAS 166 should be applied to each structured note upon transfer. This revision to EITF 98-15 does not impact the previous conclusion to reject this EITF for statutory accounting.

45. No further discussion is planned.

Note: The EAIWG project to incorporate guidance from INTs into SSAPs may impact this proposal

7. *INT 01-31—Assets Pledged as Collateral*

Proposed Changes: Revisions are proposed to update references and the status section of this INT:

INT 01-31 References

SSAP No. 4—Assets and Nonadmitted Assets (SSAP No. 4)

SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets (SSAP No. 5R)

SSAP No. 18—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities (SSAP No. 18)

SSAP No. 33—Securitization (SSAP No. 33)

SSAP No. 45—Repurchase Agreements, Reverse Repurchase Agreements and Dollar Repurchase Agreements (SSAP No. 45)

SSAP No. 91R—Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities (SSAP No. 91R) (Added Shading)

SSAP No. 103—Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities (Add new SSAP reference)

INT 99-02: Accounting for Collateral in Excess of Debt Principal (INT 99-02)

7. Therefore, for the examples described above, the pledging insurer would record the collateral (including the overcollateralization amount) as an admitted asset until they have committed a contract default that has not been cured in accordance with the contract provisions. This accounting is in accordance with the provisions of ~~SSAP No. 91R~~ SSAP No. 103. This consensus of reporting collateral as an admitted asset is further supported by SSAP Nos. 4 and 5 since generally, the insurer can readily substitute pledged assets. Additionally, an insurer may typically unwind the transaction allowing the assets to be available to the pledging insurer to meet policyholder obligations. Furthermore, no event has occurred to indicate an impairment or potential loss contingency with respect to such pledged assets. The fact that some pledged assets may constitute an overcollateralization amount does not change this analysis. Accordingly, all assets pledged in support of these type transactions should also be admitted.

8. At the time of an uncured default, the provisions of paragraph ~~44-20 of SSAP No. 91R~~ SSAP No. 103 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 insurer 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 should 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 should only record an admitted asset for the amount of collateral that it can redeem.

9. As of March 18, 2002, the consensus position of this interpretation is consistent with the position of the NAIC Invested Asset (E) Working Group. This interpretation will be reviewed by the FAS 140 Subgroup of the NAIC Statutory Accounting Principles (E) Working Group in conjunction of its consideration of incorporating GAAP pronouncement *FAS 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, a replacement of FASB Statement 125* into the statutory accounting model. As such, this interpretation is subject to amendment pending disposition of the FAS 140 Subgroup's review of collateral and FAS 140 in its entirety.

10. On September 12, 2004, the Working Group noted that the review of FAS 140 was complete and INT 01-31 was listed as an interpretation of SSAP No. 91R. On March 3, 2012, the Working Group adopted, with modification, FAS 166—Accounting for Transfers of Financial Assets, an Amendment of FAS 140 (FAS 166). With this adoption, there was no change to the consensus opinion within this interpretation, and this INT was listed as an interpretation of SSAP No. 103.

11. No further discussion is planned.

8. *INT 03-05—EITF 01-7: Creditor's Accounting for a Modification or Exchange of Debt Instruments*

Proposed Changes: There is no impact to this interpretation from the adoption, with modification of FAS 166. However, changes will occur to reference the new SSAP, rather than SSAP No. 91R:

INT 03-05 References

SSAP No. 18—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities (SSAP No. 18)

SSAP No. 91R—Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities (SSAP No. 91R) (Added Shading)

SSAP No. 103—Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities

9. *INT 04-07—EITF 02-15: Determining Whether Certain Conversions of Convertible Debt to Equity Securities Are Within the Scope of FAS Statement No. 84*

Proposed Changes: Revisions are proposed to update references in this INT:

2. EITF 02-15 utilizes guidance from several sources in the GAAP hierarchy. The statutory accounting status of these statements is listed below:

- a. *FASB Statement No. 15, Accounting by Debtors and Creditors for Troubled Debt Restructurings*, which was adopted by *SSAP No. 36—Troubled Debt Restructuring*.
- b. FAS 84, which was adopted by SSAP No. 15.
- c. *FASB Statement No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, which was adopted with modification in *SSAP No. 91R—Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* and refers back to SSAP No. 15 for guidance regarding any troubled debt restructuring. (FAS 166 amended FAS 140 and was adopted, with modification in SSAP No. 103. SSAP No. 103 superseded SSAP No. 91R, but continues to reference SSAP No. 15 for guidance regarding trouble debt restructuring.)

