

## EITF ABSTRACTS

Issue No. 84-20

**Title:** GNMA Dollar Rolls

**Dates Discussed:** September 25, 1984; October 18, 1984; November 15, 1984; December 13, 1984

**References:** FASB Statement No. 125, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*  
FASB Statement No. 127, *Deferral of the Effective Date of Certain Provisions of FASB Statement No. 125*  
FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*  
FASB Statement No. 137, *Accounting for Derivative Instruments and Hedging Activities—Deferral of the Effective Date of FASB Statement No. 133*  
FASB Statement No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities*  
FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*  
FASB Statement No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities*  
AICPA Audit and Accounting Guide, *Audits of Savings Institutions*, 1991  
AICPA Statement of Position 85-2, *Accounting for Dollar Repurchase—Dollar Reverse Repurchase Agreements by Sellers-Borrowers*  
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*

### ISSUE

The term *GNMA rolls* has been used broadly to refer to a variety of transactions involving mortgage-backed securities, frequently those issued by the Government National Mortgage Association (GNMA). Four basic types of transactions are involved:

1. Reverse repurchase agreements for which the exact same security is received at the end of the repurchase period (vanilla repo)
2. Fixed coupon dollar reverse repurchase agreements (dollar repo)
3. Fixed coupon dollar reverse repurchase agreements that are rolled at their maturities, that is, renewed in lieu of taking delivery of an underlying security (GNMA roll)
4. Forward commitment dollar rolls (also referred to as To Be Announced [TBA] GNMA forward contracts or TBA GNMA rolls), for which the underlying security does not yet exist.

The issues are (1) whether the above transactions should be accounted for as financings or as separate sales and repurchases and (2) if considered separate sales and repurchases, how changes in the value of the underlying security should be recognized (that is, whether the underlying security should be marked to market).

## **EITF DISCUSSION**

The Task Force reached a consensus that forward commitment dollar rolls (the type of transactions also referred to as Type 4 transactions) should be accounted for in accordance with the accounting approach described in a proposed Federal Home Loan Bank Board (FHLBB) Statement of Policy; that is, those transactions should be marked to market. Task Force members also reached a consensus that it is acceptable for non-SEC registrants who prepare their financial statements in conformity with GAAP to adopt this method of accounting for Type 4 transactions if it is required for regulatory reporting purposes. The FHLBB has currently proposed that mark-to-market accounting be required for forward commitment dollar rolls effective March 31, 1985. Several Task Force members said they plan to encourage earlier adoption by their clients. Task Force members also noted that institutions that do not adopt mark-to-market accounting at December 31, 1984 should disclose the effect on the financial statements. [Note: See STATUS section.]

The SEC Observer stated that transition is not an issue for SEC registrants because the SEC believes that mark-to-market accounting is presently required in filings with the Commission. The SEC Observer also noted that a non-SEC registrant that fails to adopt mark-to-market accounting for Type 4 transactions at December 31, 1984, and then subsequently becomes subject to SEC filing requirements, will be questioned about its prior years' financial statements if the SEC staff becomes aware of the practice.

The Task Force was unable to reach a consensus regarding reverse repurchase agreements (vanilla repos or Type 1 transactions), dollar reverse repurchase agreements (Type 2 transactions), and rolled or extended dollar reverse repurchase agreements (Type 3 transactions).

The SEC Observer expressed reservations about the proposed FHLBB Statement of Policy, specifically the use of a general funding test rather than requiring that an institution be able to show an ability to fund from short-term liquid assets, and the absence of a requirement for a substantive initial holding period for a reverse repurchase agreement.

An FHLBB representative explained the rationale behind certain specific provisions of the proposed Statement of Policy. He noted that the FHLBB staff believes that a specific funding test might have caused institutions to enter into disadvantageous transactions (borrowing otherwise unneeded funds or selling assets) for the sole purpose of meeting the liquidity test and also noted that the FHLBB imposes other liquidity requirements. He said the holding period of 35 days rather than some longer period was proposed based on the advice of investment bankers and others. He also noted that the FHLBB does not believe that an initial holding period is necessary for reverse repurchase agreements if the institution holds title to the underlying security.

One Task Force member stated that he agreed with the proposed FHLBB Statement of Policy with respect to the absence of an initial holding period on reverse repurchase agreements. He said that holding periods are generally not required for borrowings secured by owned assets.

The SEC Observer stated that the requirement (for a holding period) is needed to prevent abuses whereby securities held under reverse repurchase agreements might be used to satisfy holding period requirements, thereby circumventing the intent of the proposed regulation.

The Task Force Chairman stated that the FASB will continue to communicate with the FHLBB regarding its concerns, similar to those expressed by the SEC Observer, and encouraged Task Force members to formally comment on the proposed Statement of Policy.

## **STATUS**

The issues were subsequently addressed in SOP 85-2, which was issued in January 1985. The FHLBB subsequently issued several R-Memorandums that addressed reverse repurchase transactions.

The AICPA issued SOP 90-3 in February 1990 which amended SOP 85-2 to clarify some of its terminology.

The AICPA issued the Guide on savings institutions in August 1991. That Guide supersedes and incorporates the provisions of SOP 85-2. The provisions of the Guide do not change the consensus in this Issue.

This Issue was partially resolved by Statement 125, which was issued in June 1996. Statement 125 was replaced by Statement 140, without reconsideration of this matter.

Statement 133 was issued in June 1998 and was amended by Statements 137, 138, and 149. The effective date for Statement 133, as amended, is for all fiscal quarters of all fiscal years beginning after June 15, 2000.

Paragraph 70 of Statement 125 (paragraph 100 of Statement 140) states that “fixed-coupon and dollar-roll repurchase agreements, and other contracts under which the securities to be repurchased need not be the same as the securities sold, qualify as borrowings if [for Types 2 and 3 securities] the return of substantially the same (paragraph 28 of Statement 125 [paragraph 48 of Statement 140]) securities as those concurrently transferred is assured. Therefore, those transactions shall be accounted for as secured borrowings by both parties to the transfer.” Types

1–3 of dollar rolls described in Issue 84-20 would qualify for secured borrowing treatment if the redemption of securities on substantially the same terms is assured (paragraph 29 of Statement 125 [paragraph 49 of Statement 140]). Thus, the forward contracts embedded in the Types 1–3 securities meeting that requirement are outside the scope of Statement 133 because of paragraph 10(f) and the guidance in Statement 133 Implementation Issue No. C6, “Derivative Instruments Related to Assets Transferred in Financing Transactions.”

Type 2 and 3 securities that involve repurchase of other than substantially-the-same securities are considered sales of securities and forward contracts. The forward contract would need to be evaluated under Statement 133 because it has terms that would generally meet the definition of a derivative. Paragraph 17 requires all derivatives within its scope to be recognized as assets or liabilities and measured at fair value. Such derivatives are eligible to be designated as hedging instruments if the relevant criteria are met. However, if the repurchase occurs within the *shortest time* generally established by regulations and conventions in the marketplace (which may be one day for many securities), the repurchase agreement may not be subject to Statement 133’s provisions if the contract qualifies for the “regular-way” security trades exclusion in paragraph 10(a) of Statement 133. However, that exclusion applies only to contracts with no net settlement provision and no market mechanism to facilitate net settlement.

Typically, a market mechanism to facilitate net settlement of Type 4 contracts does exist, thereby preventing the contract from meeting the requirements of paragraph 10(a) of Statement 133.

Any Type 4 contracts that are not subject to Statement 133’s provisions must be marked to market as required under Issue 84-20.