

## **FASB STAFF POSITION**

### **No. FAS 140-3**

**Title:** Accounting for Transfers of Financial Assets and Repurchase Financing Transactions

**Date Posted:** February 20, 2008

### **Overview and Background**

1. FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, provides accounting and reporting standards for transfers of financial assets. Statement 140 requires that all involvements of a transferor with the transferred financial asset be considered in analyzing whether the transferor has surrendered control over the transferred financial asset, even if those involvements occur subsequent to the transfer. Statement 140 also provides guidance on how to account for a repurchase agreement. However, Statement 140 does not directly address the repurchase financing transaction in question, as described in paragraph 4 below. Furthermore, Statement 140 presumes that the transferor and transferee account for a transfer of a financial asset symmetrically.

2. Questions have arisen about the accounting for a repurchase agreement that relates to a previously transferred financial asset (a repurchase financing), specifically, whether there are circumstances that would permit a transferor and a transferee to evaluate the accounting for a transfer of a financial asset separately from a repurchase financing when the counterparties to the two transactions are the same under Statement 140. Questions about the accounting for repurchase financings were first noted in the mortgage real estate investment trust industry, but other industries also will be affected by this FSP.

### **Objective**

3. The objective of this FSP is to provide guidance on accounting for a transfer of a financial asset and a repurchase financing. This FSP presumes that an initial transfer of a financial asset and a repurchase financing are considered part of the same arrangement

(linked transaction) under Statement 140. However, if certain criteria are met, the initial transfer and repurchase financing shall not be evaluated as a linked transaction and shall be evaluated separately under Statement 140.

All paragraphs in this FSP have equal authority. Paragraphs in bold set out the main principles.
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## **FASB Staff Position**

### **Scope**

4. **This FSP applies to a repurchase financing, which is a repurchase agreement<sup>1</sup> that relates to a previously transferred financial asset between the same counterparties (or consolidated affiliates<sup>2</sup> of either counterparty), that is entered into contemporaneously with, or in contemplation of, the initial transfer.**

5. A repurchase financing involves the transfer of a previously transferred financial asset back to the initial transferor as collateral for a financing between the initial transferee (the borrower) and the initial transferor (the lender). A repurchase financing also typically involves the initial transferor returning the transferred financial asset (or substantially the same asset)<sup>3</sup> to the initial transferee when the financing is repaid on a stated date. A repurchase financing is entered into in contemplation of the initial transfer if both transactions are considered together at the execution of the initial transfer.

6. When a transferor transfers a financial asset and also enters into a repurchase financing with the transferee, there are typically three transfers of the financial asset:

- a. Initial transfer—An initial transferor transfers a financial asset to an initial transferee.

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<sup>1</sup>The term *repurchase agreement* is described in paragraphs 96 and 97 of Statement 140.

<sup>2</sup>The term *consolidated affiliate*, for purposes of this FSP, is as an entity whose assets and liabilities are included with those of the counterparty in the consolidated, combined, or other financial statements being presented.

<sup>3</sup>The term *substantially the same* is defined in 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*.

- b. Execution of a repurchase financing—The initial transferee (the borrower) transfers the previously transferred financial asset back to the initial transferor (the lender) as collateral for a financing between the initial transferor and initial transferee.
- c. Settlement of the repurchase financing—The initial transferor (the lender) returns the financial asset (or substantially the same asset) to the initial transferee (the borrower) upon receipt of payment from the initial transferee.

## **Derecognition and Recognition**

**7. A transferor and transferee shall not separately account for a transfer of a financial asset and a related repurchase financing unless (a) the two transactions have a valid and distinct business or economic purpose for being entered into separately and (b) the repurchase financing does not result in the initial transferor regaining control over the financial asset.**

8. An example of transactions lacking a valid business or economic purpose for being entered into separately is if the transactions are structured to circumvent an accounting standard or solely to achieve a specific accounting result. Unless the initial transfer and the repurchase financing meet all of the criteria in paragraph 9 of this FSP, the transactions must be considered linked for purposes of applying Statement 140.

