**Exposure Draft**

***SSAP NO. 32r—PREFERRED STOCK***

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| **Hearing Date:** 2020 Spring National Meeting | **Location:**  2020 Spring National Meeting |
| **Deadline for Written Notice of Intent to Speak:**  January 31, 2020 | **Deadline for Receipt of Written Comments:**  January 31, 2020 |

Notice of Public Hearing and Request for Written Comments

**Basis for hearings**. The Statutory Accounting Principles Working Group (SAPWG) will hold a public hearing to obtain information from and views of interested individuals and organizations about the standards proposed in this Exposure Draft. The SAPWG will conduct the hearing in accordance with the National Association of Insurance Commissioners (NAIC) policy statement on open meetings. An individual or organization desiring to speak must notify the NAIC in writing by **January 31, 2020.** Speakers will be notified as to the date, location, and other details of the hearings.

**Oral presentation requirements.** The intended speaker must submit a position paper, a detailed outline of a proposed presentation or comment letter addressing the standards proposed in the Exposure Draft by **January 31, 2020**. Individuals or organizations whose submission is not received by that date will only be granted permission to present at the discretion of the SAPWG chair. All submissions should be addressed to the NAIC staff at the address listed below.

**Format of the hearings**. Speakers will be allotted up to 10 minutes for their presentations to be followed by a period for answering questions from the SAPWG. Speakers should use their allotted time to provide information in addition to their already submitted written comments as those comments will have been read and analyzed by the SAPWG. Those submissions will be included in the public record and will be available at the hearings for inspection.

**Copies**. Exposure Drafts can be obtained on the Internet at the NAIC Home Page (http://www.naic.org). The documents can be downloaded using Microsoft Word.

**Written comments**. Participation at a public hearing is not a prerequisite to submitting written comments on this Exposure Draft. Written comments are given the same consideration as public hearing testimony.

The Statutory Accounting Principles Statement of Concepts was adopted by the Accounting Practices & Procedures (EX4) Task Force on September 20, 1994, in order to provide a foundation for the evaluation of alternative accounting treatments. All issues considered by the SAPWG will be evaluated in conjunction with the objectives of statutory reporting and the concepts set forth in the Statutory Accounting Principles Statement of Concepts. Whenever possible, establish a relationship between your comments and the principles defining statutory accounting.

The exposure period is not meant to measure support for, or opposition to, a particular accounting treatment but rather to accumulate an analysis of the issues from other perspectives and persuasive comments supporting them. Therefore, form letters and objections without valid support for their conclusions are not helpful in the deliberations of the working group. Comments should not simply register your agreement or disagreement without a detailed explanation, a description of the impact of the proposed guidelines, or possible alternative recommendations for accomplishing the regulatory objective.

Any individual or organization may send written comments addressed to the Working Group to the attention of Julie Gann at [jgann@naic.org](mailto:jgann@naic.org), Robin Marcotte at [rmarcotte@naic.org](mailto:rmarcotte@naic.org), Jim Pinegar at [jpinegar@naic.org](mailto:jpinegar@naic.org), Fatima Sediqzad at [fsediqzad@naic.org](mailto:fsediqzad@naic.org) and Jake Stultz at [jstultz@naic.org](mailto:jstultz@naic.org) no later than **January 31, 2020**. Electronic submission is preferred. Julie Gann is the NAIC Staff that is the project lead for this topic.

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# Statement of Statutory Accounting Principles No. 32R

# Preferred Stock

## Status

|  |  |
| --- | --- |
| Type of Issue | Common Area |
| Issued | Initial Draft; December 7, 2019 exposure draft |
| Effective Date | January 1, 2001; Substantive revisions - TBD |
| Affects | No other pronouncements |
| Affected by | No other pronouncements |
| Interpreted by | INT 06-02; INT 06-07 |
| Relevant Appendix A Guidance | None |

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## SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for preferred stock.
2. Investments in preferred stock of entities captured in *SSAP No. 97—Investments in subsidiaries, controlled or affiliated entities* or *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*, as well as preferred stock interests of certified capital companies per *INT 06-02: Accounting and Reporting for Investments in a Certified Capital Company (CAPCO)* are included within the scope of this statement. The requirement to file investments in preferred stock of certain subsidiaries, controlled or affiliated entities with the NAIC pursuant to SSAP No. 97 does not affect the application of the accounting under this statement.

