

Statutory Issue Paper No. 152

Short Sales

STATUS

Finalized June 9, 2016

Original SSAP: SSAP No. 103; Current Authoritative Guidance: SSAP No. 103R

Type of Issue:

Common Area

SUMMARY OF ISSUE

1. This issue paper provides explicit statutory accounting guidance for short sales in scope of *SSAP No. 103—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (SSAP No. 103), with reference added to the proposed guidance in *SSAP No. 86—Derivatives* (SSAP No. 86).

SUMMARY CONCLUSION

2. This issue paper proposes to substantively revise *SSAP No. 103—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (SSAP No. 103) (resulting in SSAP No. 103R) to incorporate guidance for short sales and securities borrowing transactions that do not meet sale criteria.

Substantive Revisions to SSAP No. 103R:

Short Sales

79. A short sale, as defined for statutory accounting, is the sale of a security that a selling reporting entity (seller) does not own at the time of sale or a sale which is consummated by the delivery of a security borrowed by, or for the account of, the seller. Short sales are normally settled by the delivery of a security borrowed by or on behalf of the seller. The seller later closes out the position by returning the borrowed security to the lender, typically by purchasing securities on the open market. If the price of the security rises, short sellers who buy it at the higher price will incur a loss.

80. In a "naked" short sale, the seller does not borrow or arrange to borrow the securities in time to make delivery to the buyer within the standard three-day settlement period (T+3). As a result, the seller fails to deliver securities to the buyer when delivery is due (known as a "failure to deliver" or "fail").

81. Consistent with GAAP guidance, short-sales generally do not meet the definition of a derivative unless a forward purchase or forward sale is involved. Even if a forward purchase or forward sale element is included, if the contract meets the regular-way security trade exception, it would not be subject to the derivative guidance.

82. State statutes or state laws may have restrictions regarding whether a reporting entity is permitted to sell securities short. In situations in which state regulations do not prohibit, or otherwise provide specific guidance, short-sale transactions shall be accounted for in accordance with this statement.

83. Selling a security short is an action by a reporting entity, which results with the reporting entity recognizing proceeds from the sale and an obligation to deliver the sold security. For statutory accounting purposes, obligations to deliver securities resulting from short sales shall be reported as contra-assets (negative assets) in the respective investment schedule for the type of

asset sold, with an investment code detailing the item as a short sale. The obligation (negative asset) shall be initially reflected at fair value, with changes in fair value recognized as unrealized gains and losses. These unrealized gains and losses shall be realized upon settlement of the short sale obligation. Interest on short sale positions shall be accrued periodically and reported as interest expense.

84. If short sales are supported by a securities borrowing transaction, the accounting and reporting guidelines in paragraphs 93-95 shall also be followed.

Disclosures

28.n. For reporting entities that have sold securities short within the reporting period, provide the following disclosures:

- i. For Unsettled Short Sale Transactions (outstanding at reporting date) – The amount of proceeds received and the fair value of the securities to deliver, with current unrealized gains and/or losses, and the expected settlement timeframe (number of days). This disclosure shall include the fair value of current transactions that were not settled within three days and the fair value of the short sales expected to be satisfied by a securities borrowing transaction. This disclosure shall be aggregated by security type. (For example, short sales of common stock shall be aggregated and reported together.)
- ii. For Settled Short Sale Transactions (settled during the reporting period) – The aggregate amount of proceeds received and the fair value of the security as of the settlement date with recognized gains and/or losses. This disclosure shall identify the aggregated fair value of settled transactions that were not settled within three-days and the fair value of transactions that were settled through a securities borrowing transaction.

The following are example disclosure templates. These are not proposed to be in SSAP No. 103, but upon adoption of the proposed revisions would be referred to the Blanks (E) Working Group for consideration as illustrations in the annual statement instructions.

Unsettled Short Sale Transactions (Outstanding as of Reporting Date)						
	Proceeds Received	Current Fair Value of Securities Sold Short	Unrealized Gain or Loss	Expected Settlement (# of Days)	Fair Value of Short Sales Exceeding (or expected to exceed) 3 Settlement Days	Fair Value of Short Sales Expected to be Settled by Secured Borrowing
Bonds						
Common Stock						
Totals						

Short Sales

Settled Short Sale Transactions					
	Proceeds Received	Current Fair Value of Securities Sold Short	Realized Gain or Loss on Transaction	Fair Value of Short Sales that Exceeded 3 Settlement Days	Fair Value of Short Sales Settled by Secured Borrowing
Bonds					
Common Stock					
Totals					

The following proposed revisions provide explicit “secured borrowing” guidance within SSAP No. 103:

Secured Borrowings and Collateral

19. A debtor may grant a security interest in certain assets to a lender (the secured party) to serve as collateral for its obligation under a borrowing, with or without recourse to other assets of the debtor. An obligor under other kinds of current or potential obligations, for example, interest rate swaps, also may grant a security interest in certain assets to a secured party. If collateral is transferred to the secured party, the custodial arrangement is commonly referred to as a pledge. Secured parties sometimes are permitted to sell or repledge (or otherwise transfer) collateral held under a pledge. The same relationships occur, under different names, in transfers documented as sales that are accounted for as secured borrowings (paragraph 14). The accounting for 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. (Paragraphs 85-121 provide application guidance for securities lending, securities borrowing, and repurchase agreements.)