9. An initial transfer of a financial asset and repurchase financing that are entered into contemporaneously with, or in contemplation of, one another shall be considered linked unless all of the following criteria are met at the inception of the transaction:

- a. The initial transfer and the repurchase financing are not contractually contingent on one another. Even if no contractual relationship exists, the pricing and performance of either the initial transfer or the repurchase financing must not be dependent on the terms and execution of the other transaction.
- b. The repurchase financing provides the initial transferor with recourse to the initial transferee upon default. That recourse must expose the initial transferor to the credit risk of the initial transferee, or its affiliates, and not solely to the market risk of the transferred financial asset. The initial transferee's agreement to repurchase the previously transferred financial asset (or substantially the same asset) is for a fixed price and not fair value.
- c. The financial asset subject to the initial transfer and repurchase financing is readily obtainable in the marketplace. In addition, the initial transfer of a financial asset and the repurchase financing are executed at market rates. This criterion may not be circumvented by embedding off-market terms in a separate transaction contemplated with the initial transfer or the repurchase financing.

- d. The financial asset and repurchase agreement are not coterminous (the maturity of the repurchase financing must be before the maturity<sup>4</sup> of the financial asset).

10. If the transactions meet all of the provisions in paragraphs 7–9 of this FSP, the initial transfer shall be accounted for separately from the repurchase financing. In this circumstance, the initial transfer should be evaluated to determine if it meets the requirements for sale accounting under Statement 140 without taking into consideration the repurchase financing. The initial transferor and initial transferee shall then analyze the repurchase financing as a repurchase agreement under Statement 140.<sup>5</sup> Statement 140 requires that both parties to a repurchase agreement use the same criteria in determining the accounting for a repurchase agreement.

11. If the transactions do not meet all of the provisions in paragraphs 7–9 of this FSP, the initial transfer and repurchase financing should be evaluated as a linked transaction. The linked transaction should be evaluated to determine whether it meets the requirements for sale accounting under Statement 140. If the linked transaction does not meet the requirements for sale accounting, the linked transaction shall be accounted for based on the economics of the combined transactions, which generally represent a forward contract. FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, should be used to evaluate whether the linked transaction must be accounted for as a derivative. Other accounting literature may need to be considered as a result of accounting for the transactions linked (for example, the effect on other aspects of a securitization transaction when the initial transferor retains the financial asset subject to the repurchase financing).

### **Effective Date and Transition**

12. This FSP shall be effective for financial statements issued for fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. Earlier application is not permitted.

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<sup>4</sup>Question 48 of the FASB Special Report, *A Guide to Implementation of Statement 140 on Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, addresses the issue of determining whether the repurchase agreement is before the maturity of the asset.

<sup>5</sup>The specific transactions must be considered to determine the relevant paragraphs of Statement 140, which may include paragraphs 9–12, 15, 47–49, and 96–101 of Statement 140.

13. This FSP shall be applied prospectively to initial transfers and repurchase financings for which the initial transfer is executed on or after the beginning of the fiscal year in which this FSP is initially applied.

The provisions of this FSP need not be applied to immaterial items.
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*This FSP was adopted by the unanimous vote of the seven members of the Financial Accounting Standards Board:*

Robert H. Herz, *Chairman*  
George J. Batavick  
G. Michael Crooch  
Thomas J. Linsmeier  
Leslie F. Seidman  
Lawrence W. Smith  
Donald M. Young

## **Appendix A**

### **BACKGROUND INFORMATION AND BASIS FOR CONCLUSIONS**

#### **Introduction**

A1. This appendix summarizes considerations that Board members deemed significant in reaching the conclusions in this FSP. It includes reasons for accepting certain views and rejecting others. Individual Board members gave greater weight to some factors than to others.

#### **Background Information and Basis for Conclusions**

##### **Need for Improvement in Financial Reporting**

A2. In March 2006, the Board decided to address a request from constituents that it reevaluate the requirement in Statement 140 that all involvements of a transferor with the transferred financial asset be included in the analysis of whether a transferor has surrendered control over a transferred financial asset. In current practice, many constituents believe that it is appropriate to separately account for a transfer of a financial asset and a repurchase financing. Constituents argued that a repurchase financing does not cause the initial transferor to regain control over the transferred financial asset in circumstances in which:

- a. The transactions are entered into at arm's length in an active, competitive market.
- b. The selection of the counterparty for a repurchase financing is performed independently by separate operating units of the initial transferee (although the counterparty selected may still be the original transferor).
- c. The transactions limit the initial transferor's ability to pledge and exchange the financial asset and provide the initial transferee with the ability to substitute other assets as collateral.
- d. The risks and rewards of ownership remain with the initial transferee.