## SUMMARY CONCLUSION

1. Preferred stock, which may or may not be publicly traded, is a security that represents ownership of a corporation and gives the holder a claim, prior to the claim of common stockholders on earnings and also generally on assets in the event of liquidation. Most preferred stock pays a fixed dividend that is paid prior to the common stock dividend, stated in a dollar amount or as a percentage of par value. Preferred stock does not usually carry voting rights. Preferred stock has characteristics of both common stock and debt. Preferred stock shall include:
2. Redeemable preferred stock, which is preferred stock subject to mandatory redemption requirements or whose redemption is outside the control of the issuer. Redeemable preferred stock is any stock which 1) the issuer undertakes to redeem at a fixed or determinable price on the fixed or determinable date or dates, whether by operation of a sinking fund or otherwise; 2) is redeemable at the option of the holders; or 3) has conditions for redemption which are not solely within the control of the issuer, such as stock which must be redeemed out of future earnings. Preferred stock which meet one or more of these three criteria would be classified as redeemable preferred stock[[1]](#footnote-1) regardless of other attributes such as voting rights or dividend rights.
3. Perpetual preferred stock, which is preferred stocks which are not redeemable or are redeemable solely at the option of the issuer (non-redeemable preferred stock). Perpetual preferred stock is any preferred stock which does not meet the criteria to be classified as redeemable preferred stock pursuant to paragraph 3.a.
4. The definition of preferred stock, as defined in paragraph 3 does not include fund investments. However, the following types of SVO-identified investments are captured within scope of this statement.
5. Exchange Traded Funds, which qualify for preferred stock treatment, as identified in Part Six, Section 2, of the *Purposes and Procedures Manual of the NAIC Investment Analysis Office.* SVO-Identified Preferred Stock ETFs shall follow the accounting provisions for perpetual preferred stock.
6. Restricted preferred stock is defined[[2]](#footnote-2) as either redeemable or perpetual preferred stock that must be traded in compliance with special Securities Exchange Commission (SEC) regulations concerning its purchase and resale. These restrictions generally result from affiliate ownership, merger and acquisition (M&A) activity and underwriting activity. Pursuant to the SEC, restricted securities are securities acquired in an unregistered, private sale from the issuing company or from an affiliate of the issuer. They typically bear a “restrictive” legend clearly stating that the holding may not resell the stock in the public marketplace unless the sale is exempt from the SEC’s registration requirements. Restricted preferred stock is generally considered an admitted asset; however, admittance may be limited based on the degree of restriction in accordance with *SSAP No. 4—Assets and Nonadmitted Assets*. Restricted preferred stock shall be coded as restricted in the investment schedule and disclosed pursuant to *SSAP No. 1—Accounting Policies, Risks & Uncertainties, and Other Disclosures.*
7. Preferred stocks meet the definition of assets as defined in *SSAP No. 4—Assets and Nonadmitted Assets* and are admitted assets to the extent they conform to the requirements of this statement.

### Acquisitions and Sales

1. At acquisition, preferred stock shall be reported at cost, including brokerage and other related fees. Preferred stock received as dividends shall be initially recorded at fair value. Acquisitions and dispositions shall be recorded on the trade date. Private placement stock transactions shall be recorded on the funding date.
2. A reporting entity can subscribe for the purchase of stock, but not be required to make payment until a later time. Transactions of this nature are common in the formation of corporations. Preferred stock acquired under a subscription represents a conditional transaction in which a preferred stock is authorized for issuance but not yet actually issued. Such transactions are settled if and when the actual preferred stock is issued and the exchange or National Association of Securities Dealers (NASD) rules that the transactions are to be settled. Preferred stock acquired under a subscription shall be recorded as an admitted asset when the reporting entity or its designated custodian or transfer agent takes delivery of the preferred stock and the preferred stock is recorded in the name of the reporting entity or its nominee, (i.e., the accounting for such preferred stock acquisitions shall be on the settlement date).

