

**Statement of Statutory Accounting Principles No. 18****Transfers and Servicing of Financial Assets and Extinguishments of Liabilities****STATUS**

Type of Issue:	Common Area
Issued:	Initial Draft
Effective Date:	January 1, 2001
Affects:	No other pronouncements
Affected by:	Superseded by SSAP No. 91R
Interpreted by:	INT 99-00, INT 99-02, INT 99-14, INT 99-21, INT 99-22, INT 01-04, INT 01-31, INT 03-05

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## Transfers and Servicing of Financial Assets and Extinguishments of Liabilities

### SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for accounting for transfers and servicing of financial assets and extinguishments of liabilities. This statement discusses generalized situations. Facts and circumstances and specific contracts need to be considered carefully in applying this statement.

2. Except as addressed in this statement and in other statements (including, but not limited to, *SSAP No. 15—Debt and Holding Company Obligations* (SSAP No. 15), *SSAP No. 25—Accounting for and Disclosures about Transactions with Affiliates and Other Related Parties*, *SSAP No. 26—Bonds, Excluding Loan-Backed and Structured Securities*, *SSAP No. 30—Investments in Common Stock (excluding investments in common stock of subsidiary, controlled, or affiliated entities)*, *SSAP No. 32—Investments in Preferred Stock (including investments in preferred stock of subsidiary, controlled, or affiliated entities)*, *SSAP No. 42—Sale of Premium Receivables* (SSAP No. 42), *SSAP No. 43—Loan-backed and Structured Securities*, *SSAP No. 45—Repurchase Agreements, Reverse Repurchase Agreements and Dollar Repurchase Agreements* (SSAP No. 45), and *SSAP No. 33—Securitization* (SSAP No. 33)), transfers and servicing of financial assets and extinguishments of liabilities shall be accounted for in accordance with *FASB Statement No. 125, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (FAS 125).

### SUMMARY CONCLUSION

3. Except as discussed in paragraph 35, 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 12 and 13);
  - b. Either (i) each transferee obtains the right, free of conditions that constrain it from taking advantage of that right (see paragraph 14), to pledge or exchange the transferred assets or (ii) the transferee is a qualifying special-purpose entity as defined in paragraph 9 of SSAP No. 33 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 14), to pledge or exchange those interests; 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 15-17) or (ii) an agreement that entitles the transferor to repurchase or redeem transferred assets that are not readily obtainable (see paragraph 18).
4. Upon completion of any transfer of financial assets, the transferor shall:
- a. Continue to carry in its balance sheet any retained interest in the transferred assets, including, if applicable, beneficial interests in assets transferred to a qualifying special-purpose entity in a securitization (see SSAP No. 33), and retained undivided interests (see paragraph 20); and

- b. Allocate the previous carrying amount between the assets sold, if any, and the retained interests, if any, based on their relative fair values at the date of transfer (see paragraphs 19 and 20).
5. Upon completion of a transfer of assets that satisfies the conditions to be accounted for as a sale (see paragraph 3), 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 retained by the reporting entity, if any, and the securities representing beneficial interests not retained, 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 retained beneficial interests in the assets (e.g., loan-backed securities);
  - d. Recognize all additional assets obtained (i.e., other than the securities representing retained beneficial interests which are recorded in accordance with 5 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; and
  - f. For reporting entities required to maintain an Interest Maintenance Reserve (IMR), the accounting for realized 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 gains and losses shall be reported as net realized capital gains or losses in the statement of income.
6. The transferee shall recognize all assets obtained and any liabilities incurred, and initially measure them at fair value (in aggregate, presumptively the price paid).
7. Repurchase agreements, reverse repurchase agreements, and dollar repurchase agreements shall meet the definition of SSAP No. 45. 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 and disclosed as required by paragraph 37. 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.
8. 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 3, or (b) is a sale of receivables with recourse (see paragraph 35); the transferor and transferee shall account for the transfer as a secured borrowing with pledge of collateral (see paragraph 10).