A3. The FASB staff became aware that in many instances a transferor and transferee separately evaluate an initial transfer and a repurchase financing when applying Statement 140. In doing so, the transferor and transferee first analyze the initial transfer for derecognition, which includes performing the isolation analysis under paragraph 9(a) of

Statement 140, without considering the effect of the repurchase financing. The repurchase financing is then separately analyzed as a transfer of a financial asset (as collateral) with an agreement to repurchase the financial asset, under paragraphs 47–49 and 96–101 of Statement 140.

A4. Although attorneys might be able to provide a “true sale” opinion relating to the initial transfer, when the two transactions are considered part of the same arrangement, the rights obtained by the initial transferor through the repurchase financing would generally preclude a conclusion that the assets have been put presumptively beyond the reach of the initial transferor and its creditors as required by paragraph 9(a) of Statement 140. The Uniform Commercial Code has special “safe harbors” relating to repurchase agreements, but those provisions would not apply in the bankruptcy of the initial transferor.

### **FASB Staff Position**

A5. The Board decided to permit an initial transfer of a financial asset to be accounted for separately from a repurchase financing if the provisions in paragraphs 7–9 of this FSP are met. The Board’s objective in developing the criteria is to permit a transfer of a financial asset and a repurchase financing to be considered separately if there is a valid business or economic purpose for the counterparties to enter into two transactions separately and the repurchase financing does not return control of the previously transferred financial asset to the initial transferor. Consistent with that objective, the Board concluded that those criteria should be used to determine whether the repurchase financing should be considered linked with the initial transfer of the financial asset for purposes of evaluating the transactions under Statement 140.

### ***Scope***

A6. The proposed FSP would have applied to all repurchase financings regardless of the lapse in time between the initial transfer and the repurchase financing. Constituents disagreed with that scope and stated that the lapse in time is a relevant criterion when determining whether the transactions have a valid and distinct business purpose for being entered into separately. Constituents also stated that it would be operationally

burdensome to evaluate all repurchase financings over the entire life of a transferred financial asset.

A7. During redeliberations, the Board decided that this FSP should apply only to repurchase financings that are entered into contemporaneously with, or in contemplation of, the initial transfer. The Board agreed that if a significant amount of time has passed between the two transactions, it would be likely that there was a valid and distinct business purpose for entering into the two transactions separately. The Board also stated that narrowing the scope would reduce the operational burden of applying this FSP by reducing the volume of transactions that must be evaluated.

A8. The Board discussed the notion of *in contemplation* and decided that an entity would be able to implement controls and/or procedures to determine when a repurchase financing and an initial transfer are done in contemplation of one another (both transactions considered together at the execution of the initial transfer). The determination of whether the two transactions were entered into in contemplation of one another is not required to be symmetrical between the counterparties. However, the counterparties should apply the criteria of this FSP in the same manner.

### ***Approach***

A9. This FSP presumes that an initial transfer of a financial asset and a repurchase financing are linked transactions unless the provisions in paragraphs 7-9 of this FSP are met. Some constituents requested that this FSP not presume that linkage exists; rather, they said that the criteria in paragraph 9 of this FSP should be indicators that a reporting entity would consider to determine if the two transactions should be linked. The Board considered those comments but was concerned that it would be difficult for preparers to apply an indicator approach consistently. The Board concluded that the rebuttable presumption approach was appropriate because it is consistent with paragraph 27 of Statement 140 and was more operational.

***Contractual Relationships***

A10. The Board reasoned that a transfer of a financial asset and a repurchase financing should be considered a linked transaction if there is a contractual relationship between the two transactions. Additionally, the Board stated that the absence of a contract does not automatically indicate that the transactions are not linked. The Board decided that if the pricing and performance of either transaction are dependent on the terms or execution of the other transaction, the two transactions should be accounted for as linked.

