

FASB Update

November 8, 2007

Purchase + Repurchase = ???

- What is this project about?

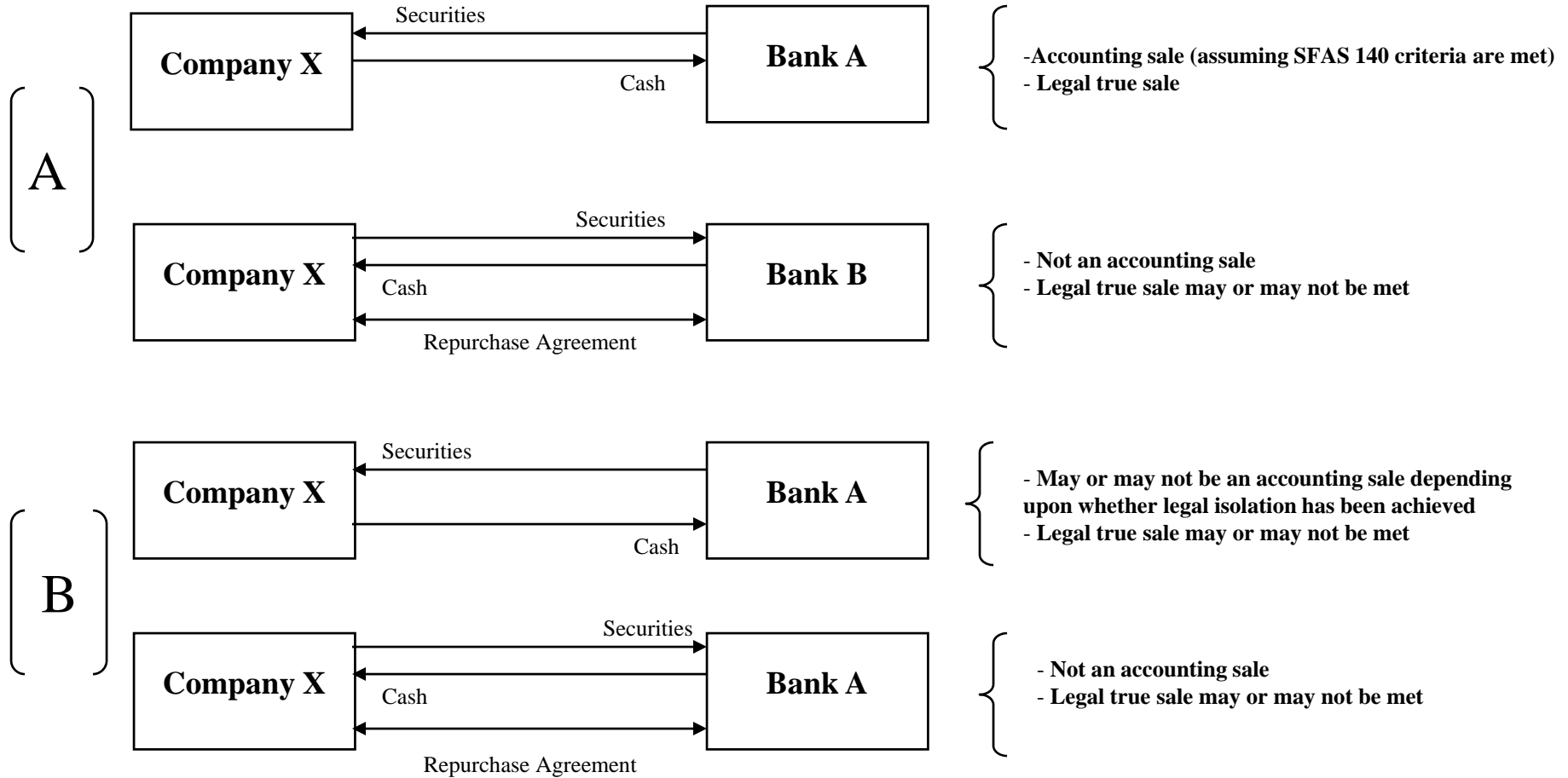
- The Board issued the Exposure Draft for FASB Staff Position (FSP) 140-d, *Accounting for Transfers of Financial Assets and Repurchase Financing Transactions*, on July 24, 2007
- Proposed FSP addresses transactions involving a transfer of financial asset and a repurchase financing of that asset involving the same parties to the initial transfer
- Provides guidance on when transactions (the transfer and the repo) must be viewed as linked (thus, not accounted for as a sale) or can be viewed as two separate transactions (and thus, accounted for as a sale)
- The comment period ended on September 14, 2007. More than 25 comment letters received
- Effective date in ED: interim periods within fiscal years beginning after November 15, 2007
- No grandfathering of any outstanding repurchase financings (cumulative effect adjustment upon adoption); application is neither full retrospective nor prospective only