**Recognition and Measurement of Servicing Assets and Liabilities**

9. 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. If distinct servicing rights to transferred assets exist and are retained by the reporting entity, 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. The servicing asset or liability shall be amortized into income in proportion to, and over the period of estimated servicing income (if an asset) or estimated servicing loss (if a liability). A servicing asset or liability shall be assessed for impairment or increased obligation based on its fair value.

**Secured Borrowings and Collateral**

10. 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 8). The accounting for collateral by the debtor (or obligor) and the secured party depends on whether the secured party has taken control over the collateral, and on the rights and obligations that result from the collateral arrangement:

- a. If the secured party is permitted to sell or repledge the collateral, and the debtor does not have the right and ability to redeem the collateral on short notice, (e.g., by substituting other collateral or terminating the contract), then:
  - i. The debtor shall disclose the amount of such assets and the secured party's right to sell or repledge such collateral;
  - ii. The secured party shall recognize that collateral as its asset, initially measure it at fair value, and also recognize its obligation to return it.
- b. If the secured party sells or repledges collateral on terms that do not give it the right and ability to repurchase or redeem the collateral from the transferee on short notice, the secured party shall recognize the proceeds from the sale or the asset repledged and its obligation to return the asset to the extent that it has not already recognized them. The sale or repledging of the asset is a transfer subject to the provisions of this statement;
- c. If the debtor defaults under the terms of the secured contract and is no longer entitled to redeem the collateral, it shall derecognize the collateral. The secured party shall recognize the collateral as an asset (to the extent it has not already recognized it) and initially measure it at fair value;
- d. Otherwise, the debtor shall continue to carry the collateral as an asset, and the secured party shall not recognize the pledged asset.

**Extinguishments of Liabilities**

11. A debtor shall derecognize a liability if, and only if, it has been extinguished (see 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; or
- b. The debtor is legally released from being the primary obligor under the liability, either judicially or by the creditor.

**Isolation Beyond the Reach of the Transferor and Its Creditors**

12. 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—depend 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 or any of its affiliates, except for an affiliate that is a qualifying special-purpose entity designed to make remote the possibility that it would enter bankruptcy or other receivership (see SSAP No. 33).

13. Many common financial transactions, for example, typical repurchase agreements (see SSAP No. 45) 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**

14. Many transferor-imposed or other conditions on a transferee's contractual right to pledge or exchange a transferred asset constrain a transferee from taking advantage of that right. However, a transferor's right of first refusal on a bona fide offer from a third party, a requirement to obtain the transferor's permission to sell or pledge that shall not be unreasonably withheld, or a prohibition on sale to the transferor's competitor generally does not constrain a transferee from pledging or exchanging the asset and, therefore, presumptively does not preclude a transfer containing such a condition from being accounted for as a sale. For example, a prohibition on sale to the transferor's competitor would not constrain the transferee if it were able to sell the transferred assets to a number of other parties; however, it would be a constraint if that competitor were the only potential willing buyer.

**Agreements That Maintain Effective Control Over Transferred Assets**

15. 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 (see paragraph 16);

- b. The transferor is able to repurchase or redeem them on substantially the agreed terms, even in the event of default by the transferee (see paragraph 17);
  - 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.
16. 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.
17. 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.
18. A call option or forward contract that entitles the transferor to repurchase, prior to maturity, transferred assets not readily obtainable elsewhere maintains the transferor's effective control, because it would constrain the transferee from exchanging those assets, unless it is only a cleanup call.

#### **Assets Obtained and Liabilities Incurred as Proceeds**

19. The proceeds from a sale of financial assets consist of the cash and any other assets obtained in the transfer less any liabilities incurred. 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.

### Retained Interests

20. Other interests in transferred assets—those that are not part of the proceeds of the transfer—are retained interests 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 retained interests, based on their relative fair values. That procedure shall be applied to all transfers in which interests are retained, even those that do not qualify as sales. Examples of retained interests include securities backed by the transferred assets, undivided interests, servicing assets, and cash reserve accounts and residual interests in securitization trusts. If a transferor cannot determine whether an asset is a retained interest or proceeds from the sale, the asset shall be treated as proceeds from the sale and accounted for in accordance with paragraph 19.

