



TO: Carrie Mears, Chair, Valuation of Securities (E) Task Force
Members of the Valuation of Securities (E) Task Force

FROM: Charles A. Therriault, Director, NAIC Securities Valuation Office (SVO)
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CC: Eric Kolchinsky, Director, NAIC Structured Securities Group (SSG) and Capital Markets Bureau

RE: Clarify the meaning of Repurchase Agreement in the Derivatives Transaction Definition for Funds in Part Three of the *Purposes and Procedures Manual of the NAIC Investment Analysis Office*

DATE: April 28, 2023

Summary: In 2021 the Task Force adopted amendments to the NAIC Fund Lists section of the Purposes and Procedures Manual of the NAIC Investment Analysis Office (the “Purposes and Procedures Manual”) to provide greater clarity and predictability regarding the acceptable use of derivatives in funds and permit funds greater flexibility in their use of derivatives while maintaining limits on funds’ use of leverage. The SVO now proposes a new amendment to clarify which side of a repurchase agreement constitutes a derivative transaction for purposes of the section.

The definition “Derivatives Transaction” in the Purposes and Procedures Manual was modeled after the SEC definition in Rule 18f-4 under the Investment Company Act of 1940. The Purposes and Procedures Manual definition reads:

Derivatives Transaction – means: (1) any swap, security-based swap, futures contract, forward contract, option, any combination of the foregoing, or any similar instrument (*“derivatives instrument”*), under which a fund is or may be required to make any payment or delivery of cash or other assets during the life of the instrument or at maturity or early termination, whether as margin or settlement payment or otherwise; (2) any short sale borrowing; and (3) *any reverse repurchase agreement or similar financing transaction* [Italics added for emphasis].

One purpose of the original amendment was to limit the use of leverage by funds and, therefore, “Derivative Transactions” encompasses instruments pursuant to which a fund may be required to make a future payment of cash or other assets. Likewise, the inclusion of “reverse repurchase agreements” was intended to capture arrangements by which the fund would owe a future cash payment to the counterparty.



According to the SEC definition in the Rule 18f-4 adopting release, “In a reverse repurchase agreement, a fund transfers a security to another party in return for a percentage of the value of the security. At an agreed-upon future date, the fund repurchases the transferred security by paying an amount equal to the proceeds of the initial sale transaction plus interest.” However, according to SSAP No. 103R - Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, “Reverse repurchase agreements are defined as agreements under which a reporting entity purchases securities and simultaneously agrees to resell the same or substantially the same securities at a stated price on a specified date.” The SSAP No. 103R reverse repurchase agreement definition is the opposite of the SEC definition. According to SSAP No. 103, “Repurchase agreements are defined as agreements under which a reporting entity sells securities and simultaneously agrees to repurchase the same or substantially the same securities at a stated price on a specified date.” The SAPP No. 103R definition of repurchase agreement matches the SEC definition of reverse repurchase agreement, in which the fund is obligated to make a repurchase payment at a later date.

Recommendation: To maintain consistency between the Purposes and Procedures Manual and SSAP No. 103R and eliminate any misconception that a fund cannot be the purchaser of securities/lender of cash, the SVO proposes the following changes to the NAIC Fund Lists section of the Purposes and Procedures Manual. The proposed text changes to P&P Manual are shown below with additions in red underline, deletions in ~~red strikethrough~~ as it would appear in the 2023 P&P Manual format.



PART THREE
SVO PROCEDURES AND METHODOLOGY FOR PRODUCTION
OF NAIC DESIGNATIONS



NAIC FUND LISTS

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REQUIRED DOCUMENTATION, ANALYTICAL PROCEDURES AND ELIGIBILITY CRITERIA

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Definitions

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293. **Derivatives Transaction** – means: (1) any swap, security-based swap, futures contract, forward contract, option, any combination of the foregoing, or any similar instrument (“derivatives instrument”), under which a fund is or may be required to make any payment or delivery of cash or other assets during the life of the instrument or at maturity or early termination, whether as margin or settlement payment or otherwise; (2) any short sale borrowing; and (3) any ~~reverse~~ repurchase agreement under which the fund sells securities and simultaneously agrees to repurchase the same or substantially the same securities at a stated price on a specified date, or similar financing transaction, irrespective of accounting treatment.

https://naiconline.sharepoint.com/teams/SVOVOSTaskForce/Shared Documents/Meetings/2023/2023-05-15 Interim meeting/03-Funds Rep Derivatives/2023-006-01 PP Manual Amend - Funds_Repos.docx