Purchase + Repurchase = ??? (cont'd)

- Types of Repurchase Transactions

- Type of transaction in which a party acquires funds by selling securities and simultaneously agreeing to repurchase the same or similar securities after a specified time at a given price
- Repurchase Agreements and Reverse Repurchase Agreements
- Dollar Rolls:
 - Fixed-coupon dollar roll
 - Yield-maintenance agreement
- Characteristics of Repo Agreements:
 - Maturities; principal amounts; yields; repo rates; margin; mark-to-market provisions

Purchase + Repurchase = ??? (cont'd)



Purchase + Repurchase = ??? (cont'd)

- Accounting Issues

- How to apply criteria in paragraph 9(a) of Statement 140 in accounting for transactions involving the purchase of financial assets and simultaneous repurchase of the same financial assets with the seller
- Current practice is to record transactions gross booking asset as purchase and repo as financing
- The proposed FSP will provide five factors to distinguish between those transactions that should be considered linked and those that should not be considered linked
- All five factors would have to be met to overcome a presumption that the transactions are linked
- If all of the five factors are not met:
 - The transactions would be considered linked
 - Initial transferor would continue to recognize the assets originally transferred
 - Transferor and transferee would likely account for the linked transactions as a derivative (i.e., a forward contract); however, Level III assets for physically settled forwards may not be derivatives (and hence the initial transferee retains the risk but does not record the asset or derivative)

Purchase + Repurchase = ??? (cont'd)

- **Delinking Criteria**

- The transactions are not contractually contingent on each other (e.g., through a written contract, the actions of the counterparties, or implied commitments that indicate that the two transactions are dependent on one another)
- The contracts provide for recourse upon the default of the initial transferee or involve a repurchase agreement that allows the initial transferee to repurchase the financial asset for a fixed price and not fair value at settlement of the financing (such that the initial transferor does not retain the economics of the transferred asset)
- The financial asset subject to the initial transfer and repurchase financing has a quoted price in an active market (Level I inputs as defined in Statement 157). In addition, the initial transfer of a financial asset and the repurchase financing are executed at market rates
- The initial transferee has the ability to substitute collateral for the asset provided in the repurchase agreement
- The financial asset and repurchase agreement are not coterminous (repo maturity is before the maturity of the financial asset)

Purchase + Repurchase = ??? (cont'd)

- Comment Letters

- Clarify scope that other financing arrangements (e.g., collateralized financing arrangements) that are not “traditional” repurchase agreements are excluded from scope
- Use other GAAP “linkage” models vs. introducing a new one; change “criteria that must be met” to “indicators that should be considered” in evaluation of the transactions by the companies
- No ability to consider lapse of time between original transfer and repurchase transaction; significant tracking burden; virtually inoperable
- Requirement of Level I assets only is overly restrictive
- Unconditional right of the borrower in a repo to substitute collateral is not practical; change to “the borrower be able to negotiate to substitute collateral”
- Proposed adoption timeline is aggressive and non-operable. Delay adoption to allow companies and auditors more time to prepare

Loan Classifications

- **SOP 01-6 Criteria**

- Held for investment (HFI): management must have both intent and ability to hold for the foreseeable future, payoff, or until maturity
- Held for sale (HFS): loans that do not meet HFI criteria

- **FAS 65, Par.6**

- A mortgage loan shall not be classified as a long-term investment unless the mortgage banking enterprise has both the ability and the intent to hold the loan for the foreseeable future or until maturity.