### Fair Value

21. The fair value of an asset (or liability) is the amount at which that asset (or liability) could be bought (or incurred) or sold (or settled) in a current transaction between willing parties, that is, other than in a forced or liquidation sale. Quoted market prices in active markets are the best evidence of fair value and shall be used as the basis for the measurement, if available. If a quoted market price is available, the fair value is the product of the number of trading units times market price.

22. If quoted market prices are not available, the estimate of fair value shall be based on the best information available. The estimate of fair value shall consider prices for similar assets and liabilities and the results of valuation techniques to the extent available in the circumstances. Examples of valuation techniques include the present value of estimated expected future cash flows using a discount rate commensurate with the risks involved, option-pricing models, matrix pricing, option-adjusted spread models, and fundamental analysis. Valuation techniques for measuring financial assets and liabilities and servicing assets and liabilities shall be consistent with the objective of measuring fair value. Those techniques shall incorporate assumptions that market participants would use in their estimates of values, future revenues, and future expenses, including assumptions about interest rates, default, prepayment, and volatility. In measuring financial liabilities and servicing liabilities at fair value by discounting estimated future cash flows, an objective is to use discount rates at which those liabilities could be settled in an arm's-length transaction.

23. Estimates of expected future cash flows, if used to estimate fair value, shall be the best estimate based on reasonable and supportable assumptions and projections. All available evidence shall be considered in developing estimates of expected future cash flows. The weight given to the evidence shall be commensurate with the extent to which the evidence can be verified objectively. If a range is estimated for either the amount or timing of possible cash flows, the likelihood of possible outcomes shall be considered in determining the best estimate of future cash flows.

### If It Is Not Practicable to Estimate Fair Values

24. If it is not practicable to estimate the fair values of assets, the transferor shall record those assets at 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—Liabilities, Contingencies and Impairments of Assets*.



## Securities Lending Transactions

25. When securities are loaned, they remain assets of the reporting entity and are not removed from the accounting records. Any fees received by the transferor for loaning the securities, net of direct expenses, shall be recorded in investment income in the subcategory of investment income known as aggregate write-ins for miscellaneous income. Interest income on loaned securities that is unrelated to securities lending shall be reported in the annual statement categories and exhibits that are consistent with the income earned on similar investment categories, e.g., bonds. During a securities lending transaction, collateral is pledged by the transferee to the transferor that has loaned the securities. If the collateral pledged by the transferee is not available for the general use of the transferor (restricted), then the transferor shall not reflect the collateral in the transferor's balance sheet as an asset, and the transferor shall not establish a liability for the return of the collateral. However, if the collateral pledged is available for the general use of the transferor (unrestricted), then the collateral shall be recorded as an asset on the transferor's balance sheet and a separate liability shall be established on the transferor's balance sheet to record the obligation to return the collateral. The failure by the transferor to maintain sufficient collateral for the loaned securities would result in nonadmission of the undercollateralized portion. The specific collateral requirements are as follows:

- a. 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 collateral is less than 100 percent of the fair value of the loaned securities, the counterparty shall be obligated to deliver additional collateral, 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.
- b. 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 is less than 102 percent of the fair value of the loaned securities, the reporting entity must obtain additional collateral, 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.

26. 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. 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.

27. 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 (see paragraphs 15-18). Those transactions shall be accounted for as secured borrowings, in which cash (or securities that the holder 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 borrowed, and any rebate paid to the transferee of securities is interest on the cash the transferor is considered to have borrowed. Collateral provided in securities lending transactions that are accounted for as secured borrowings shall be reported and disclosed like other collateral, as set forth in paragraphs 10 and 25.

28. In some transactions, characterized as securities lending, all of the criteria in paragraph 3 are met. During the term of such agreements, 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. Those transactions shall be accounted for:

- a. By the transferor as a sale of the loaned securities, for proceeds consisting of the collateral and a forward repurchase commitment. (If the collateral is a financial asset that the holder is permitted to sell or repledge and the debtor does not have the right and ability to redeem the collateral on short notice, e.g., by substituting other collateral or terminating the contract, 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 is not permitted to sell or pledge, 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); and
- b. By the transferee as a purchase of the borrowed securities in exchange for the collateral and a forward resale commitment.