- a. If the secured party (transferee) or its agent has the right by contract or custom to sell or repledge the collateral, then the debtor (transferor) shall report that asset in its balance sheet.
- b. If the secured party (transferee) sells collateral pledged to it, it shall recognize the proceeds from the sale and its obligation to return the collateral. The sale of the collateral is a transfer subject to the provisions of this statement.
- c. If the debtor (transferor) defaults under the terms of the secured contract and is no longer entitled to redeem the pledged asset, it shall derecognize the pledged asset, and the secured party (transferee) shall recognize the collateral as its asset initially measured at fair value or, if it has already sold the collateral, derecognize its obligation to return the collateral.
- d. Except as provided in paragraph 19.c., the debtor (transferor) shall continue to carry the collateral as its asset, and the secured party (transferee) shall not recognize the pledged asset.

Securities Borrowing Transactions – Sale Criteria is Not Met (Secured Borrowing)

93. In addition to being the transferor of securities being loaned and receiving collateral under a securities lending arrangement, reporting entities may be a transferee of borrowed securities, and provide collateral under a securities borrowing arrangement.

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.

94. A transferee that sells borrowed securities shall recognize the proceeds from the sale of the securities and an obligation, at fair value, to return the borrowed securities to the transferor. If cash proceeds from the sale of borrowed securities are invested into other assets, or if non-cash proceeds are received from the sale, the assets acquired shall be shown as assets on the reporting entity's (transferee's) financial statements and accounted and reported in accordance with the SSAP for the type of assets acquired. For all instances in which the transferee sells borrowed securities, the reporting entity shall designate restricted assets equivalent to the fair value of the obligation to return the borrowed securities to the transferor.

95. A reporting entity transferee that borrows securities captured under this section (sale criteria is not met) and uses the borrowed securities to settle a short sale transaction shall eliminate the contra-asset recognized under the short sale (paragraph 83) and establish a liability to return the borrowed security. The liability to return the borrowed security shall remain on the books until the reporting entity acquires the security to return to the transferor. The accounting / reporting for the short sale and the secured borrowing transaction shall be separately reflected within the financial statements. As such, use of the borrowed asset for the short sale would be similar to recognizing "proceeds" from selling a borrowed asset, as such, if the borrowed asset is used to settle a short sale, the reporting entity shall recognize the borrowed asset and the obligation to return the asset under the secured borrowing agreement until the asset has been returned under the secured borrowing transaction.

126132. This statement also adopts FASB Staff Position 140-3, Accounting for Transfers of Financial Assets and Repurchase Financing Transactions (FSP FAS 140-3), ASU 2011-03, Transfers and Servicing (Topic 860), Reconsideration of Effective Control for Repurchase Agreements 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, FASB EITF No. 96-19, Debtor's Accounting for a Modification or Exchange of Debt Instruments, as amended by FAS 166, and FASB EITF No. 01-7, Creditor's Accounting for a Modification or Exchange of Debt Instruments. This statement adopts FASB ASC guidance for short sales with modification to require the short sale obligation to be reflected as a contra-asset rather than a liability. Also, the recognition of unrealized gains and losses is consistent with statutory accounting recognition, rather than directly to net income under GAAP. (The adopted ASC guidance includes guidance reflected in 942-405-25-1 through 25-2, 942-405-35-1, and 942-405-45-1. Additionally, the guidance in ASC 815-10-55-57 through 59 and 815-10-15-15 through 17, which addresses whether short sales are within the scope of SSAP No. 86, and the definition of a regular-way security trade is also adopted.)

New Illustration - # 5 - Short Sale Settled with Securities Borrowed Under a Secured Borrowing Agreement (Does not Meet Sales Criteria): (Note: This transaction is intended to present a basic short sales settled by a secured borrowing and does not detail the recognition of gains / losses or interest expense. If the WG/IPs desire illustration for clarity, staff can incorporate those elements.)

Cash
Contra-Asset – Securities Sold Short

To recognize the cash received and the obligation to delivery securities under a short-sale.

Receivable Under Securities Loan Agreement (Borrow Securities)
Cash

To recognize transfer of cash under the security borrowing agreement, with recognition of a receivable for the return. The actual securities borrowed under the agreement (as sale accounting criteria is not met) shall not be recognized on the financial statements.