***A Nonrecourse Repurchase Agreement or an Agreement to Repurchase the Financial Asset Transferred at Fair Value***

A11. The Board considered the counterparties' exposures to risk associated with the transferred financial asset. The Board decided that the initial transferor remains subject to all the market risks of the security if (a) the initial transferor does not have recourse to the initial transferee in the event of default (that is, the only remedy of the initial transferor is to liquidate the security) or (b) the repurchase agreement is at fair value. The Board concluded that if the market risk remains with the initial transferor, the initial transferor is deemed to control the asset because it has obtained more than a trivial benefit from the second transaction.

A12. Constituents generally agreed with the criterion but stated that the language in the proposed FSP could be clarified to avoid the need for implementation guidance on the level of recourse required to meet this criterion. The Board clarified that the transferor should receive a sufficient level of recourse to expose it to the credit risk of the transferee, or its affiliates, and not solely to the market risk of the transferred financial asset.

***Marketability***

A13. The Board reasoned that if the initial transferor provides the initial transferee with a lower rate on the repurchase financing than would otherwise be obtained in an active market (as described in paragraph 9(c) of this FSP) or if the initial transferor requires specific knowledge of the asset to provide a better rate on the repurchase financing, the initial transferee is economically compelled to execute the repurchase financing with the initial transferor. In that circumstance, the Board believes that the initial transferor would

effectively maintain control over the transferred financial asset because the initial transferee is unlikely to execute the repurchase financing with anyone other than the initial transferor. The Board concluded that marketability is important because it provides evidence that the decision to execute the repurchase financing with the same counterparty is not based solely on the uniqueness of the asset.

A14. To provide evidence that the initial transferor does not require specific knowledge of the asset (that is, the asset is not unique), the Board decided to require that the financial asset be readily obtainable in the marketplace, which is an existing concept in Statement 140.

### ***Rights to Collateral***

A15. The proposed FSP would have required that the initial transferee maintain rights to the collateral (that is, be able to take control of the transferred financial asset and substitute it with a different financial asset) for an initial transfer and repurchase financing to be accounted for as separate transactions. Constituents stated that this criterion was not consistent with standard repurchase agreements. Under the terms of standard repurchase agreements, the counterparties are permitted to negotiate a substitution of collateral during the term of the agreement.

A16. In redeliberations, the Board agreed that amending the criterion to conform to standard repurchase agreements would negate the usefulness of the criterion because counterparties can always negotiate a substitution of collateral. In addition, the Board agreed that requiring a change in standard repurchase agreements would be costly and add complexity to the agreements because it would be necessary for the agreements to provide details on the circumstances that would either permit or prohibit a substitution of collateral. The Board agreed that the costs of requiring such a change would not justify the benefits of requiring this criterion. However, the Board stated that if the initial transferee was specifically precluded from taking control of the transferred financial asset, the two transactions should not be accounted separately. The Board concluded that a specific preclusion of substitution of collateral would be rare and that this criterion is not necessary.

***Timing and Terms***

A17. The Board concluded that when a repurchase transaction has the same term as the underlying financial asset (a repurchase to maturity), the initial transferor effectively maintains control over the transferred asset because the asset would mature at the same time it would have to be returned to the initial transferee.

**Applicability**

A18. The Board concluded that the guidance provided in this FSP should be applied by both transferors and transferees because Statement 140 presumes that the transferor and transferee account for a transfer of a financial asset symmetrically.

**Effective Date and Transition**

A19. The Board decided that this FSP should be effective for fiscal years, and interim periods within those fiscal years, beginning on or after November 15, 2008. The Board believes that the effective date provides sufficient time for preparers to analyze, interpret, and implement this FSP.

A20. This FSP prohibits early adoption. The FASB's Investors Technical Advisory Committee and other users of financial statements have informed the Board that providing alternatives on when entities adopt a new standard decreases the comparability of information presented, thereby increasing the cost of analyzing and using that information. The Board, therefore, decided to prohibit early adoption.