### Amortization

1. Redeemable preferred stock purchased at a premium shall be amortized to reduce the carrying value to the call or redemption value over the period to the call or earliest redemption date, whichever produces the lowest asset value (yield to worst). Redeemable preferred stock purchased at a discount shall be accreted to increase the carrying value to the redemption price over the period to maturity or the latest redemption date. Amortization (and accretion) of the premium and discount arising at acquisition shall be calculated using the interest method and shall be reported through investment income.

### Balance Sheet Amount

1. Preferred stock shall be valued based on (a) the underlying characteristics (redeemable, perpetual or mandatory convertible), (b) the quality rating expressed as an NAIC designation, and (c) whether an asset valuation reserve (AVR) is maintained by the reporting entity:
   1. For reporting entities that do not maintain an AVR:
      1. Highest-quality or high-quality redeemable preferred stocks (NAIC designations 1 and 2) shall be valued at amortized cost. All other redeemable preferred stocks (NAIC designations 3 to 6) shall be reported at the lower of amortized cost or fair value.
      2. Perpetual preferred stocks shall be reported at fair value, not to exceed any stated call price.
      3. Mandatory convertible preferred stocks (regardless if the preferred stock is redeemable or perpetual) shall be reported at fair value, not to exceed any stated call price, in the periods prior to conversion. Upon conversion to common stock, these securities shall be in scope of SSAP No. 30R.
      4. For preferred stocks reported at fair value, unrealized gains and losses shall be recorded as a direct credit or charge to unassigned funds (surplus).
   2. For reporting entities that maintain an AVR:
      1. Highest-quality, high-quality or medium quality redeemable preferred stocks (NAIC designations 1 to 3) shall be valued at amortized cost. All other redeemable preferred stocks (NAIC designations 4 to 6) shall be reported at the lower of amortized cost or fair value.
      2. Perpetual preferred stocks shall be valued at fair value, not to exceed any stated call price.
      3. Mandatory convertible preferred stocks (regardless if the preferred stock is redeemable or perpetual) shall be reported at fair value, not to exceed any stated call price, in the periods prior to conversion. Upon conversion to common stock, these securities shall be in scope of SSAP No. 30R.
      4. For preferred stocks reported at fair value, the accounting for unrealized gains and losses shall be in accordance with *SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve* (SSAP No. 7).

### Impairment of Redeemable Preferred Stock

1. An other-than-temporary (INT 06-07) impairment shall be considered to have occurred if it is probable that the reporting entity will be unable to collect all amounts due according to the contractual terms of the preferred stock in effect at the date of acquisition. An assessment of other-than-temporary impairment shall occur whenever mandatory redemption rights or sinking fund requirements do not occur. A decline in fair value which is other-than-temporary includes situations where the reporting entity has made a decision to sell the preferred stock prior to its maturity at an amount below its carrying value (i.e., amortized cost). If it is determined that a decline in the fair value of a redeemable preferred stock is other-than-temporary, an impairment loss shall be recognized as a realized loss equal to the entire difference between the redeemable preferred stock’s carrying value and its fair value at the balance sheet date of the reporting period for which the assessment is made. The measurement of the impairment loss shall not include partial recoveries of fair value subsequent to the balance sheet date. For reporting entities required to maintain an AVR, realized losses shall be accounted for in accordance with SSAP No. 7.
2. In periods subsequent to the recognition of other-than-temporary impairment loss for a redeemable preferred stock, the reporting entity shall account for the other-than-temporarily impaired preferred stock as if the preferred stock had been purchased on the measurement date of the other-than-temporary impairment. The fair value of the redeemable preferred stock on the other-than-temporary impairment measurement date shall become the new cost basis of the redeemable preferred stock and the new cost basis shall not be adjusted for subsequent recoveries in fair value. The discount or reduced premium recorded for the preferred stock, based on the new cost basis, shall be amortized over the remaining life of the preferred stock in the prospective manner based on the amount and timing of future estimated cash flows. The preferred stock shall continue to be subject to impairment analysis for each subsequent reporting period. Future declines in fair value which are determined to be other-than-temporary shall be recorded as realized losses.