Borrowed Asset ("Proceeds" of selling asset)
Obligation to return Securities Borrowed

To recognize the use of the borrowed security to settle a short-sale transaction. This transaction would be similar to receiving "proceeds" from the sale of a borrowed security – but instead of "cash" recognition of the actual borrowed asset, with an obligation to return the borrowed securities.

Contra-Asset – Securities Sold Short
Borrowed Asset

Close out the short sale by delivering the asset to the counterparty.

Obligation to Return Securities Borrowed
Cash

Eliminate the liability to return the borrowed asset by purchasing the asset and re-establishing it as off-balance sheet collateral for the securities borrowing transaction.

Cash
Receivable Under Securities Loan Agreement

To recognize the return of cash collateral from the transferor and the unwinding of the securities borrowing agreement.

In addition to the revisions above, the following terms will be added in the SSAP No. 103 Glossary:

Short Sale - A short sale, as defined for statutory accounting, is the sale of a security that a selling reporting entity (seller) does not own at the time of sale or a sale which is consummated by the delivery of a security borrowed by, or for the account of, the seller.

Naked Short Sale – A short sale in which the seller does not borrow or arrange to borrow the securities in time to make delivery to the buyer within the standard three-day settlement period (T+3). As a result, the seller fails to deliver securities to the buyer when delivery is due (known as a "failure to deliver" or "fail").

Regular-Way Security Trade - Contracts that provide for delivery of a security within a period of time after the trade date generally established by regulations or conventions in the marketplace or exchange in which it is being executed.

Revisions to SSAP No. 86—Derivative Instruments

61. This statement adopts U.S. GAAP guidance for determining whether short sales are considered a derivative instrument including the regular-way security trade exception. The adopted GAAP guidance includes ASC 815-10-55-57 through 59 and 815-10-15-15 through 17. As a result, short sales shall generally be accounted for in accordance with SSAP No. 103—Short Sales. Contracts that may resemble "short sales" but do not meet the criteria may be in scope of SSAP No. 86 as forward contracts.

DISCUSSION

3. During the 2015 Spring National Meeting, an agenda item was initially presented to the Statutory Accounting Principles (E) Working Group to address questions on whether guidance for short sales shall be incorporated within statutory accounting principles. This agenda item identified that there is no explicit

guidance for short sales within statutory accounting, and prior references to the derivative guidance for income generation transactions (which are required to be “covered”) is inconsistent with the GAAP guidance for the treatment of short sales.

4. In determining whether to proceed with guidance on short sales, it was identified that current statutory accounting guidance does not address the accounting of “short sales.” Historically, questions received regarding the statutory accounting treatment for short sales have generally been addressed by directing the inquirer to the state of domicile, with notation that a number of states prohibit short sales in their state laws. Recently, the amount of questions have increased, with inquiries on whether statutory accounting guidance should address these transactions, and if these actions should be in scope of *SSAP No. 103—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (SSAP No. 103) or *SSAP No. 86—Derivatives* (SSAP No. 86).

5. In response to the questions received, an agenda item was drafted detailing the statutory accounting derivative guidance for income generation transactions and the U.S. GAAP and SEC guidance for short sales. As a result of the research completed for this agenda item, it was identified that short sales are often supported by a securities borrowing transaction. It was also noted that the current statutory accounting guidance was limited on securities borrowing transactions if borrowing securities. (Statutory guidance is detailed for securities lending transactions (reporting entity lends securities) that do not meet sale criteria, but is not explicit for securities borrowing transactions.)

6. During a June 17, 2015 conference call, the Working Group considered interested party comments from the exposure of the agenda item regarding statutory accounting guidance for short sales. Based on interested party feedback supporting the use of state laws for the restriction of short sales, the Working Group directed the preparation of an issue paper to incorporate statutory guidance for short sales and securities borrowing transactions that do not meet sale criteria.

7. In the agenda item it was identified that the current statutory accounting guidance for “receivable for securities” allows a 15-day settlement period for admittance purposes, whereas, SEC guidance considers a three-day settlement period to be an industry standard (T+3). Although nonadmitted guidance is a statutory-specific concept, settlement after T+3, particularly in terms of short-sales, results with the transaction being considered “naked” and subject to greater scrutiny. As a result of the discussion, a proposal to review the settlement guidance for “receivables for securities” – to assess whether a shorter timeframe for admittance should be implemented for statutory purposes - was directed to be addressed in a separate agenda item.

Definition of Short Sales

8. The SEC defines a short sale as “A short sale is the sale of a stock that an investor does not own or a sale which is consummated by the delivery of a stock borrowed by, or for the account of, the investor.” The FASB defines short sales as “Sales of securities that the seller does not own at the time of sale.” The FASB explicitly excludes short sales from the scope of their debt and equity investment guidance as short sales are obligations and not investments.

