Notice to Recipients of
This Proposed FASB Staff Position

This proposed FASB Staff Position (FSP) addresses the following issue:

> 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 agreement that relates to a previously transferred financial asset (repurchase financing), when the counterparties to the two transactions are the same under FASB Statement No. 140, *Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*.

The Board invites individuals and organizations to send written comments on all matters in this proposed FSP. Comments are requested from those who agree with the provisions in the proposed FSP as well as those who do not. Comments are most helpful if they identify the specific paragraph or paragraphs to which they relate and clearly explain the issue or question. Those who disagree with any portion of this proposed FSP are asked to describe their suggested alternatives, supported by specific reasoning.

The Board requests that constituents provide comments on the following:

1. Are the criteria in paragraph 7 of this proposed FSP operational and do they appropriately identify those transactions that should be accounted for separately? If you disagree, please provide example transactions that do not meet the criteria but should be accounted for separately or that do meet the criteria but should not be accounted for separately. Explain the business purpose (or lack thereof) of the example transactions provided.

2. What costs would be incurred to implement this proposed FSP?

3. What procedures, controls, and systems are required to implement this proposed FSP? Can such procedures, controls, and systems be in place by the proposed effective date—the beginning of the first fiscal year after November 15, 2007? If not, when can the procedures, controls, and systems be in place to implement this proposed FSP?

4. Are there other implementation issues that the Board should consider?

5. Are the transition provisions of this proposed FSP, to new transactions and outstanding repurchase financings, appropriate?

Responses must be received in writing by September 14, 2007. Interested parties should submit their comments by email to "director@fasb.org, File Reference: Proposed FSP FAS 140-d." Those without email may send their comments to "Russell G. Golden, Director of Technical Application & Implementation Activities, FASB, 401 Merritt 7, P.O. Box 5116, Norwalk, CT 06856-5116, File Reference: Proposed FSP FAS 140-d." Responses should not be sent by fax.

All comments received by the FASB are considered public information. Those comments will be posted to the FASB's website and included as part of the public record with other project materials.

PROPOSED FASB STAFF POSITION

No. FAS 140-d

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

Comment Deadline: September 14, 2007

Introduction

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. 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 on repurchase financings were first noted in the mortgage real estate investment trust industry, but other industries will also be affected by this FASB Staff Position (FSP).

2. 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 specifically 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.

3. This FSP addresses the 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 shall be considered part of the same arrangement (linked transaction) under Statement 140 when the counterparties to the two transactions are the same. However, if certain criteria are met, the initial transfer and repurchase financing shall not be evaluated as a linked transaction, and the two agreements shall be evaluated separately under Statement 140.

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4. **A *repurchase financing* is a repurchase agreement[1] relating to a previously transferred financial asset between the same counterparties.** A repurchase financing generally involves the transfer of a previously transferred financial asset back to the initial transferor as collateral for a financing[2] 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)[3] to the initial transferee when the financing is repaid at a fixed price on a stated date. The repurchase financing may be entered into simultaneously with the initial transfer or may occur at a later date. The lapse of time between the initial transfer and the repurchase agreement is not relevant when determining if the transaction is a repurchase financing within the scope of this FSP.

5. 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.
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.

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[1] The term *repurchase agreement* is described in paragraph 97 of Statement 140.
[2] The legal form of the repurchase financing may vary; however, the substance of the transaction should be considered to determine whether a repurchase financing exists.
[3] 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.*

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.

6. A transferor and transferee shall separately account for a transfer of a financial asset and a related repurchase financing, either entered into at the same time or subsequently, if (a) the 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's regaining control over the financial asset. An example of a transaction lacking a valid business or economic purpose is a transaction entered into to circumvent an accounting standard or solely to achieve a specific accounting result. Unless the initial transfer and the repurchase financing meet the criteria in paragraph 7, indicating that a valid business or economic purpose exists and control has not been regained by the initial transferor, the transactions must be considered linked for purposes of applying Statement 140.