10. *INT 04-21—EITF 02-9: Accounting for Changes that Result in a Transferor Regaining Control of Financial Assets Sold*

Proposed Changes: With the issuance of FAS 166 guidance in EITF 02-9 was updated to reflect the revised terminology in FAS 166 as well as to delete the issue and conclusion pertaining to qualified special-purpose entities as the concept of a QSPE is no longer captured within FAS 166. Revisions are proposed to reflect the revised guidance from FAS 166:

INT 04-21 References

SSAP No. 91R—Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities (SSAP No. 91R) (Added Shading)

SSAP No. 103—Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities

1. EITF No. 02-9, *Accounting for Changes That Result in a Transferor Regaining Control of Financial Assets Sold* (EITF 02-9) expands on a key concept presented in FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (FAS 140), paragraph 55. This key concept requires a transferred financial asset that has been accounted for as sold to be accounted for as "re-purchased" if the basis for that sale accounting subsequently becomes invalid.

2. The following is excerpted from EITF 02-9:

1. ~~Two One~~ circumstances that ~~hashave~~ raised questions about the application of paragraph 55 occurs when the provisions of paragraph 55 are triggered because ~~(a) a qualifying special purpose entity (SPE) becomes nonqualifying and (b) the transferor holds a contingent right such as a contingent call option on the transferred financial assets (for example, a removal of accounts provision or "ROAP") and the contingency has been met. This issue assumes that the transferee is not consolidated by the transferor.~~
 2. ~~A qualifying SPE may become nonqualifying or "tainted" for several reasons, including a decision by the outside beneficial interest holders to grant the SPE decision-making powers that are prohibited for qualifying SPEs. Under the requirements of paragraph 55, the disqualification of a formerly qualifying SPE will generally result in the "re-purchase" by the transferor of all assets sold to and still held by the SPE because the transferee (the SPE that is no longer qualifying) is constrained from pledging or exchanging the financial assets and this condition provides more than a trivial benefit to the transferor (refer to paragraph 9(b) of Statement 140). This Issue considers the application of the guidance in paragraph 55 prior to any consideration of whether the transferee (for example, an SPE) should be consolidated and, therefore, prior to considering any eliminating entries that may result from consolidation.~~
 3. Under Statement 140, rights held by the transferor (typically in the form of purchased options or forward purchase contracts) only preclude sale accounting under paragraph 9(c)(2) if they provide the transferor with (a) the unilateral right to cause the holder to return specific transferred financial assets and (b) more than a trivial benefit. One class of contingent rights (including certain ROAPs 1) does not preclude sale accounting because it does not include unilateral rights. The most common type of ROAP is a default ROAP, which gives the holder the right but not the obligation to purchase (call) a loan that is in default (the meaning of default typically is specifically defined in each transaction). Such rights are common in credit card securitizations and in securitizations sponsored by the Government National Mortgage Association (GNMA) 2 and other governmental or quasi-governmental agencies. Once the contingency is met (in this case, when a given loan goes into default), the call option on that asset (loan) is no longer contingent. At that point, the transfer fails the criterion in paragraph 9(c)(2) of Statement 140 because the transferor has the unilateral right to purchase a specific transferred financial asset and obtains more than a trivial benefit. Under the requirements of paragraph 55, when a contingency related to a transferor's contingent right has been met, the transferor generally must account for the "re-purchase" of a specific subset of the financial assets transferred to and held by the qualifying SPE entity. The transferor must do so regardless of whether it intends to exercise its call option.
3. Per EITF 02-9, the issues are:
- Issue 1—How the transferor should account for the transferor's retained beneficial interests when the underlying assets are re-recognized under the provisions of paragraph 55 because the transferor's contingent right (for example, a ROAP or other contingent call option on the transferred financial assets) becomes exercisable, including whether any gain or loss should be recognized by the transferor when paragraph 55 is applied.
- ~~Issue 2—How assets re-recognized by the transferor that were previously sold to an SPE that was formerly considered qualifying should be accounted for when the entire SPE becomes nonqualifying under the provisions of paragraph 55, including whether any gain or loss should be recognized by the transferor when paragraph 55 is applied.~~
- Issue 3—Whether under any circumstances a loan loss allowance should initially be recorded for loans that do not meet the definition of a security when they are re-recognized under the provisions of paragraph 55

Issue 4—How re-recognition under paragraph 55 of assets sold affects the accounting for the related servicing asset.