9. For purposes of statutory accounting, the definition of a short sale is proposed to incorporate elements from both the FASB and SEC definitions. Although the SEC definition indicates that these transactions involve “stock,” it has been identified that short-sales have occurred with debt instruments. As such, the definition proposed for statutory accounting uses the broader GAAP reference for “securities that an investor does not own” but also includes the SEC guidance to include “a sale which is consummated by the delivery of a security borrowed by, or for the account of, the investor.”

Accounting for Short Sales

10. The accounting guidance detailed in this issue paper for short sales is modified from the GAAP guidance. Under GAAP, the obligations for short-sales are reflected as liabilities, and are generally labeled in the financial statements as “securities sold, not yet purchased.” Consistent with the prior Statutory Accounting Principles (E) Working Group decision for the reporting of negative cash, this issue paper details that short-sales shall be reported as negative assets in the statutory balance sheet. As detailed in *Issue Paper No. 2—Definition of Cash* (Issue Paper No. 2), paragraph 7, the treatment of recording negative cash as a negative asset in the statutory balance sheet follows the concept of conservatism as many regulatory limitations are calculated based on the total admitted assets.

11. If short sales followed the GAAP accounting and were reported as a liability, the overall surplus presentation would still be correct (proceeds received and the liability would both be reflected gross), however, the admitted asset portion (as it would include the gross proceeds received from the sale, but not a deduction for the sold security) would not be reflective of the actual assets available. With the guidance to reflect the obligation to provide a security as a negative asset, the overall surplus position is still correct, and the assets reported on the statutory balance sheet as of the reporting date would reflect the assets available for policyholder claims after satisfying the delivery of the security sold short.

12. Pursuant to the SEC guidelines to prevent classification as a “naked short sale”, the seller must arrange to make delivery to the buyer within the standard three-day settlement period (T+3). The short-duration of this obligation further supports the reporting as a negative asset (rather than as a liability), as reporting as a negative asset would prevent scenarios in which short sales are conducted immediately prior to a reporting date to arbitrarily increase assets.

13. From preliminary information received, staff does not believe that there are significant instances of securities sold short, however, it has been communicated that instances of these transactions have previously been reported as negative amounts on the investment schedules, therefore, this guidance may not result in changes for companies that have previously engaged in short sales.

Short Sale Disclosures

14. The disclosure guidance is intended to provide information to the regulators regarding the outstanding short sale transactions at each reporting date, as well as information regarding the short sale transactions that occurred during a reporting period. As the extent of overall transactions and the resulting impact to the financial statements is perceived to be the information necessary for assessment, the disclosures are proposed to be completed on an aggregate basis, by financial instrument type.

Securities Borrowing Transactions

15. Pursuant to U.S. GAAP guidance, securities lending transactions are initiated by broker-dealers or other financial institutions that need specific securities to cover a short sale. In reviewing the possibility to incorporate short sale guidance within statutory accounting principles, it was identified that securities borrowing guidance, for transactions accounted for as secured borrowings, was not detailed within statutory accounting principles. The guidance in SSAP No. 103 focuses on collateral received (and the reinvestment of that collateral) from the lending of securities, with limited guidance for the borrowing of securities when sales criteria were met. Due to the limited guidance, the Form A recommended inclusion of securities borrowing guidance to address these scenarios.

16. Consistent with U.S. GAAP, this issue paper has incorporated guidance to clarify that the proceeds provided to borrow securities (cash and non-cash securities for which the transferor can sell or repledge) are removed from the transferee’s financial statements with an offsetting receivable reflecting the return of the cash/non-cash securities under the securities borrowing agreement. Also consistent with

U.S. GAAP, the securities borrowed under a secured-borrowing arrangement are not reflected on the reporting entity's financial statements. However, if the borrowed securities are sold by the reporting entity (transferee), the reporting entity would recognize the proceeds from the sale as well as an obligation to return the borrowed security to the transferor.

17. This issue paper provides information to detail how a borrowed security utilized to satisfy a short sale obligation would be reflected in statutory accounting. Although that guidance is not explicitly detailed under U.S. GAAP, with the exception that the statutory guidance utilizes a contra-asset (instead of a liability) for short sale recognition, the guidance is intended to be consistent with how the transactions would occur under U.S. GAAP.

EFFECTIVE DATE

18. Upon adoption of this issue paper, the NAIC will release a substantively revised Statement of Statutory Accounting Principles (SSAP) for comment. 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.

RELEVANT STATUTORY ACCOUNTING AND GAAP GUIDANCE

Statutory Accounting

19. *SSAP No. 2—Cash, Drafts and Short-Term Investments*

Treatment of Negative Cash Balances

5. If a reporting entity has multiple cash accounts, the net amount of all accounts shall be reported jointly. Cash accounts with positive balances shall not be reported separately from cash accounts with negative balances. If in the aggregate, the reporting entity has a net negative cash balance, it shall be reported as a negative asset and shall not be recorded as a liability.