### Impairment of Perpetual Preferred Stock

1. For any decline in the fair value of perpetual preferred stock which is determined to be other-than-temporary (INT 06-07), the perpetual preferred stock shall be written down to fair value as the new cost basis and the amount of the write down shall be accounted for as a realized loss. For reporting entities required to maintain an AVR, realized losses shall be accounted for in accordance with SSAP No. 7. Subsequent fluctuations in fair value shall be recorded as unrealized gains or losses. Future declines which are determined to be other-than-temporary shall be recognized as realized losses. A decline in fair value which is other-than-temporary includes situations where the reporting entity has made a decision to sell a preferred stock at an amount below its carrying value.

### Income

1. Dividends on preferred stock shall be recorded as investment income for qualifying preferred stock on the ex-dividend date with a corresponding receivable to be extinguished upon dividend settlement. Dividends received shall be recognized in the form received (e.g., cash, preferred stock, common stock) at fair value with differences between fair value and the dividend receivable recognized as gains or losses. Subsequent treatment shall follow the statement that addresses the type of asset received. For example, dividends received in the form of common stock shall be accounted for and reported in accordance with *SSAP No. 30R—Unaffiliated Common Stock*.

### Redemption of Preferred Stock

1. A reporting entity that sells or redeems preferred stock back to the issuer shall recognize consideration received in excess of the book/adjusted carrying value as a realized gain or loss. This recognition shall occur regardless of whether the issuer repurchases the preferred shares at market value, or if the shares are redeemed by the issuer at a predetermined set call price.

### Exchanges and Conversions

1. If preferred stock is exchanged or converted into other securities, the fair value of the preferred stock surrendered at the date of the exchange or conversion shall become the cost basis for the new securities with any gain or loss realized at the time of the exchange or conversion. However, if the fair value of the securities received in an exchange or conversion is more clearly evident than the fair value of the preferred stock surrendered, then it shall become the cost basis for the new securities.

### Disclosures

1. The following disclosures regarding preferred stocks shall be made in the financial statements:
2. Fair values in accordance with *SSAP No. 100R—Fair Value* (SSAP No. 100R)*;*
3. Concentrations of credit risk in accordance with SSAP No. 27;
4. Basis at which the preferred stocks are stated; and
5. A description, as well as the amount, of preferred stock that is restricted and the nature of the restriction.
6. For each balance sheet presented, all preferred stocks in an unrealized loss position for which other-than-temporary declines in value have not been recognized
7. The aggregate amount of unrealized losses (that is, the amount by which cost or amortized cost exceeds fair value) and
8. The aggregate related fair value of preferred stocks with unrealized losses.
9. The disclosures in (i) and (ii) above should be segregated by those preferred stocks that have been in a continuous unrealized loss position for less than 12 months and those that have been in a continuous unrealized loss position for 12 months or longer using fair values determined in accordance with SSAP No. 100R*.*
10. As of the date of the most recent balance sheet presented, additional information should be included describing the general categories of information that the investor considered in reaching the conclusion that the impairments are not other-than-temporary.
11. When it is not practicable to estimate fair value, the investor should disclose the following additional information, if applicable, as of each date for which a statement of financial position is presented in its annual financial statements:
12. The aggregate carrying value of the investments not evaluated for impairment, and
13. The circumstances that may have a significant adverse effect on the fair value.
14. Refer to the Preamble for further discussion regarding disclosure requirements. The disclosure requirements of paragraphs 17.b., 17.e., 17.f., 17.g. and 17.h. shall be included in the annual audited statutory financial reports only.

### Relevant Literature

1. This statement rejects *ASU 2018-03, Recognition and Measurement of Financial Assets and Financial Liabilities, ASU 2016-01, Financial Instruments – Overall,* *FASB Statement No. 115, Accounting for Certain Investments in Debt and Equity Securities* and *FASB Emerging Issues Task Force No. 86-32, Early Extinguishment of a Subsidiary’s Mandatorily Redeemable Preferred Stock*. This statement adopts *FASB Staff Position 115-1/124-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments,* paragraph 16, with modification to be consistent with statutory language in the respective statutory accounting statements.