Issue 5—After a paragraph 55 event, how the transferor should account for the transferor's ~~its retained interests~~ (other than the servicing asset).

4. EITF 02-9 consensus on each issue is as follows:

5. The Task Force reached a consensus on Issue 1 that upon application of paragraph 55, no gain or loss should be recognized in earnings with respect to any of the transferor's beneficial interests ~~retained by the transferor~~. Beneficial interests should be evaluated periodically for possible impairment, including at the time paragraph 55 is applied. A gain or loss may be recognized upon the exercise of a ROAP or similar contingent right with respect to the "re-purchased" ~~portion of the transferred financial~~ assets that were sold if the ROAP or similar contingent right held by the transferor is not accounted for as a derivative under Statement 133 and is not at-the-money, resulting in the fair value of those repurchased assets being greater or less than the related obligation to the transferee.

~~6. The Task Force reached a consensus on Issue 2 that in the event the entire SPE becomes nonqualifying upon application of paragraph 55, no gain or loss should be recognized with respect to the "re purchase" by the transferor of the financial assets originally sold that remain outstanding in the SPE (or the portion thereof if the transferor retained a partial interest in those assets). The fair value of the re-recognized assets will equal the fair value of the liability assumed by the transferor because the transferor is contractually required to pass on 100 percent of the cash flows from the re-recognized assets to the SPE for distribution in accordance with the contractual documents governing the SPE. The process of determining the fair value of both the re-recognized assets and the assumed liability may require a careful analysis of all of the expected cash flows of the securitization vehicle, including cash flows of assets within the vehicle that are not subject to paragraph 55 (for example, proceeds that are temporarily reinvested by the SPE). In performing that analysis, the transferor would need to consider both the timing and the amounts of the expected cash flows and also which party has rights to such expected cash flows at the time of the paragraph 55 event.~~

~~7. The Task Force reached a consensus on Issue 3 that under no circumstances should a loan loss allowance be initially recorded for loans that do not meet the definition of a security when they are re-recognized pursuant to paragraph 55.~~

~~8. The Task Force reached a consensus on Issue 4 that when a paragraph 55 event occurs, the accounting for the servicing asset related to the previously sold financial assets does not change as a result of the application of paragraph 55. That is, even though the transferor has regained control over the previously sold assets, the cash flows from those assets will contractually be paid to the SPE, which will then distribute the proceeds to satisfy its contractual obligations (including obligations to the beneficial interest holders). Because the transferor, as servicer, is still contractually required to collect the asset's cash flows for the benefit of the SPE and otherwise service the assets, it should continue to recognize the servicing asset and assess the asset for impairment as required by Statement 140.~~

~~9. The Task Force reached a consensus on Issue 5 that when a paragraph 55 event occurs, the transferor should continue to account for the transferor's ~~its retained interests~~ in those underlying financial assets apart from any re-recognized financial assets. That is, the transferor's ~~retained interests~~ should not be combined with and accounted for with the re-recognized financial assets. However, a subsequent event that results in the transferor reclaiming those financial assets from the transferee—for example, the exercise of a ROAP or the consolidation by the transferor of the SPE securitization entity in accordance with applicable generally accepted accounting principles, including~~

Interpretation 46R would result in a recombination of the transferor's retained interests with the underlying financial assets.

5. The Working Group reached a consensus to adopt EITF 02-9 as an interpretation of SSAP No. 91R, with modification as follows:

- a. Change references to FAS 140 to ~~SSAP 91R~~ SSAP No. 103 including paragraph specific references. Modify FAS 140, paragraph 55 references to refer to SSAP No. ~~91R~~103, paragraph ~~59~~46.
- b. Change references to FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities* to SSAP No. 86 as an interpretation of SSAP No. 91R.
- c. Remove reference to Interpretation 46 as FASB Interpretation No. 46R, *Consolidation of Variable Interest Entities*, is pending review for statutory accounting. (The prior GAAP guidance in FASB Interpretation FIN 46 was rejected for statutory accounting in *SSAP No. 3—Accounting Changes and Corrections of Errors*.)
- d. Limit the applicability of EITF 02-9, Issue 3 to only valuation allowances applicable to statutory accounting for mortgage loans and real estate under development as provided in *SSAP No. 37—Mortgage Loans* and real estate under development as discussed in *SSAP No. 38—Acquisition, Development and Construction Arrangements*.