Rationale from *Issue Paper No. 2—Cash, Drafts and Short-Term Investments*:

7. The treatment of recording negative cash as a negative asset in the statutory balance sheet follows the concept of conservatism as many regulatory limitations are calculated based upon total admitted assets.

20. *SSAP No. 103—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (SSAP No. 103) provides the accounting for transactions accounted for as secured borrowings and securities lending transactions. SSAP No. 103 adopts GAAP with modifications for statutory-specific treatment, specifically for collateral requirements and reinvested collateral from securities lending transactions. (This guidance is not duplicated in this issue paper.)

Generally Accepted Accounting Principles

21. The current GAAP guidance in the Accounting Standards Codification (ASC) is identified below along with the original source of the ASC guidance and the related statutory accounting action. The related excerpts from the GAAP guidance are then included.

- a. *ASC 942-405 – Financial Services – Depository and Lending – Liabilities*

- *SOP 01-06, Statement of Position 01-6, Accounting by Certain Entities (Including Entities With Trade Receivables) That Lend to or Finance the Activities of Others – Rejected as not applicable.*
 - b. *ASC 815-10 & 815-15 – Derivatives and Hedging – Scope and Implementation Guidance*
 - *FAS 133, Accounting for Derivative Instruments and Hedging Activities – Adopted with modification in SSAP No. 86.*
 - c. *ASC 860-30 – Transfers and Servicing, Secured Borrowing and Collateral*
 - *FAS 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, A Replacement of FAS 125 – Adopted with modification in SSAP No. 103.*
 - *QA 140 (FASB Staff Implementation Guide) – Not reviewed for statutory accounting*
 - *ASU 2014-11, Transfers and Servicing, Repurchase-to-Maturity Transactions, Repurchase Financings and Disclosures – Pending statutory accounting review*
22. FASB Codification 942 Financial Services—Depository and Lending – 405 Liabilities provides the accounting for short sales. As a note, the obligations incurred are reported as liabilities at fair value.

Short Sales of Securities (SOP 01-06)

942-405-25-1 The obligations incurred in short sales shall be reported as liabilities. Such liabilities are generally called securities sold, not yet purchased.

942-405-25-2 See paragraph 815-10-55-57 for additional guidance concerning short sales.

942-405-35-1 The obligations incurred in short sales shall be subsequently measured at fair value through the income statement at each reporting date. Interest on the short positions shall be accrued periodically and reported as interest expense.

942-405-45-1 The fair value adjustment on short sales of securities shall be classified in the income statement with gains and losses on securities.

23. FASB Codification 815 Derivatives and Hedging – 10 Overall - 55 Implementation Guidance and Illustrations identifies that short sales are generally not considered derivatives.

Short Sales (Sales of Borrowed Securities) (FAS 133)

815-10-55-57 The following discussion applies only to short sales with the characteristics described. Some groups of transactions that are referred to as short sales may have different characteristics. If so, a different analysis would be appropriate, and other derivative instruments may be involved. Short sales (sales of borrowed securities) typically involve all of the following activities:

- a. Selling a security (by the short seller to the purchaser)
- b. Borrowing a security (by the short seller from the lender)
- c. Delivering the borrowed security (by the short seller to the purchaser)
- d. Purchasing a security (by the short seller from the market)
- e. Delivering the purchased security (by the short seller to the lender).

Those five activities involve three separate contracts.

815-10-55-58 A contract that distinguishes a short sale involves activities in (b) and (e) in the preceding paragraph, borrowing a security and replacing it by delivering an identical security. Such a contract has two of the three characteristics of a derivative instrument. The settlement is based on an underlying (the price of the security) and a notional amount (the face amount of the security or the number of shares), and the settlement is made by delivery of a security that is readily convertible to cash. However, the other characteristic, no initial net investment or an initial net investment that is smaller by more than a nominal amount than would be required for other types of contracts that would be expected to have a similar response to changes in market factors, is not present. (See paragraphs 815-10-15-94 through 15-96.) The borrowed security is the lender's initial net investment in the contract. **Consequently, the contract relating to activities in (b) and in (e) in the preceding paragraph is not a derivative instrument.**

815-10-55-59 The other two contracts (one for activities in paragraph 815-10-55-57[a] and in paragraph 815-10-55-57[c] and the other for activity in paragraph 815-10-55-57[d]) **are routine and do not generally involve derivative instruments. However, if a forward purchase or forward sale is involved, and the contract does not qualify for the exception in paragraphs 815-10-15-15 through 15-17, it is subject to the requirements of this Subtopic.**

24. FASB Codification 815 Derivatives and Hedging - 10 Overall - 15 Scope and Scope Exceptions provides the definition for a “regular-way security trade”. As discussed in 815-10-55-59, even if a forward purchase or forward sale is involved with a short sale, if the contract qualifies as a regular-way security trade exception, then it is not subject to the derivative guidance.