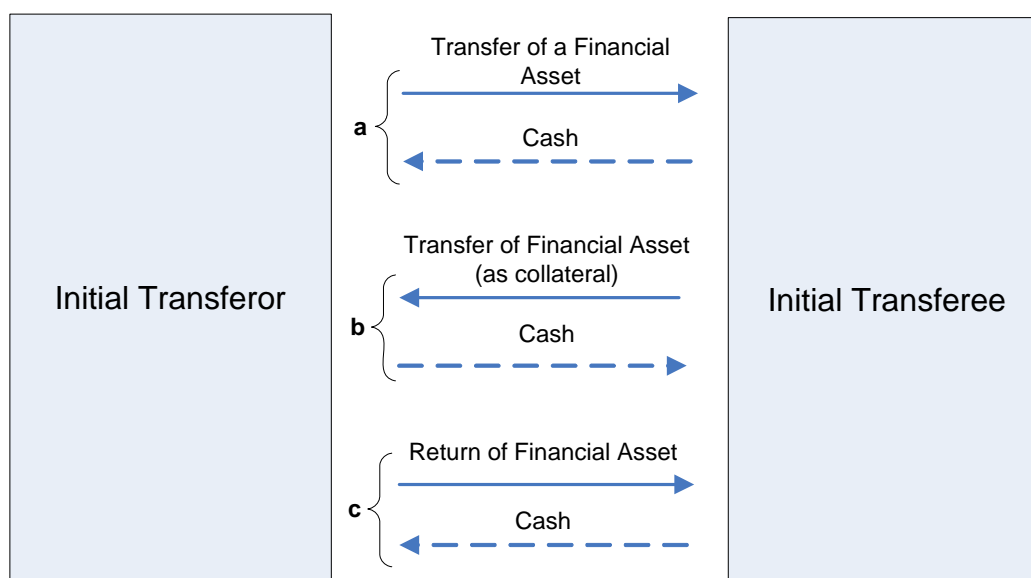
A21. The Board considered requiring full retrospective application of this FSP because it would maximize consistency of financial information between periods and would enhance the usefulness of the financial statements to users. However, the Board concluded that for the transactions covered by this FSP, full retrospective application would not be practical or cost beneficial because the volume of expired financings is extensive and most repurchase financings are short term such that most repurchase financings initiated prior to this FSP would not still be outstanding at the effective date of this FSP. Therefore, the Board proposed that this FSP should be applied to any existing repurchase financings as of the effective date of this FSP as a cumulative-effect adjustment.

A22. Constituents asked the Board to consider prospective application of this FSP due to the lack of historical information available, the need to use hindsight when determining whether transactions were entered into in contemplation of one another for transactions occurring prior to the effective date, and the significant cost of analyzing transactions occurring prior to the effective date of this FSP. The Board considered the lack of historical information as well as the operational difficulties that would occur as a result of amending the scope of this FSP to consider only repurchase financings entered into contemporaneously with, or in contemplation of, the initial transfer. Largely for those reasons, the Board concluded that this FSP should be applied prospectively.

**Appendix B**

**EXAMPLE OF AN INITIAL TRANSFER AND A REPURCHASE FINANCING**

B1. The following diagram is an example of an initial transfer of a financial asset and a subsequent repurchase financing, as described in paragraphs 5 and 6 of this FSP, which should be analyzed using the provisions in paragraphs 7–9 of this FSP. The purpose of this example is to illustrate the characteristics of the transaction and to prevent an inappropriate analogy to other financing transactions that are outside the scope of this FSP.



B2. The diagram above depicts the following three transfers of a financial asset that typically occur in the transactions covered by the scope of this FSP:

- a. The initial transferor transfers a financial asset to the initial transferee in return for cash.<sup>6</sup>
- b. The initial transferee enters into a financing arrangement with the initial transferor. The initial transferee transfers the previously transferred financial asset to the initial transferor as collateral for the financing. The initial transferee

<sup>6</sup>Whether or not the parties agree to net settle steps (a) and (b) shall not affect whether the transactions are within the scope of this FSP. However, the ability to net settle the transactions is a factor to consider in determining whether the two transactions meet all of the provisions in paragraphs 7–9 of this FSP.

receives cash from the initial transferor.<sup>7</sup> As part of the financing arrangement, the initial transferee is obligated to repurchase the financial asset (or substantially the same financial asset) at a fixed price within a prescribed time period.

- c. The initial transferee makes the required payment to the initial transferor under the terms of the repurchase financing. Upon receipt of payment, the initial transferor returns the transferred asset (or substantially the same asset) to the initial transferee.

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<sup>7</sup>See footnote 6.