

FASB In Focus

Accounting Standards Update, *Transfers and Servicing (Topic 860): Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures*

Introduction

On June 12, 2014, the FASB issued a new Accounting Standards Update, *Transfers and Servicing (Topic 860): Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures*. The Update improves the financial reporting of repurchase agreements and other similar transactions through a change in accounting for repurchase-to-maturity transactions and repurchase financings, and the introduction of two new disclosure requirements. New disclosures are required for (1) transfers accounted for as sales in transactions that are economically similar to repurchase agreements, in which the transferor retains substantially all of the exposure to the economic return on the transferred financial asset throughout the term of the transaction and (2) repurchase agreements, securities lending transactions, and repurchase-to-maturity transactions accounted for as secured borrowings about the nature of collateral pledged and the time to maturity of those transactions.

What Are Repurchase Agreements?

Repurchase agreements are transactions in which the transferor (repo party) transfers a financial asset to a transferee (repo counterparty) in exchange for cash and

concurrently agrees to reacquire that financial asset at a future date for an amount equal to the cash exchanged plus or minus a stipulated interest factor. Instead of cash, other securities or letters of credit sometimes are exchanged. Some repurchase agreements call for repurchase of financial assets that need not be identical to the financial assets transferred.

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Repurchase agreements are used by some companies and institutions as a source of short-term financing on a collateralized basis, allowing lenders in this market to invest money on a secured, short-term basis. For example, an investment fund with excess cash might enter into a repurchase agreement with a bank in need of short-term financing. Under that contract, the bank, or transferor, sells securities to the investment fund, or transferee, and agrees to repurchase the securities at a specific date in the future for a price that is sufficient to cover the

fund's original purchase price, plus an additional return on investment. During the term of a typical repurchase agreement, the transferee fund can obtain certain benefits of the transferred financial assets by selling or pledging the transferred assets.

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Why Did the FASB Embark on a Project to Improve Financial Reporting in This Area?

The Board decided to embark on this project in response to stakeholder concerns about the existence of different accounting treatments for certain repurchase agreements and similar transactions. The Board also sought to increase transparency about the

types of collateral pledged in those agreements that are accounted for as secured borrowings and about the effect of sale accounting for transactions that are economically similar to repurchase agreements, in which the transferor retains substantially all of the exposure to the economic return on the transferred financial asset throughout the term of the transaction.

Many stakeholders expressed concern that current accounting guidance distinguishes between repurchase agreements that settle at the same time as the maturity of the transferred financial asset and those that settle any time before maturity. In particular, repurchase-to-maturity agreements generally are accounted for as sales with forward agreements under current accounting, whereas repurchase agreements that settle before the maturity of the transferred financial asset generally are accounted for as secured borrowings. Additionally, current accounting guidance requires an evaluation of whether an initial transfer of a financial asset and a contemporaneous repurchase agreement (a repurchase financing) should be accounted for separately or linked. If linked, the arrangement is accounted for on a combined basis as a forward agreement. These outcomes often are referred to as off-balance-sheet accounting. Stakeholders noted that accounting distinctions between different types of repurchase agreements should not exist because the transferor retains exposure to the transferred financial assets and obtains important benefits of those assets throughout the term of the transaction in all types of repurchase transactions.

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Additionally, the Board noted that the marketplace for repurchase agreements and securities lending transactions has evolved significantly since the FASB first issued guidance in this area in FASB Statement No. 125, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. For example, while repurchase agreements historically had involved mostly U.S. Treasury and U.S. government agency securities, the range of financial instruments pledged as collateral have broadened to include other types of asset-backed securities, structured debt securities, and sovereign debt securities, which may be less liquid and affect how those transactions operate and how investors consider the risks associated with them.

How Does the Update Address These Issues?

The new guidance contained in the Update requires two accounting changes.