Regular-Way Security Trades

815-10-15-15 Regular-way security trades are defined as contracts that provide for delivery of a security within the period of time (after the trade date) generally established by regulations or conventions in the marketplace or exchange in which the transaction is being executed. For example, a contract to purchase or sell a publicly traded equity security in the United States customarily requires settlement within three business days. If a contract for purchase of that type of security requires settlement in three business days, the regular-way security trades scope exception applies, but if the contract requires settlement in five days, the regular-way security trades scope exception does not apply unless the reporting entity is required to account for the contract on a trade-date basis.

815-10-15-16 Except as provided in (a) in the following paragraph, a contract for an existing security does not qualify for the regular-way security trades scope exception if either of the following is true:

- a. It requires or permits net settlement (as discussed in paragraphs 815-10-15-100 through 15-109).
- b. A market mechanism exists to facilitate net settlement of that contract (as discussed in paragraphs 815-10-15-110 through 15-118).

815-10-15-17 The scope exception for regular-way security trades applies only to a contract that requires delivery of securities that are **readily convertible to cash** except that the scope exception also shall or may apply in any of the following circumstances:

- a. If an entity is required, or has a continuing policy, to account for a contract to purchase or sell an existing security on a trade-date basis, rather than a settlement-date basis, and thus recognizes the acquisition (or disposition) of the security at the inception of the contract, then the entity shall apply the regular-way security trades scope exception to that contract.

- b. If an entity is required, or has a continuing policy, to account for a contract for the purchase or sale of when-issued securities or other securities that do not yet exist on a trade-date basis, rather than a settlement-date basis, and thus recognizes the acquisition or disposition of the securities at the inception of the contract, that entity shall apply the regular-way security trades scope exception to those contracts.
- c. Contracts for the purchase or sale of when-issued securities or other securities that do not yet exist, except for those contracts accounted for on a trade-date basis, are excluded from the requirements of this Subtopic as a regular-way security trade only if all of the following are true:
 - 1. There is no other way to purchase or sell that security.
 - 2. Delivery of that security and settlement will occur within the shortest period possible for that type of security.
 - 3. It is probable at inception and throughout the term of the individual contract that the contract will not settle net and will result in physical delivery of a security when it is issued. (The entity shall document the basis for concluding that it is probable that the contract will not settle net and will result in physical delivery.)

25. FASB Codification 860-10 – Transfers and Servicing, Overall provides guidance for securities lending transactions

> > Securities Lending Transactions

860-10-05-16 (FAS 140 / SSAP No. 103, paragraph 79) Securities lending transactions are 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 custodians or other **agents** commonly carry out securities lending activities on behalf of clients.

860-10-05-17 (FAS 140 / SSAP No. 103, paragraph 79) 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.

860-10-05-18 (FAS 140 / SSAP No. 103, paragraph 79) 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.

26. FASB Codification 860-30 – Transfers and Servicing, Secured Borrowing and Collateral provides guidance for secured borrowing transactions (transactions which do not meet sale criteria).

860-30-25-1 This Section provides guidance on the recognition of transfers of financial assets as secured borrowings with a pledge of collateral. It addresses the following areas:

- a. Cash collateral
- b. Noncash collateral
- c. Cash or securities received as proceeds

d. Sales of collateral received.

860-30-25-2 (FAS 140 / SSAP No. 103, paragraph 14) The transferor and transferee shall account for a transfer as a secured borrowing with pledge of collateral in either of the following circumstances:

- a. 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 860-10-40-5
- b. If a transfer of a portion of an entire financial asset does not meet the definition of a participating interest.

The transferor shall continue to report the transferred financial asset in its statement of financial position with no change in the asset's measurement (that is, basis of accounting).

> Cash Collateral

860-30-25-3 (FAS 140 / SSAP No. 103, paragraph 82) Transfers of financial assets in exchange for cash collateral cannot be distinguished from borrowing cash. Further, because cash is fungible, it is impossible to determine whether it has been used by the secured party. Accordingly, all cash collateral shall be recorded as an asset by the party receiving it (the secured party), together with a liability for the obligation to return it to the payer (obligor), whose asset is a receivable.

860-30-25-4 (FAS 140 / Not In SSAP No. 103) Cash collateral used, for example, in securities lending transactions (see paragraphs 860-10-05-16 through 05-18) shall be derecognized by the obligor and recognized by the secured party, not as collateral but rather as proceeds of either a sale or a borrowing. See paragraphs 860-30-25-6 through 25-9 for further discussion of recognition of cash and noncash collateral as proceeds of a transfer.