- **Analogies to FAS 144 criteria for held for sale is NOT appropriate for loans**

- **No FAS 115 “Available-For-Sale” category**

Loan Classifications (cont'd)

- Sales of HFI

- FAS 65 / SOP 01-6 do not have a “tainting” notion like FAS 115 for sales of HTM securities
- SOP 01-6 – classification to HFS once management has made the decision to sell loans previously classified as HFI / abandoned intent to hold for the “foreseeable future, or until payoff or maturity”
 - Interagency Guidance on Certain Loans Held for Sale, March 26, 2001 + the accompanying SEC Chief Accountant letter
- Facts and circumstances; judgment required in determining whether a decision to sell has been made
 - Budgets
 - Plans and forecasts
 - ALCO packages / Secondary Marketing activities
 - Treasury
- Subsequent events (classified HFI at balance sheet date; sold prior to the release of financials)

Loan Classifications (cont'd)

- Transfers from HFS to HFI

- FAS 65, Par. 6

- A mortgage loan transferred to a long-term-investment classification shall be transferred at the lower of cost or fair value on the transfer date. Any difference between the carrying amount of the loan and its outstanding principal balance shall be recognized as an adjustment to yield by the interest method

Loan Classifications (cont'd)

- **Cash Flow Statement Classifications**

- Loans should only be classified as held for investment when management has intent and ability to hold for the foreseeable future, or until payoff or maturity
- FAS 102 - cash receipts and payments resulting from acquisition and sales of loans that are originated or purchased for resale should be classified as operating
- Subsequent transfers to or from held for sale do not impact cash flow classification
- HFI loans transferred to HFS and then sold; sale proceeds are to be shown in investing activities (since the HFI cash flows are shown in investing activities)
- Transfers between HFS and HFI, if material, should be disclosed as non-cash activities

Loan Classifications (cont'd)

- Cash Flow Statement Classifications (cont'd)

- FAS 115 Securities and Retained Interests

- Cash receipts and payments resulting from purchase or sale of trading securities should be classified as operating
- Cash receipts and payments resulting from purchase, sale or maturity of AFS securities should be classified as investing
- Cash receipts from the maturity of retained interests accounted for like AFS or HTM securities should be classified as investing, even if the retained interest resulted from the sale of held for sale loans

Center for Audit Quality – White Papers

- CAQ is not a GAAP setter
- No affiliation with FASB or SEC
- Issued three white papers with “friendly reminders” of existing GAAP
 - Measurements of Fair Value in Illiquid (or Less Liquid) Markets
 - Consolidation of Commercial Paper Conduits – summarizing the basic structures and risks of commercial paper conduits and the application of FASB Interpretation No. 46(R), *Consolidation of Variable Interest Entities*, by their sponsors
 - Accounting for Underwriting and Loan Commitments – summarizes GAAP associated with commitments to lend money or underwrite securities in the context of illiquid (or less liquid) market conditions that currently exist in many segments of the credit markets
- The white papers are available at <http://thecaq.aicpa.org>

Other Matters and References

- **Current Mortgage Accounting / Financial Reporting Continuing Topics**
 - OTTI on securities
 - ALLL and loan accounting
 - Valuations
 - Impairment of goodwill, identifiable intangibles, capitalized software
 - Restructuring and reorganization
- **Plenty of GAAP Literature (selected items are listed in the following slides)**

Other Matters and References (cont'd)

