

## Statement of Statutory Accounting Principles No. 33

### Securitization

#### STATUS

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**Securitization****SCOPE OF STATEMENT**

1. This statement establishes statutory accounting principles for asset securitizations and securitizations of policy acquisition costs. This statement is not intended to address transfers accomplished by means other than securitization.

**SUMMARY CONCLUSION**

2. An asset securitization is the process of converting assets which would normally serve as collateral for a loan into securities.

**Accounting for Securitizations of Financial Assets**

3. A financial asset shall be defined as cash, evidence of an ownership interest in an entity, or a contract that both

- a. Imposes on one entity a contractual obligation (i) to deliver cash or another financial instrument to a second entity or (ii) to exchange other financial instruments on potentially unfavorable terms with the second entity; and
- b. Conveys to that second entity a contractual right (i) to receive cash or another financial instrument from the first entity or (ii) to exchange other financial instruments on potentially favorable terms with the first entity.

4. A securitization in which the transferor surrenders control over the financial asset transferred shall be accounted for as a sale, with recognition of proceeds and measurement of a gain or loss only to the extent that consideration other than beneficial interests in the transferred assets is received in exchange. The portion of the securitization for which beneficial interests in the transferred assets are received shall not be accounted for as a sale, but shall be treated as an exchange of assets with no measurement of a gain or loss. All other securitizations shall be accounted for as secured borrowings in accordance with paragraph 11.

5. The transferor has surrendered control 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;
- b. The transferee is a qualifying special-purpose entity and the holders of beneficial interests in that entity have the right—free of transferor-imposed conditions that constrain them from taking advantage of that right—to pledge or exchange those interests; and
- c. The transferor does not maintain effective control over the transferred assets through (i) an agreement that entitles and obligates the transferor to repurchase or redeem them before their maturity, or (ii) an agreement that entitles the transferor to repurchase or redeem transferred assets that are not readily obtainable.

6. A beneficial interest shall be defined as the right to receive all or portions of specified cash inflows to a trust or other entity, including senior and subordinated shares of interest or principal inflows to be “passed through” or “paid through,” premiums due guarantors, and residual interests. Residual interests are interests in the cash flows of the trust or other entity, after the cash flows of structured securities issued by the trust are met.

7. Upon completion of the securitization of financial assets meeting the criteria for sales treatment required by paragraph 5, the transferor shall:

- a. Eliminate the transferred assets from the statement of financial position;
- 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 statement of financial position, 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 7 c.) and liabilities incurred in consideration as proceeds of the sale;
- e. Initially measure such additional assets obtained and liabilities incurred in the sale at fair value; 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 line in the Investment Income section of the Underwriting and Investment Exhibit.

8. The successor (transferee) shall recognize all assets obtained and any liabilities incurred and initially measure them at fair value.

9. A qualifying special-purpose entity (including a CMO special-purpose entity) as used in this statement must meet all of the following conditions:

- a. It is a trust, corporation, or other legal vehicle whose activities are permanently limited by the legal documents establishing the special-purpose entity to:
  - i. Holding title to transferred financial assets;
  - ii. Issuing beneficial interests (If some of the beneficial interests are in the form of debt securities or equity securities, the transfer of assets is a securitization.);
  - iii. Collecting cash proceeds from assets held, reinvesting proceeds in financial instruments pending distribution to holders of beneficial interests, and otherwise servicing the assets held; and
  - iv. Distributing proceeds to the holders of its beneficial interests.
- b. It has a standing at law distinct from the transferor. Having standing at law depends in part on the nature of the special-purpose entity. For example, generally, under U.S. law, if a transferor of assets to a special-purpose trust holds all of the beneficial interests, it can unilaterally dissolve the trust, and thereby resume control over the individual assets held in the trust, and the transferor can effectively assign its interest and its creditors can reach it. In that circumstance, the trust has no standing at law, is not distinct, and thus is

not a qualified special-purpose entity. A special-purpose entity that has distinct standing at law may still be an affiliate of the transferor.

### **Investments in Special-Purpose Entities**

10. Reporting entities that have qualifying special-purpose entities as affiliates shall carry their investment in such entity at its underlying statutory book value in accordance with *SSAP No. 88—Investments in Subsidiary, Controlled, and Affiliated Entities, A Replacement of SSAP No. 46*. Additionally, transactions entered involving affiliated qualifying special-purpose entities are subject to the provisions of *SSAP No. 25—Accounting for and Disclosures about Transactions with Affiliates and Other Related Parties*.

### **Secured Obligations and Collateral**

11. Securitizations of financial assets that do not meet the criteria for sale treatment set forth in paragraph 5 shall be presumed to be secured borrowings and shall be recorded as follows. Financial assets shall remain on the reporting entity's books and a liability shall be recorded to reflect the proceeds from the issuance of any type of certificate. Non-cash proceeds shall be recorded as a contra liability and netted against the liability. The liability shall be reduced as the obligation to holders of beneficial interests is repaid. Financial assets pledged as collateral shall not be offset against the liability reflecting the proceeds of the transaction.

### **Recognition of Servicing Rights**

12. 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). The servicing asset or liability shall be measured in a manner consistent with paragraphs 13 and 35-38 of *FASB Statement No. 125, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (FAS 125).

### **Sales of Future Revenues**

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

**Relevant Literature**

14. This statement adopts portions of FAS 125, with the following modifications (FAS 125 is addressed in its entirety in *SSAP No. 18—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*):

- a. This statement requires servicing rights assets to be nonadmitted;
- b. This statement does not permit sales treatment for transactions where recourse provisions exist or where “call” or “put” options exist on the transferred assets whereas GAAP would permit the recognition of the transfer as a sale under some circumstances;
- c. This statement requires debtors to provide disclosure when a secured party is permitted to sell or pledge financial assets transferred as collateral whereas FAS 125 requires the encumbered assets to be reported separately from unencumbered assets;
- d. This statement does not address transfers of financial assets accomplished in a manner other than through securitizations whereas FAS 125 does address such transfers; and
- e. Paragraph 14 is rejected as it is not applicable.

**Effective Date and Transition**

15. This statement is effective for years beginning January 1, 2001. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*.

**AUTHORITATIVE LITERATURE****Generally Accepted Accounting Principles**

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

**RELEVANT ISSUE PAPERS**

- *Issue Paper No. 86—Securitization*