> Noncash Collateral

860-30-25-5 (FAS 140 / SSAP No. 103, paragraph 19) The accounting for noncash collateral by the obligor (or debtor) and the secured party depends on whether the secured party has the right to sell or repledge the collateral and on whether the obligor has defaulted. Noncash collateral shall be accounted for as follows:

- a. If the secured party (transferee) has the right by contract or custom to sell or repledge the collateral, then paragraph 860-30-45-1 requires that the obligor (transferor) reclassify that asset and report that asset in its statement of financial position separately (for example, as security pledged to creditors) from other assets not so encumbered.
- 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 Topic.
- c. If the obligor (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 as required by paragraph 860-30-40-1 and the secured party (transferee) shall recognize the collateral as its asset. (See paragraph 860-30-30-1 for guidance on the secured party's initial measurement of collateral recognized. See paragraph 860-30-40-1 for further guidance if the debtor has sold the collateral.)
- d. Except as provided in paragraph 860-30-40-1 the obligor (transferor) shall continue to carry the collateral as its asset, and the secured party (transferee) shall not recognize the pledged asset.

> **Cash or Securities Received as Proceeds**

860-30-25-6 Paragraph 860-10-55-55A discusses securities lending transactions in which the criteria in paragraph 860-10-40-5 for a sale are met. The following guidance relates to securities lending or similar transactions in which a transferor (lender) transfers securities and receives either cash or securities as collateral and the transfer does not meet the sale criteria in that paragraph.

860-30-25-7 (*FAS 140 / SSAP No. 103, paragraph 81*) Many securities lending transactions are accompanied by an agreement that both entitles and obligates the transferor to repurchase or redeem the transferred financial assets before their maturity. Paragraph 860-10-40-24 states that 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 860-10-40-5(c)(1), if all of the conditions in paragraph 860-10-40-24 are met. Those transactions shall be accounted for as secured borrowings, in which either cash or securities that the holder is permitted by contract or custom to sell or repledge received as collateral are considered the amount borrowed, the securities loaned are considered pledged as collateral against the cash borrowed and reclassified as set forth in paragraph 860-30-25-5(a), and any rebate paid to the transferee of securities is interest on the cash the transferor is considered to have borrowed.

860-30-25-8 (*FAS 140 / Partly in SSAP No. 103, paragraph 82*) In a securities lending transaction, 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. Cash collateral or securities received as collateral that a securities lender is permitted to sell or repledge are the proceeds of a borrowing secured by them. 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. See Example 1 (paragraph 860-30-55-1) for an illustration of a securities lending transaction that is accounted for as a secured borrowing in which cash collateral is transferred.

860-30-25-9 (*QA 140 / Not in SSAP No. 103*) As noted in paragraphs 860-30-25-4 and 860-30-25-8, the collateral accounting provisions do not apply to cash, or securities that can be sold or pledged for cash, received as so-called collateral for noncash financial assets, for example, in certain securities lending transactions. Such cash or securities that can be sold or pledged for cash are accounted for as proceeds of either a sale or a borrowing.

> **Sales of Collateral Held**

860-30-25-10 (*FAS 140 / Not in SSAP No. 103*) Obligations to return to the transferor assets borrowed and then sold have sometimes been effectively recognized as part of a liability for securities sold but not yet purchased, and this Section does not require any change in that practice.

860-30-30 – Initial Measurement

> **Noncash Collateral**

860-30-30-1 (*FAS 140 / Not in SSAP No. 103*) Noncash **collateral** recognized by the secured party as its asset under paragraph 860-30-25-5(c) that the secured party has not already sold shall be initially measured at fair value.

860-30-35 – Subsequent Measurement

860-30-35-1 This Section provides subsequent measurement guidance for the following assets and liabilities related to **transfers** that are accounted for as secured borrowings:

- a. Pledged assets required to be reclassified
- b. Obligation to return transferred **collateral**.

> Pledged Assets Required to Be Reclassified

860-30-35-2 (QA 140 / Not in SSAP No. 103) A **transferor** that has transferred collateral that must be reclassified in accordance with paragraph 860-30-25-5(a) (for example, as securities pledged to creditors) shall not change its measurement of that collateral. The transferor shall follow the same measurement principles as before the transfer. For example, securities reclassified from the available-for-sale category to securities pledged to creditors should continue to be measured at fair value, with changes in fair value reported in comprehensive income, while debt securities reclassified from the held-to-maturity category to securities pledged to creditors should continue to be measured at amortized cost. See Topic 320 for guidance related to measurement of investments in securities classified as available for sale and held to maturity.

> Obligation to Return Transferred Collateral

860-30-35-3 (QA 140 / Not in SSAP No. 103) This Section does not provide specific guidance on the subsequent measurement of the obligation to return transferred collateral. The liability to return the collateral shall be measured in accordance with other relevant accounting guidance. Paragraph 942-405-35-1 requires that a bank or savings institution that, as **transferee**, sells transferred collateral subsequently measure that liability like a short sale at fair value.

860-30-40 – Derecognition

860-30-40-1 (FAS 140 / Not in SSAP No. 103) In circumstances where an obligor (transferor) transfers noncash collateral in a secured borrowing and the obligor (transferor) defaults under the terms of the secured contract and is no longer entitled to redeem the pledged asset, the obligor shall derecognize the pledged asset. If the secured party has already sold the collateral, the secured party shall derecognize its obligation to return the collateral.