- *Other-Than-Temporary Impairment of Investments in Debt and Equity Securities*
 - FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities* (including its Implementation Guide)
 - FASB Staff Position No. FAS 115-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*
 - EITF Issue No. 99-20, *Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets*
 - SEC Staff Accounting Bulletin No. 59, *Accounting for Noncurrent Marketable Equity Securities* (as codified in Staff Topic 5M)
 - AICPA Statement on Auditing Standards No. 92, *Auditing Derivative Instruments, Hedging Activities, and Investments in Securities*

Other Matters and References (cont'd)

– *Loans and Allowance for Credit Losses*

- FASB Statement No. 5, *Accounting for Contingencies*
- FASB Statement No. 15, *Accounting by Creditors for Troubled Debt Restructurings*
- FASB Statement No. 91, *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases*
- FASB Statement No. 114, *Accounting by Creditors for Impairment of a Loan*
- EITF Issue No. 01-7, *Creditor's Accounting for a Modification or Exchange of Debt Instruments*
- SEC Staff Accounting Bulletin No. 102, *Selected Loan Loss Allowance Methodology and Documentation Issues*
- Interagency Policy Statement on the Allowance for Loan and Lease Losses (December 2006)

– *Mortgage Loans Held for Sale*

- FASB Statement No. 65, *Accounting for Certain Mortgage Banking Activities*
- FASB Statement No. 102, *Statement of Cash Flows – Exemption of Certain Enterprises and Classification of Cash Flows from Certain Securities Acquired for Resale*

Other Matters and References (cont'd)

– *Loans Acquired in a Transfer*

- FASB Statement No. 5, *Accounting for Contingencies*
- Statement of Position 03-3, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer*

– *Other Real Estate Owned*

- FASB Statement No. 15, *Accounting by Creditors for Troubled Debt Restructurings*
- FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*
- FASB Staff Position No. FAS 144-1, *Determination of Cost Basis for Foreclosed Assets under FASB Statement No. 15, Accounting by Debtors and Creditors for Troubled Debt Restructurings, and the Measurement of Cumulative Losses Previously Recognized under Paragraph 37 of FASB Statement No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets*
- Statement of Position 01-6, *Accounting by Certain Entities (Including Entities With Trade Receivables) That Lend to or Finance the Activities of Others*

Other Matters and References (cont'd)

- *Credit Enhancements, Including Recourse and Guarantees, and Loans Covered by Buyback Provisions*
 - FASB Statement No. 5, *Accounting for Contingencies*
 - FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*
 - FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (including its Implementation Guide)
 - FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*
 - EITF Issue No. 02-9, *Accounting for Changes That Result in a Transferor Regaining Control of Financial Assets Sold*
 - Statement of Position 03-3, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer*

Other Matters and References (cont'd)

– *Beneficial Interests and Servicing Rights*

- FASB Statement No. 91, *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases*
- FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (including its Implementation Guide)
- FASB Statement No. 156, *Accounting for Servicing of Financial Assets – an amendment of FASB Statement No. 140*
- EITF Issue No. 99-20, *Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets*

– *Qualifying and Non-Qualifying Special-Purpose Entities*

- FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (including its Implementation Guide)
- FASB Interpretation No. 46(R), *Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51*

Other Matters and References (cont'd)

- *Restructurings in Loan Origination and Servicing Departments in Response to Decreases in Production Volumes or Other Business Changes*
 - FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*
 - FASB Statement No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*
 - FASB Concepts Statement No. 6, *Elements of Financial Statements*
 - SEC Staff Accounting Bulletin No. 100, *Restructuring and Impairment Charges*
- *Residential Loan Product Disclosures, Including Troubled Debt Restructuring and Impaired Loan Disclosures*
 - FASB Statement No. 15, *Accounting by Creditors for Troubled Debt Restructurings*
 - FASB Statement No. 114, *Accounting by Creditors for Impairment of a Loan*
 - FASB Staff Position No. SOP 94-6-1, *Terms of Loan Products That May Give Rise to a Concentration of Credit Risk*
 - Securities Act Guide 3