6. This interpretation was originally ~~is~~ effective for years beginning January 1, 2005 to be consistent with the original effective date of SSAP No. 91R. Revisions adopted to this interpretation on March 3, 2012 are in accordance with the adoption with modification of FAS 166 in a new SSAP to supersede SSAP No. 91R.

INT 04-21 STATUS

7. In 2009, FAS 166, Accounting for Transfers of Financial Assets, an Amendment of FAS 140, was issued. In addition to amending FAS 140, it also amended FASB EITF 02-9. FAS 166 was adopted for statutory accounting in SSAP No. 103 to supersede SSAP No. 91R. On March 3, 2012, corresponding revisions to INT 04-21 were also adopted to reflect the updated GAAP guidance adopted for statutory interpreting SSAP No. 103. These changes will not be tracked in subsequent editions of the Manual.

~~87.~~ No further discussion is planned.

11. *INT 09-08—Accounting for Loans Received under the Federal TALF Program*

Proposed Changes: Revisions are proposed to update references in this INT:

INT 09-08 References

SSAP No. 64—Offsetting and Netting of Assets and Liabilities

SSAP No. 91R—Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities – Revised (Added shading)

SSAP No. 103—Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities

9. In considering whether a provision should be incorporated within a specific statutory accounting principle to permit netting, although no valid right of setoff exists, it is noted that guidance for collateral is included within *SSAP No. ~~91R~~103—Accounting for Transfers and*

Servicing of Financial Assets and Extinguishments of Liabilities (SSAP No. ~~94R-103~~). Pursuant to guidance within this SSAP, unless the transferor defaults on the secured contract, the transferor shall continue to carry the collateral as an asset. It is only after default that the reporting entity would remove the collateral as an asset, with a corresponding reduction to the liability. It is noted that a specific provision for TALF loans would be inconsistent with existing SSAP No. ~~94R-103~~ guidance for the reporting of loans and collateral.

APPENDIX B – ILLUSTRATIONS OF REVISIONS TO SSAPS:

NOTE: THIS APPENDIX WAS INCLUDED IN THE EXPOSED SSAP NO. 103 TO IDENTIFY REVISIONS TO SSAPS THAT WILL BE INCORPORATED ONCE THE SSAP IS ADOPTED.

SSAP NO. 103—ACCOUNTING FOR TRANSFERS AND SERVICING OF FINANCIAL ASSETS AND EXTINGUISHMENTS OF LIABILITIES WAS ADOPTED AT THE SPRING 2012 NATIONAL MEETING. UPON ADOPTION, THE WORKING GROUP DIRECTED FOR THIS APPENDIX TO BE INCLUDED IN ISSUE PAPER NO. 141 FOR HISTORICAL PURPOSES.

This Appendix proposes revisions to the SSAPs to reflect revisions from the adoption, with modification, of FAS 166 in a new SSAP to supersede SSAP No. 91R. **It is recommended that these revisions be adopted into the related SSAPs, but that this appendix not be retained within the adopted SSAP. This appendix will be incorporated within Issue Paper No. 141 for historical purposes.**

1. *SSAP No. 40—Real Estate Investments*

Proposed Changes: Revisions are proposed to update references in this SSAP:

23. Extinguishment of participating mortgage loans prior to the due date should be determined in accordance with *SSAP No. ~~91R103~~—Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities (SSAP No. 91R)*. Gains or losses from early extinguishment should be determined in considering the difference between the recorded amount of debt (including unamortized debt discount and the participation liability) and the amount exchanged to extinguish the debt.

2. *SSAP No. 42—Sale of Premium Receivables*

Proposed Changes: Revisions are proposed to update references in this SSAP:

9. This statement rejects paragraph 83 of *FASB Statement No. 125, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities (FAS 125)* to the extent that it permits sales recognition for sales of receivables with recourse provisions. FAS 125 is addressed in its entirety in *SSAP No. 18—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, which was superseded by *SSAP No. 91R—Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. SSAP No. 103—Accounting for Transfers and Servicing of Financial Assets adopts, with modification, FAS 166, Accounting for Transfers of Financial Assets—an amendment of FASB Statement No. 140 and supersedes SSAP No. 91R.