### **Loan Syndications**

29. 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.

30. 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**

31. 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.

32. 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.

33. If the loan participation agreement gives the transferee the right to pledge or exchange those participations and the other criteria in paragraph 3 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**

34. 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 3 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**

35. 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.

### **Disclosures**

36. A reporting entity shall disclose the following:

- a. 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;
- b. 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; and
- c. For all servicing assets and servicing liabilities:
  - i. The amounts of servicing assets nonadmitted or liabilities recognized and amortized during the period; and
  - ii. The fair value of servicing liabilities for which it is practicable to estimate that value and the method and significant assumptions used to estimate the fair value.

37. A reporting entity shall disclose the following information for wash sales, as defined in paragraph 7, involving transactions for securities with a NAIC designation of 3 or below, or unrated:

- a. A description of the reporting entity's objectives regarding these transactions;
- b. An aggregation of transactions by NAIC Designation 3 or below, or unrated;
- c. The number of transactions involved during the reporting period;
- d. The book value of securities sold;
- e. The cost of securities repurchased; and
- f. The realized gains/losses associated with the securities involved.

38. Refer to the preamble for further discussion regarding disclosure requirements. The disclosures required by paragraph 37 shall be made for the current quarter in the quarterly statement and for the year in the annual statement.

### Relevant Literature

39. This statement adopts FAS 125 with modification to paragraphs 9, 10.a., 11.d., 13, 15-17, 35-41, and 68. Additionally, paragraphs 14, 59-60, 77-81, and 83 are rejected. The modifications to FAS 125 primarily relate to (a) the nonadmission of servicing rights assets, (b) the accounting for repurchase agreements, reverse repurchase agreements, and dollar repurchase agreements, (c) the accounting for realized gains and losses for reporting entities required to maintain an IMR, (d) the accounting for financial assets subject to prepayment, (e) the accounting for assets pledged as collateral, (f) the accounting for leases in accordance with *SSAP No. 22—Leases*, and (g) the accounting for sales of receivables with recourse. Paragraphs 77-81 are rejected because they are not applicable to the insurance industry.

40. This statement adopts *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 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* and *FASB Emerging Issues Task Force No. 96-19, Debtor's Accounting for a Modification or Exchange of Debt Instruments*.

41. This statement rejects *FASB Statement No. 127, Deferral of the Effective Date of Certain Provisions of FASB Statement No. 125, an amendment of FASB Statement No. 125*, *FASB Emerging Issues Task Force No. 84-5, Sale of Marketable Securities with a Put Option*, *FASB Emerging Issues Task Force No. 92-2, Measuring Loss Accruals by Transferors of Receivables with Recourse*, and *FASB Emerging Issues Task Force No. 96-20, Impact of FASB Statement No. 125 on Consolidation of Special-Purpose Entities*.

### Effective Date and Transition

42. This statement shall be effective for transfers and servicing of financial assets and extinguishments of liabilities occurring after January 1, 2001, and shall be applied prospectively.

43. For each servicing contract in existence before January 1, 2001, 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

- *Purposes and Procedures Manual of the NAIC Securities Valuation Office*

**Generally Accepted Accounting Principles**

- *FASB Statement No. 125, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*
- *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*

**SSAP NO. 18—GLOSSARY****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, and residual interests.

**Cleanup call**

An option held by the servicer, which may be the transferor, to purchase transferred financial assets when the amount of outstanding assets falls to a level at which the cost of servicing those assets becomes burdensome.

**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 futures, forward, swap, or option contract, or other financial instrument with similar characteristics.

**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.

**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.

**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.

**Unrestricted collateral**

Securities received that may be sold or repledged and which were obtained under agreements that are not subject to repurchase or redemption on short notice, for example, by substitution of other collateral or termination of the contract.