7. The initial transfer of a financial asset and repurchase financing shall be considered linked unless *all* of the following criteria are met:

a. The initial transfer and the repurchase financing are not contractually contingent on one another. There are no implied commitments that are entered into at or near the same time with the same counterparty (or an affiliate or agent of the counterparty) that depend on or affect either of the transactions. For example, if the pricing or performance of either the initial transfer or the repurchase financing depends on terms and execution of the other agreement, an implied commitment likely exists.

b. The repurchase financing provides the initial transferor with full recourse to the initial transferee upon default, and 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 has a quoted price in an active market (Level 1 inputs as defined in FASB Statement

No. 157, *Fair Value Measurements)*. In addition, the initial transfer of a financial asset and the repurchase financing are executed at market rates.

d. The initial transferee (the borrower) maintains rights to the collateral (is able to take control of the transferred financial asset and substitute it with a different financial asset). In addition, the initial transferor (the lender) cannot sell or repledge the collateral at any point prior to the settlement of the repurchase financing, unless the asset is readily obtainable.

e. The financial asset and repurchase agreement are not coterminous (the maturity of the repurchase financing is before the maturity[4] of the financial asset).

8. If the transactions meet all of the criteria in paragraph 7, the repurchase financing shall be accounted for separately from the initial transfer, and the transferor and transferee shall analyze the repurchase financing as a repurchase agreement under Statement 140.[5] Statement 140 requires that both parties to a repurchase agreement account for a repurchase agreement in the same manner.

9. If the transactions do not meet all of the criteria in paragraph 7, the initial transfer and repurchase financing should be evaluated as a linked transaction. The linked transaction should then be evaluated to determine if 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 the forward contract.

[4] 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.

[5] Consideration of the specific transaction is needed to determine the relevant paragraphs of Statement 140. Paragraphs 9–12, 15, 47–49, and 96–101 of Statement 140 may be considered.

Effective Date and Transition

10. This FSP shall be effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. Earlier application is not permitted.

11. This FSP shall be applied to existing repurchase financings as of the beginning of the fiscal year in which this FSP is initially applied as a cumulative-effect adjustment. The cumulative effect of the change in accounting principle shall be recognized as an adjustment to the opening balance of retained earnings (or other appropriate components of equity or net assets in the statement of financial position). The cumulative-effect adjustment is the difference between the amounts (if any) recognized in the statement of financial position before the initial application of this FSP and the amounts recognized in the statement of financial position at initial application of this FSP.

12. In the year of initial application of this FSP, an entity shall disclose the nature of the change and the cumulative effect of the change on retained earnings or on other components of equity or net assets in the statement of financial position. An entity shall also disclose the effect of the change on any other affected financial statement line item in the statement of financial position.

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

The 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 even when the same counterparties are involved. Constituents argued that a repurchase financing does not cause the initial transferor to regain control over the transferred assets 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 involving a previously transferred financial asset 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 impact 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. If a typical transfer and repurchase financing are considered part of the same arrangement, attorneys have told the FASB staff that it would be difficult to provide a true sale opinion under U.S. bankruptcy law due to the lack of precedent. However, attorneys also have told the FASB staff that recent revisions to the Uniform Commercial Code provide "safe harbors" in some cases that may allow certain transactions to meet the isolation requirement in concept but would not likely meet an attorney's requirements for a "true sale" opinion.

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A5. The Board decided to permit an initial transfer of a financial asset to be accounted for separately from a repurchase financing if the transactions meet the criteria in paragraph 7 of this FSP. 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.

Contractual Relationships

A6. 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. The Board believes that a written contract is evidence that the two transactions are dependent on one another and the transactions should be linked. However, the Board stated that the absence of such a contract does not automatically indicate that the transactions are not linked. The Board decided that implied commitments must be considered because they may provide evidence of the counterparties' intent to engage in a series of related transactions.