3. *SSAP No. 43R—Loan-Backed and Structured Securities*

Proposed Changes: Revisions are proposed:

1. This statement establishes statutory accounting principles for investments in loan-backed securities and structured securities. In accordance with *SSAP No. ~~91R103~~—Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities (SSAP No. 91R103)*, retained beneficial interests from the sale of loan-backed securities and structured securities are accounted for in accordance with this statement. In this statement loan-backed securities and structured securities are collectively referred to as loan-backed securities.

6. The scope of this statement encompasses all types of loan-backed and structured securities, including, but not limited to, the following:

- a. Loan-backed and structured securities acquired at origination,

- b. Loan-backed and structured securities acquired subsequent to origination for which it is probable, at acquisition, that the reporting entity will be **able** to collect all contractually required payments receivable, and are accounted for at acquisition under SSAP No. ~~94R103~~,
- c. Loan-backed and structured securities for which it is probable, either known at acquisition or identified during the holding period¹, that the reporting entity will be **unable** to collect all contractually required payments receivable, and
- d. ~~Transferor's B~~beneficial interests ~~that continue to be held by a reporting entity (transferor)~~ in securitization transactions that are accounted for as sales under SSAP No. ~~94R-103~~ and purchased beneficial interests in securitized financial assets.

Beneficial Interests

20. The following paragraphs provide statutory accounting guidance for interest income and impairment for a reporting entity that continues to hold an interest in securitized financial assets accounted for as sales under SSAP No. ~~94R103~~, or that purchases a beneficial interest in securitized financial assets that are not of high credit quality or can contractually be prepaid or otherwise settled in such a way that the reporting entity would not recover substantially all of its recorded amount, determined at acquisition or the date of transfer⁵. Beneficial interests that are of high credit quality and cannot contractually be prepaid or otherwise settled in such a way that the reporting entity would not recover substantially all of its recorded investment, shall be accounted for in accordance with paragraphs 12 through 16.

Footnote 5: The accounting requirements related to these types of securities included in paragraphs 20-24 shall be determined at acquisition or initial transfer. As referenced in the Relevant Literature section, this Statement adopts EITF 99-20 (as amended by FAS 166), including the scope requirements of that guidance.

21. The reporting entity shall recognize the excess of all cash flows attributable to the beneficial interest estimated at the acquisition/transaction date (referred to herein as the transaction date) over the initial investment (the accretable yield) as interest income over the life of the beneficial interest using the effective yield method. If the holder of the beneficial interest is the reporting entity that transferred the financial assets for securitization, the initial investment would be the ~~allocated carrying amount after application of the relative fair value of the beneficial interest as of the date of transfer, allocation method~~ as required by SSAP No. ~~10394R~~. The amount of accretable yield shall not be displayed in the balance sheet.
23. All cash flows estimated at the transaction date are defined as the holder's estimate of the amount and timing of estimated future principal and interest cash flows used in determining the purchase price or the holder's fair value determination for purposes of determining a gain or loss under SSAP No. ~~10394R~~. Subsequent to the transaction date, estimated cash flows are defined as the holder's estimate of the amount and timing of estimated principal and interest cash flows based on the holder's best estimate of current information and events. A change in estimated cash flows is considered in the context of both timing and amount of the estimated cash flows.

¹ Securities classified within the type of paragraph 6.a. or 6.b. may be required to change classification to type 6.c. when it becomes probable that the reporting entity will be unable to collect all contractually required payments receivable.