First, it changes the accounting for repurchase-to-maturity transactions to secured borrowing accounting, such that those transactions will be accounted for as if the transferor maintains effective control over the transferred assets. This makes it consistent with the accounting treatment for other typical repurchase agreements.

Second, the new guidance requires separate accounting for a

transfer of a financial asset executed with a repurchase agreement with the same counterparty, which will result in secured borrowing accounting for the repurchase agreement.

Additionally, the Update requires disclosures for certain transactions comprised of (1) a transfer of a financial asset accounted for as a sale and (2) an agreement with the same transferee entered into in contemplation of the initial transfer that results in the transferor retaining substantially all of the exposure to the economic return on the transferred financial asset throughout the term of the transaction. Because these transactions accounted for as sales might be economically similar to repurchase agreements accounted for as secured borrowings, this disclosure helps investors understand the nature of the transactions. For such transactions accounted for as a sale that are outstanding at the reporting date, the transferor is required to disclose the following by type of transaction (for example, repurchase agreements, securities lending arrangements, and a sale with a total return swap):

1. The carrying amount of assets derecognized (sold) as of the date of derecognition
2. The amount of gross proceeds received by the transferor at the time of derecognition for the assets derecognized
3. The information about the transferor's ongoing exposure to the economic return on the transferred financial assets
4. The amounts that are reported in the statement of financial position arising from

the transaction, such as those represented by derivative contracts.

In order to increase transparency about the types of collateral pledged in those agreements that are accounted for as secured borrowings, the Update also requires the following disclosures for repurchase agreements, securities lending transactions, and repurchase-to-maturity transactions that are accounted for as secured borrowings:

1. A disaggregation of the gross obligation by the class of collateral pledged
2. The remaining contractual time to maturity of the agreements
3. A discussion of the potential risks associated with the agreements and the related collateral pledged including obligations arising from a decline in the fair value of the collateral pledged and how those risks are managed.

How Does the New Guidance Contained in the Update Compare with International Financial Reporting Standards (IFRS)?

This Update brings GAAP into greater alignment with International Financial Reporting Standards (IFRS) for repurchase-to-maturity transactions. The Board's decision to require secured borrowing accounting for repurchase-to-maturity

transactions results in a converged outcome for these types of transactions because substantially all the risks and rewards in this transaction are typically considered to be retained by the transferor, resulting in a requirement for secured borrowing accounting under IFRS. Additionally, the new disclosures for repurchase agreements, securities lending transactions, and repurchase-to-maturity transactions accounted for as secured borrowings are similar to existing disclosures under IFRS.

Who Will Be Affected by the Update?

The amendments to current GAAP contained in this Update affect all organizations that enter into repurchase-to-maturity transactions or repurchase financings. All organizations also are subject to the new disclosure requirements described above.

When Will the Update Be Effective?

Accounting Changes

Public companies: The first interim or annual period beginning after December 15, 2014. Earlier application is prohibited.

Private companies and not-for-profit organizations: Annual periods beginning after December 15, 2014, and interim periods beginning after December 15, 2015 (with the option to apply the requirements for interim periods

beginning after December 15, 2014).

All reporting organizations—both public and private—are required to present changes in accounting for transactions outstanding on the effective date as a cumulative-effect adjustment to retained earnings as of the beginning of the period of adoption.

Disclosures

Public companies: The disclosure for certain transactions accounted for as a sale are required to be presented for interim and annual periods beginning after December 15, 2014. The disclosure for repurchase agreements, securities lending transactions, and repurchase-to-maturity transactions accounted for as secured borrowings is required to be presented for annual periods beginning after December 15, 2014, and for interim periods beginning after March 15, 2015.

Private companies and not-for-profit organizations: Both new disclosures are required to be presented for annual periods beginning after December 15, 2014, and interim periods beginning after December 15, 2015.

The disclosures are not required to be presented for comparative periods before the effective date.

For more information about the project, please visit the FASB's website at www.fasb.org.