

MEMO# 24801

December 20, 2010

FASB Issues Proposal on Transfers of Securities

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TO: ACCOUNTING/TREASURERS COMMITTEE No. 16-10 RE: FASB ISSUES PROPOSAL ON TRANSFERS OF SECURITIES

The Financial Accounting Standards Board recently released a proposed accounting standards update that would modify the criteria under ASC Topic 860 for assessing whether a transferor of securities maintains effective control over those securities. [\[1\]](#) Specifically, the update proposes to eliminate the collateral maintenance provision that a company may use to determine whether a transfer of securities in a repurchase agreement is accounted for as a sale or a secured borrowing. The proposal may cause certain dollar roll transactions that currently are accounted for as a sale of securities with an agreement to repurchase securities, to instead be accounted for as a secured borrowing transaction.

The proposal indicates that it is intended to improve the accounting for repurchase agreements and other agreements that obligate a transferor to repurchase or redeem financial assets before their maturity. The proposal explains that repurchase agreements are utilized principally as mechanisms for obtaining short-term financing. According to the proposal, in a repurchase agreement, one party (the “transferor”) transfers a security to another party (the “transferee”) for cash and is obligated to repurchase the transferred asset for a fixed price on a specified date. [\[2\]](#)

ASC Topic 860 prescribes when a transferor may recognize a sale upon the transfer of securities subject to repurchase agreements. That determination is based, in part, on whether the entity has maintained effective control over the transferred securities. If control is surrendered, the transferred security is removed from the transferor’s balance sheet, and the transferor accounts for the cash received and an obligation to repurchase the security. When a transfer of securities does not qualify for sale accounting, it is accounted for as a secured borrowing. In a secured borrowing, the transferred security

remains on the transferor's balance sheet and the transferor recognizes a liability for the cash received. When the transferred security remains on the transferor's balance sheet, the income associated with the security continues to be recorded as income to the transferor, and any costs associated with the borrowing are considered to be expenses to the transferor. As a result, any change from sale accounting to secured borrowing may affect the fund's expense ratio.

Sale accounting is achieved only if certain criteria are satisfied, including demonstrating that the transferor has surrendered effective control over the transferred security. The proposal would remove one of the conditions necessary to conclude that a transferor has effective control by eliminating the requirement to hold cash or other collateral that is sufficient to fund substantially all of the cost of purchasing a replacement security, should the transferee fail to return the transferred asset. The proposal makes the amount of cash collateral received by the transferor irrelevant in determining effective control. Consequently, more transfers of securities will be accounted for as financings.

Other criteria applicable to the assessment of effective control would not be changed by the proposal. The transferor would be deemed to have maintained effective control over the securities transferred (requiring secured borrowing accounting) for agreements that both entitle and obligate the transferor to repurchase the security if all of the following conditions are met:

1. The securities to be repurchased or redeemed are the same or substantially the same as those transferred;
2. The agreement is to repurchase or redeem them before maturity, at a fixed or determinable price; and
3. The agreement is entered into contemporaneously with, or in contemplation of the transfer.

Mortgage Dollar Rolls

A mortgage dollar roll is a transaction in which a fund sells a mortgage-backed security to a dealer and simultaneously agrees to repurchase a similar (but not the same) security in the future at a pre-determined price. Whether a mortgage dollar roll qualifies for sale accounting or instead is treated as a financing depends upon the particular facts and circumstances. Some funds may apply sale accounting to their mortgage dollar rolls because they initiate the transaction in the to-be-announced market as described in ASC Topic 860-10-55-17. The proposal would not change the guidance in ASC Topic 860-10-55-17. Further, the proposal would not change the guidance in ASC Topic 860-10-40-24 for determining whether securities to be repurchased are substantially the same as those transferred.

Effective Date

The proposal would be effective for new transfers and existing transactions that are modified as of the beginning of the first interim or annual period after the final accounting standards update is issued. The final update is expected to be issued during the first quarter of 2011. Comments on the proposal are due to the FASB by January 15, 2011. Members that engage in dollar roll transactions are encouraged to review the proposal to determine if it would affect their accounting for these transactions. If you have particular

concerns with the proposal please contact the undersigned.

Gregory M. Smith
Director - Operations/Compliance & Fund Accounting

endnotes

[1] The [proposal](#), Reconsideration of Effective Control for Repurchase Agreements is available on the FASB website.

[2] The proposal is written from the perspective of a broker-dealer or other entity that transfers securities in exchange for cash. Mutual funds are often the counter-party or transferee in these transactions and also refer to the transaction as a repurchase agreement. The mutual fund as transferee, however, is entering into a secured lending transaction.

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