24. ~~In situations in which it is not practicable for a transferor to estimate the fair value of the beneficial interest at the initial transfer date, interest income shall not be recognized using the interest method. For these beneficial interests (that is, those beneficial interests that continue to be held by a transferor that are recorded at \$0 pursuant to SSAP No. 91R), the transferor shall use the cash basis for recognizing interest income because the beneficial interest will have an allocated carrying amount of zero.~~
45. Repooled FHLMC and FNMA securities meet the definition of substantially the same as defined in ~~SSAP No. 91R103—Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities~~. The transaction shall not be considered a sale/purchase and no gain or loss shall be recognized. To properly document the repooling, the transaction shall be reported through Schedule D of the Annual Statement as a disposition and an acquisition.
51. This statement adopts *FASB Emerging Issues Task Force No. 99-20, Exchange of Interest-Only and Principal-Only Securities for a Mortgage-Backed Security, as amended by FAS 166, Accounting for Transfers of Financial Assets, an Amendment of FAS 140, and FASB Staff Position EITF 99-20-1, Amendments to the Impairment Guidance of EITF Issue No. 99-20*. This statement adopts paragraphs 5, 7 and 9 of *AICPA Statement of Position 03-03, Accounting for Certain Loans or Debt Securities Acquired in a Transfer (SOP 03-03)* for loan-backed and structured securities only. With the exception of this specific adoption, consideration of SOP 03-03 is still pending consideration for statutory accounting.
4. *SSAP No. 95—Exchanges of Nonmonetary Assets, A Replacement of SSAP No. 28*

Proposed Changes: Reference revisions are proposed:

5. Nonmonetary transactions shall be accounted for in accordance with this statement, except as addressed by other statements or interpretations including but not limited to *SSAP No. 12—Employee Stock Ownership Plans* (SSAP No. 12), *SSAP No. 13—Stock Option and Stock Purchase Plans* (SSAP No. 13), *SSAP No. 25—Accounting for and Disclosures about Transactions with Affiliates and Other Related Parties* (SSAP No. 25), *SSAP No. 68—Business Combinations and Goodwill* (SSAP No. 68), *SSAP No. 72—Surplus and Quasi-reorganizations* (SSAP No. 72), ~~SSAP No. 91R103—Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities~~ (SSAP No. ~~91R103~~), *INT 00-12: EITF 99-4: Accounting for Stock Received from the Demutualization of a Mutual Insurance Company*, *INT 00-26: EITF 98-3: Determining Whether a Nonmonetary Transactions Involves Receipt of Productive Assets or of a Business* (INT 00-26), *INT 00-29: EITF 99-17: Accounting for Advertising Barter Transactions* (INT 00-29), *INT 02-19: EITF 01-1: Accounting for a Convertible Instrument Granted or Issued to a Nonemployee for Goods or Services or a Combination of Goods or Services and Cash* (INT 02-19) and *INT 03-16: Contribution of Stock* (INT 03-16).
21. Although not meant to be all inclusive, accounting for specific nonmonetary transactions and unique circumstances is addressed in the following statements of statutory accounting principles:
- *SSAP No. 12—Employee Stock Ownership Plans* (SSAP No. 12)
 - *SSAP No. 13—Stock Options and Stock Purchase Plans* (SSAP No. 13)
 - *SSAP No. 25—Accounting for and Disclosures about Transactions with Affiliates and Other Related Parties* (SSAP No. 25)
 - *SSAP No. 68—Business Combinations and Goodwill* (SSAP No. 68)
 - *SSAP No. 72—Surplus and Quasi-reorganizations* (SSAP No. 72)

- *SSAP No. ~~94R103~~—Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities (SSAP No. ~~94R103~~)*
- *INT 00-12: EITF 99-4: Accounting for Stock Received from the Demutualization of a Mutual Insurance Company (INT 00-12)*
- *INT 00-26: EITF 98-3: Determining Whether a Nonmonetary Transactions Involves Receipt of Productive Assets or of a Business (INT 00-26)*
- *INT 00-29: EITF 99-17: Accounting for Advertising Barter Transactions (INT 00-29)*
- *INT 03-16: Contribution of Stock (INT 03-16)*

6. *SSAP No. 100—Fair Value Measurements*

Proposed Changes: Reference revisions are proposed:

44. The disclosures about fair value prescribed in paragraph 43 are not required for the following:
- a. Employers' and plans' obligations for pension benefits, other postretirement benefits including health care and life insurance benefits, postemployment benefits, employee stock option and stock purchase plans, and other forms of deferred compensation arrangements, as defined in *SSAP No. 12—Employee Stock Ownership Plans (SSAP No. 12)*, *SSAP No. 13—Stock Options and Stock Purchase Plans (SSAP No. 13)*, *SSAP No. 14—Postretirement Benefits Other Than Pensions (SSAP No. 14)*, and *SSAP No. 89—Accounting for Pensions, A Replacement of SSAP No. 8 (SSAP No. 89)*
 - b. Substantively extinguished debt subject to the disclosure requirements of *SSAP No. ~~94R103~~—Accounting for Transfer and Servicing of Financial Assets and Extinguishments of Liabilities (SSAP No. ~~94R103~~)*
 - c. Insurance contracts, other than financial guarantees and deposit-type contracts
 - d. Lease contracts as defined in *SSAP No. 22—Leases (SSAP No. 22)*
 - e. Warranty obligations and rights
 - f. Investments accounted for under the equity method
 - g. Equity instruments issued by the entity