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

A7. 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 full 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.

Marketability

A8. 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 7(c)) 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 effectively maintains 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.

Rights to Collateral

A9. The Board believes that control over a transferred asset is maintained by an initial transferor if it has the right to use the collateral (sell or repledge), unless the collateral is readily obtainable. In addition, the Board believes that when an initial transferee has the ability to use the collateral and has the right to substitute a dissimilar asset in place of the collateral, the initial transferor does not likely control the transferred financial asset.

Timing and Terms

A10. The Board concluded that when transactions are done for the same term (a repurchase to maturity), the initial transferor effectively maintains control over the transferred asset because the asset would mature before it would have to be returned to the initial transferee.

Applicability

A11. 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

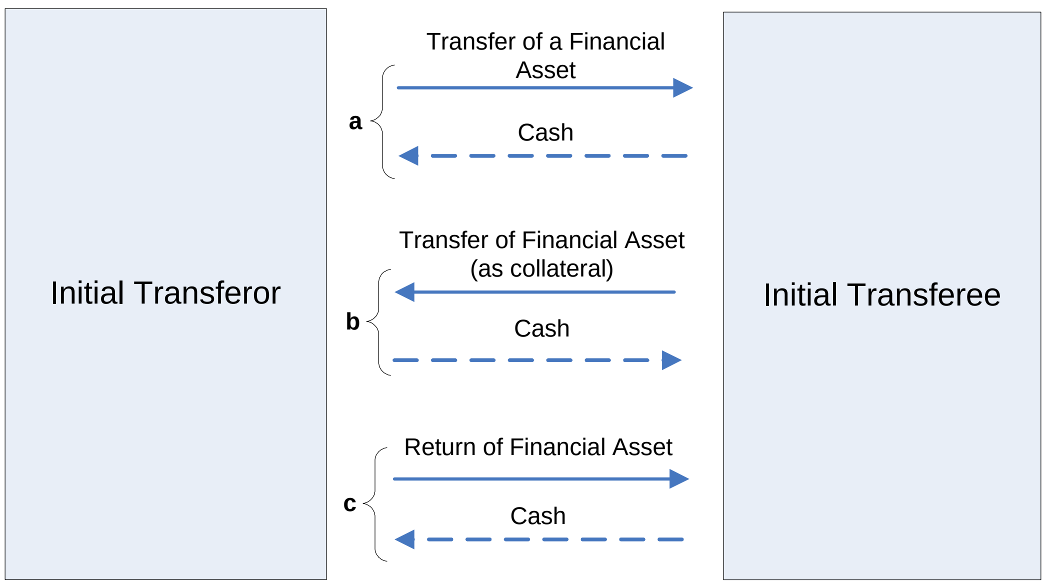
A12. Constituents told the Board that it is common practice for transferors and transferees in certain industries to separately account for transfers and repurchase financings as described in paragraph A2 of this FSP. The Board does not believe this practice is consistent with the intent of Statement 140. Consequently, the Board decided that it is desirable to make this FSP effective as soon as practicable. The Board decided that the provisions of this FSP should be effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Board decided that early adoption of this FSP would not be permitted.

A13. 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 many repurchase financings are relatively short term such that many (if not most) initiated prior to this FSP would not be in effect (outstanding) at the effective date of this FSP. Additionally, the Board decided that prospective application would not be appropriate because this would result in the outstanding repurchase financings at the effective date not being addressed. Largely for those reasons, the Board concluded that this FSP should be applied to existing repurchase financings as of the effective date of this FSP as a cumulative-effect adjustment.

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 4 and 5 of this FSP that should be analyzed using the criteria in paragraph 7. 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.[6]

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

[6] Whether the parties agree to net settle steps (a) and (b) would 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 fail the criteria in paragraph 7 of this FSP.

receives cash from the initial transferor.[7] 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 or determinable 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.

[7] See footnote 6.