860-30-40-2 Otherwise paragraph 860-30-25-5(c) addresses the secured party's accounting for the collateral. (*Paragraph 860-30-25-5c is paragraph 19c in SSAP No. 103*)

860-30-45 – Other Presentation Matters

860-30-45-1 (FAS 140 / Mostly in SSAP No. 103, *paragraph 19a*) If the secured party (transferee) has the right by contract or custom to sell or repledge the collateral, then the obligor (transferor) shall reclassify that asset and report that asset in its statement of financial position separately (for example, as security pledged to creditors) from other assets not so encumbered.

860-30-45-2 (QA 140 / Not in SSAP No. 103) Liabilities incurred by either the secured party or obligor in securities borrowing or resale transactions shall be separately classified.

860-30-45-3 (QA 140) This Section does not specify the classification or the terminology to be used to describe the following:

- a. Pledged assets reclassified by the transferor of securities loaned or transferred under a repurchase agreement accounted for as a collateralized borrowing if the transferee is permitted to sell or repledge those securities
- b. Liabilities incurred by either the secured party or obligor in securities borrowing or resale transactions.

Example 1 (see paragraph 860-30-55-1) illustrates possible classifications and terminology.

860-30-50 – Disclosure

860-30-50-1A An entity shall disclose all of the following for **collateral**:

- a. If the entity has entered into repurchase agreements or securities lending transactions, it shall disclose its policy for requiring collateral or other security. (*SSAP No. 103, paragraph 28.a.i*)
- b. As of the date of the latest statement of financial position presented, both of the following:
 1. The carrying amount and classifications of both of the following: (*SSAP No. 103, paragraph 28.a.ii*)
 - i. Any assets pledged as collateral that are not reclassified and separately reported in the statement of financial position in accordance with paragraph 860-30-25-5(a)
 - ii. Associated liabilities.
 2. Qualitative information about the relationship(s) between those assets and associated liabilities; for example, if assets are restricted solely to satisfy a specific obligation, a description of the nature of restrictions placed on those assets. (*SSAP No. 103, paragraph 28a.ii*)
- c. If the entity has accepted collateral that it is permitted by contract or custom to sell or repledge, it shall disclose all the following: (*SSAP No. 103, paragraph 28.a.iii*)
 1. The fair value as of the date of each statement of financial position presented of that collateral
 2. The fair value as of the date of each statement of financial position presented of the portion of that collateral that it has sold or repledged
 3. Information about the sources and uses of that collateral.

For overall guidance on Topic 860's disclosures, see Section 860-10-50.

860-30-50-7 (ASU 2014-11) To provide an understanding of the nature and risks of short-term collateralized financing obtained through repurchase agreements, securities lending transactions, and repurchase-to-maturity transactions, that are accounted for as secured borrowings at the reporting date, an entity shall disclose the following information for each interim and annual period about the collateral pledged and the associated risks to which the transferor continues to be exposed after the transfer:

- a. A disaggregation of the gross obligation by the class of collateral pledged. An entity shall determine the appropriate level of disaggregation and classes to be presented on the basis of the nature, characteristics, and risks of the collateral pledged.
 1. Total borrowings under those agreements shall be reconciled to the amount of the gross liability for repurchase agreements and securities lending transactions disclosed in accordance with paragraph 210-20-50-3(a) before any adjustments for offsetting. Any difference between the amount of the gross obligation disclosed under this paragraph and the

amount disclosed in accordance with paragraph 210-20-50-3(a) shall be presented as reconciling item(s).

- b. The remaining contractual maturity of the repurchase agreements, securities lending transactions, and repurchase-to-maturity transactions. An entity shall use judgment to determine an appropriate range of maturity intervals that would convey an understanding of the overall maturity profile of the entity's financing agreements.
- c. A discussion of the potential risks associated with the agreements and related collateral pledged, including obligations arising from a decline in the fair value of the collateral pledged and how those risks are managed.

860-30-50-8 (*ASU 2013-01 / SSAP No. 64, paragraph 6*) A reporting entity also shall disclose the information required by paragraphs 210-20-50-1 through 50-6 for both of the following that are either offset in accordance with Section 210-20-45 or subject to an enforceable master netting arrangement or similar agreement:

- a. Recognized repurchase agreements accounted for as a collateralized borrowing and reverse repurchase agreements accounted for as a collateralized borrowing
- b. Recognized securities borrowing and securities lending transactions.

860-30-60 – Relationships

860-30-60-1 (*FIN 41 / SSAP No. 64*) For the conditions that must be met for an entity to be permitted to offset amounts recognized as payables under repurchase agreements accounted for as collateralized borrowings and amounts recognized as receivables under reverse repurchase agreements accounted for as collateralized borrowings, see paragraphs 210-20-45-11 through 45-12.