APPENDIX C – IDENTIFICATION OF OTHER GAAP GUIDANCE IMPACTED BY FAS 166:

NOTE: THIS APPENDIX WAS INCLUDED IN THE EXPOSED SSAP NO. 103 TO IDENTIFY THE IMPACT TO OTHER GAAP GUIDANCE IMPACTED BY FAS 166.

SSAP NO. 103—ACCOUNTING FOR TRANSFERS AND SERVICING OF FINANCIAL ASSETS AND EXTINGUISHMENTS OF LIABILITIES WAS ADOPTED AT THE SPRING 2012 NATIONAL MEETING. UPON ADOPTION, THE WORKING GROUP DIRECTED FOR THIS APPENDIX TO BE INCLUDED IN ISSUE PAPER NO. 141 FOR HISTORICAL PURPOSES.

In addition to the GAAP EITFs adopted (or adopted through an INT) in SSAP No. 91R, the issuance of FAS 166 also revised other GAAP EITFs. This table identifies all GAAP EITFs (not including the EITF Appendix D Topics) and the revisions incorporated from FAS 166.

This Exhibit is not recommended to be retained within the adopted SSAP. This exhibit is for informational purposes only and will be incorporated within Issue Paper No. 141 for historical purposes.

(This does not include the identified revisions to the “Special Report on Statement 140” from the issuance of FAS 140 as it is a question and answer guidance not previously reviewed for statutory accounting.)

GAAP EITF	Summary of FAS 166 Revisions	SAP Status (Appendix D)	Recommendation
84-5	Updated to refer to FAS 166 examples of when the transferor maintains effective control over transferred financial assets (rather than the example regarding put options originally provided in the EITF), updated to refer that FAS 140 is amended by FAS 166, and updated to note that FAS 166 removed the practicability exception for the requirement to measure proceeds of a sale at fair value.	Rejected in SSAP No. 18 & 91R	No Change The statement includes specific statutory guidance for put options in paragraph 59.
84-20	Updated to note that FAS 140 was amended by FAS 166. No reconsideration of the GAAP issue.	Adopted in SSAP No. 45	No Change
85-25	Updated to refer to FAS 166 examples of when the transferor maintains effective control over transferred financial assets (rather than the examples for put options originally included). Also updated to refer that FAS 140 is amended by FAS 166.	Nullified by FAS 125, 133 & 140	No Change
85-40	Updated to refer to FAS 166 examples of when the transferor maintains effective control over transferred financial assets (rather than the example regarding put options originally provided in the EITF), updated to refer that FAS 140 is amended by FAS 166, and updated to note that FAS 166 removed the practicability exception for the requirement to measure proceeds of a	Nullified by FAS 125 and partially nullified by FAS 140	No Change

GAAP EITF	Summary of FAS 166 Revisions	SAP Status (Appendix D)	Recommendation
	sale at fair value.		
86-36	Not applicable in FASB Codification	Adopted in SSAP No. 15	No Change
87-18	Updated to note that FAS 140 was amended by FAS 166. No reconsideration of the GAAP issue.	Adopted with modification in SSAP No. 36	No Change
87-30	Updated to refer to FAS 166 examples of when the transferor maintains effective control over transferred financial assets (rather than the example regarding put options originally provided in the EITF), updated to refer that FAS 140 is amended by FAS 166, and updated to note that FAS 166 removed the practicability exception for the requirement to measure proceeds of a sale at fair value.	N/A in INT 99-00	No Change
88-20	Updated to note that FAS 140 was amended by FAS 166. No reconsideration of the GAAP issue.	N/A in INT 99-00	No Change
88-22	Updated to note that FAS 140 was amended by FAS 166. No reconsideration of the GAAP issues.	Adopted in SSAP No. 91R	No Change Referenced as adopted within the SSAP to supersede SSAP No. 91R.
89-2	Not applicable in FASB Codification	Nullified by FAS 125 and partially nullified in FAS 140	No Change
90-18	Not applicable in FASB Codification	N/A in INT 99-00	No Change
92-2	Not applicable in FASB Codification	Reject in SSAP No. 18 & 91R	No Change
96-10	Updated to note that FAS 140 was amended by FAS 166. No reconsideration of the GAAP issues.	Rejected in SSAP No. 26	No Change
96-19	Updated to note that FAS 140 was amended by FAS 166. No reconsideration of the GAAP issue.	Adopted in SSAP No. 18, 91R and INT 99-14	No Change Guidance from INT 99-14 has been included in the SSAP to supersede SSAP No. 91R.
97-3	Updated to note that FAS 140 was amended by FAS 166. No reconsideration of the GAAP issue.	Reject in INT 99-00	No Change
98-8	Updated to note that FAS 140 was amended by FAS 166. No reconsideration of the GAAP issue.	Adopted in INT 99-22	No Change Guidance from INT 99-22 has been included in the