### Effective Date and Transition

1. This statement is effective for years beginning January 1, 2001. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors.* The guidance in paragraphs 23-26 was previously included within *SSAP No. 99—Accounting for Securities Subsequent to an Other-Than-Temporary Impairment* and was effective for reporting periods beginning on January 1, 2009, and thereafter, with early adoption permitted. In 2010, the guidance from SSAP No. 99 was incorporated within the impacted standards, with SSAP No. 99 superseded. The original impairment guidance included in this standard, and the substantive revisions reflected in SSAP No. 99 are retained for historical purposes within Issue Paper No. 131. The guidance in paragraphs 2 and 3 to SSAP No. 32 was originally superseded January 1, 2005, by guidance included in *SSAP No. 88—Investments in Subsidiaries, Controlled and Affiliated Entities, A replacement of SSAP No. 46*, and then subsequently reflected in *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities.* In 2011, the guidance related to preferred stock of SCAs from SSAP No. 97 was incorporated into this statement and revised to reflect a definition of preferred stock. The original guidance included in this statement, and the substantive revisions reflected in SSAP No. 88 and SSAP No. 97 (including the title change already reflected in SSAP No. 32) are retained for historical purposes within Issue Paper Nos. 32 and 118. Guidance in paragraph 17 was originally contained in *INT 99-29: Classification of Step-Up Preferred Stock* and was effective December 6, 1999.
2. In \_\_\_\_\_\_\_, substantive revisions, as detailed in Issue Paper No. \_\_\_\_ were adopted. These revisions, effective \_\_\_\_\_\_\_\_, update definitions of preferred stock and reporting values based on characteristics of the preferred stock.

## REFERENCES

### Other

* *Purposes and Procedures Manual of the NAIC Investment Analysis Office*
* NAIC Valuation of Securities product prepared by the Securities Valuation Office

### Relevant Issue Papers

* *Issue Paper No. 32—Investments in Preferred Stock (excluding investments in preferred stock of subsidiary, controlled, or affiliated companies)*
* *Issue Paper No. 131—Accounting for Certain Securities Subsequent to an Other-Than-Temporary Impairment*
* *Issue Paper No. 1XX—Preferred Stock*

## Exhibit A – Glossary

**Callable Preferred Stock –** A preferred stock in which the issuer has the right to call or redeem the stock at a preset price after a defined date. Callable preferred stock can be either redeemable preferred stock or perpetual preferred stock depending on other characteristics of the preferred stock. For example, callable preferred stock with a maturity or a specific buyback date would be redeemable preferred stock, whereas callable preferred stock electable at the discretion of the issuer is perpetual preferred stock.

**Convertible Preferred Stock** – A preferred stock that is convertible into another security based on a conversion rate. For example, convertible preferred stock that is convertible into common stock on a two-for-one basis (two shares of common for each share of preferred).

**Cumulative Preferred Stock** – A preferred stock with a provision that missed dividend payments must be paid to cumulative preferred shareholders before other classes of preferred stock shareholders and common shareholders can receive dividend payments. Cumulative preferred stock may have different levels, with a “first” or “senior” cumulative preferred, “regular” cumulative preferred and “subordinate” cumulative preferred that determines the priority in which accumulated unpaid dividends or asset liquidation occurs. (Under SSAP No. 32R, holders of cumulative preferred stock are not permitted to recognize a receivable for unpaid cumulative dividends until declared and the reporting entity is entitled to the divided.)

**Dividend Declaration Date –** The date a corporation declares a dividend payment to its shareholders.

**Dividend Record Date** – The date that identifies the shareholders that are entitled to a declared dividend.

**Dividend Payment Date** – The date the declared dividend will be paid.

**Ex-Dividend Date** – The cut-off date of holding stock to be captured as a shareholder on record entitled to the dividend. (A shareholder that sells their stock on the ex-dividend date would continue to be identified as a shareholder on record entitled to a declared dividend. Anyone who acquires a stock on the ex-dividend date would not be a shareholder on record entitled to a declared dividend.)