GAAP EITF	Summary of FAS 166 Revisions	SAP Status (Appendix D)	Recommendation
			SSAP to supersede SSAP No. 91R.
98-14	Updated to note that FAS 140 was amended by FAS 166. No reconsideration of the GAAP issue.	Reject in INT 00-10	No Change
98-15	Updated to note that FAS 140 was amended by FAS 166. Identifies that the guidance in paragraph 11 of FAS 166 shall be applied to each structured note upon transfer.	Reject INT 00-11	No Change
99-8	Updated to note that FAS 140 was amended by FAS 166. No reconsideration of the GAAP issue.	Adopt with modification in SSAP No. 86	No Change
99-20	<p>Updated to note that FAS 140 was amended by FAS 166. Also includes the following changes:</p> <ol style="list-style-type: none"> 1. Reference “beneficial interests obtained as proceeds” rather than “beneficial interests that continue to be held by a transferor”. 2. Revise guidance to use “fair value of the beneficial interest as of the date of transfer” rather than “the allocated carrying amount after application of the relative fair value allocation method” for paragraph 11 of EITF 99-20. 3. Deleted paragraph 14 of EITF 99-20. This guidance pertains to recognitions of unrealized gains or losses as interest income. 4. Deleted paragraph 16 of EITF 99-20. This guidance provided guidance for situations when it was not practicable to estimate the fair value of the beneficial interest at the initial transfer date. 5. Revised paragraphs 20 to discuss the removal of the concept of a QSPE. 	<p>Adopted in SSAP No. 43R</p> <p>The term “beneficial interests that continue to be held by a transferor” is used in SSAP No. 43R.</p> <p>Guidance from paragraph 11 of EITF 99-20 is included in SSAP No. 43R, paragraph 21.</p> <p>SSAP No. 43R provides guidance on recognition of interest income for beneficial interests.</p> <p>Guidance from paragraph 16 is duplicated in SSAP No. 43R, paragraph 24</p> <p>Paragraph 6.d. of SSAP No. 43R</p>	<p>Consideration of the revisions from FAS 166 to EITF 99-20 should occur.</p> <p>Recommends separate project to review this updated EITF for SSAP No. 43R.</p>

GAAP EITF	Summary of FAS 166 Revisions	SAP Status (Appendix D)	Recommendation
	<p>Also provides guidance from FAS 166 on the conditions that must be met for sale accounting.</p> <p>6. Revised paragraph 21 to reference FAS 167 (variable interest entities and consolidation).</p> <p>7. Revised paragraph 27 to delete the prior change to replace the term “retained interests” with “interests that continue to be held by a transferor”</p>	<p>addresses securitization transactions that are accounted for as sales under SSAP No. 91R.</p> <p>FAS 167 is still pending statutory accounting review.</p> <p>The phrase “interests that continue to be held by a transferor” is used in SSAP No. 43R.</p>	
02-9	Updated to reflect the revised terminology in FAS 166 as well as delete the issue and conclusion pertaining to qualified special purpose entities as the concept of a QSPE is no longer captured within FAS 166.	Although there is no impact to the statutory conclusion to adopt this EITF with modifications to statutory references, proposes the guidance in INT 04-21 be revised to reflect the revisions adopted from FAS 166.	Update INT 04-21, but do not change conclusion.
02-12	Nullified by FAS 166	Listed as No EITF Consensus	Update Appendix D to identify as nullified.