**Mandatory Redeemable Preferred Stock** – A preferred stock that embodies an unconditional obligation requiring the issuer to redeem the instrument by transferring its assets at a specified or determinable date (or dates) or upon an event that is certain to occur. (The existence of a mandatory redemption right does not convert the holder of a preferred stock into a creditor, and an issuer may be prohibited from redeeming shares when redemption would cause an impairment of capital.)

**Noncumulative Preferred Stock** – A preferred stock that does not entitle the stockholder to accumulated unpaid dividends. After missing dividend payments, a corporation only has to be make current dividend payments to preferred stock holders before providing dividends to common stock holders.

**Participating Preferred Stock** – A preferred stock that gives the holder participation in the additional earnings of a business or liquidation rights in addition to the normal preferred stock dividend. Pursuant to the terms of the preferred stock, the participation rights may only be activated when income or operations of the issuer exceeds a certain threshold level.

**Payment-in-kind (PIK)** – A term of the preferred stock prospectus that identifies that dividends may take the form of securities (e.g., common stock) rather than cash.

**Perpetual Preferred Stock** - Preferred stocks which are not redeemable or are redeemable solely at the option of the issuer. Perpetual preferred stock is any preferred stock which does not meet the criteria to be classified as redeemable preferred stock.

**Preferred stock** - A security, which may or may not be publicly traded, that shows ownership of a corporation and gives the holder a claim, prior to the claim of common stockholders on earnings and also generally on assets in the event of liquidation.

**Redeemable Preferred Stock** - Preferred stock subject to mandatory redemption requirements or whose redemption is outside the control of the issuer. Redeemable preferred stock is any stock which 1) the issuer undertakes to redeem at a fixed or determinable price on the fixed or determinable date or dates, whether by operation of a sinking fund or otherwise; 2) is redeemable at the option of the holders; or 3) has conditions for redemption which are not solely within the control of the issuer, such as stock which must be redeemed out of future earnings. Preferred stock which meet one or more of these three criteria is redeemable preferred stock regardless of other attributes such as voting rights or dividend rights.

**Restricted Preferred Stock** - Redeemable or perpetual preferred stock that must be traded in compliance with special SEC regulations concerning its purchase and resale. These restrictions generally result from affiliate ownership, M&A activity and underwriting activity. Pursuant to the SEC, restricted securities are securities acquired in an unregistered, private sale from the issuing company or from an affiliate of the issuer. They typically bear a “restrictive” legend clearly stating that the holding may not resell the stock in the public marketplace unless the sale is exempt from the SEC’s registration requirements.

**Sinking Fund** – A potential component of a preferred stock charter that requires the issuer to regularly set funds aside in a separate custodial account for the exclusive purpose of redeeming preferred stock shares. Failure of an issuer to provide to the sinking fund does not create an act of default. Rather, the stock charter may implement provisions for failing to provide to the sinking fund, which could include penalties, restrictions of providing common stock dividends or the repurchase of the preferred stock.

**Step-Up Preferred Stock** – A potential component of a preferred stock charter that identifies whether specific terms will increase over time or with stated provisions. For example, a “step-up dividend” is a feature that increases the dividend rate. A “step-up call” is a feature that increases the call price. A “step-up conversion” increases the conversion price.

**Term Preferred Stock** – Preferred stock with a mandatory redemption requirement (maturity date) captured in the definition of redeemable preferred stock.

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1. Preferred stock shall be classified by its characteristics. For example, a preferred stock that is named “redeemable perpetual preferred stock” shall be reported as either “redeemable” or “perpetual” preferred stock based on whether the characteristics of paragraph 3a are met. [↑](#footnote-ref-1)
2. This definition of restricted stock does not preclude a “restricted asset” classification for any preferred stock that is restricted (e.g., not under the exclusive control of the entity) by actions of the reporting entity or others. For example, if a reporting entity has pledged preferred stock, or used preferred stock in securities lending / repo transactions, the preferred stock shall be coded and disclosed as restricted stock pursuant to SSAP No. 1. [↑](#footnote-ref-2)