**Discussion of Security Lending / Repo Reporting**

**Includes Restricted Assets Reporting & RBC Impacts**

***Overview:*** Fundamentally, securities lending and repurchase/reverse repurchase (Repo) transactions perform similar functions and are entered for short-term collateralized funding/lending. Although some articles identify that the type of collateral exchanged (security or cash) is a key difference, from discussions with industry cash or securities can be used as collateral under either a security lending or repo agreement. Industry has identified that the counterparty is a key difference between the transactions.

Although similar in function, the accounting and reporting for securities lending and repurchase transactions are different under statutory accounting even when both are accounted for under the “secured borrowing” approach. (All scenarios below focus on secured borrowing accounting, and not as a “sale,” as that is the more prevalent accounting approach.)

This memo intends to document the current accounting guidance and identify how NAIC staff believe accounting and reporting should be reflected. The Working Group is requesting comments on this memo, particularly within the established notes. Subsequently, NAIC staff plan to propose statutory accounting and reporting changes to reflect a consistent approach between securities lending and repurchase transactions.

The guidance for securities lending / borrowings and repo agreements are *in SAP No. 103—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. Although other aspects of the SSAP are applicable, focused guidance for these transactions are in the following paragraphs:

* Securities Lending: Paragraphs 85-92.
* Securities Borrowing: Paragraphs 93-95
* Repurchase Agreements: Paragraphs 102-104 & 113
* Reverse Repurchase Agreements: Paragraphs 111-113

Broad concepts for secured borrowing are in paragraph 19. The concepts for securities lending differ from this guidance with the requirement to recognize items on balance sheet with the ability to sell/repledge collateral. Disclosure guidelines for these transactions are in paragraph 28.

The “conforming” securities lending guidelines are captured in the RBC instructions. The full detail of the requirements is included as an appendix to this memo, but collateral requirements include:

* Cash and cash equivalents
* Direct obligations of, or securities that are fully guaranteed as to principal and interest by, the government of the United States, or any agency of the United States, or by the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation.
* NAIC 1 Designated Securities
* Affiliated-issued collateral is not deemed acceptable.
* In all cases, collateral held must be permitted investments in the state of domicile for the respective insurer.

**Securities Lending – Reporting Entity Lends a Security and Receives Collateral in Exchange:**

A security lending transaction involves the temporary transfer of securities from one party (security lender) to another party (security borrower) and with the lender receiving collateral from the borrower to protect against the risk of loss. The lender receives a fee for the use of the security. Under statutory accounting guidance, the accounting for security lending depends on whether the reporting entity has the ability to pledge or sell the collateral received.

1. ***Lending Entity Cannot Sell / Repledge Security Collateral Received:***
2. Reporting entity lends a security under a secured borrowing agreement. The reporting entity retains the lent security on books and codes it as a restricted asset.
3. Reporting entity lender does not recognize security collateral received as an asset and does not recognize an obligation to return the collateral.
4. If the fair value of the collateral received drops below 100% of the fair value of the loaned security, then the reporting entity (lender) is to nonadmit a portion of loaned security (which is still reported on the books). The amount nonadmitted should be the difference between the collateral and the security reported on the books. (This calculation is done at any point in time – so for a lent $100 bond, if the fair value of the bond declines to $90, then the collateral comparison would be done to the current FV of the bond, and not the FV at the time the security was lent. So, if collateral was received at $102, and declined to $90 (matching the bond), nonadmittance would not be required.) The comparison is also completed in aggregate by counterparty, so if the collateral for one security was to appreciate in value, and the collateral for another was to decline, as long as the combined collateral value continued to represent 100% of the fair value of the loaned securities, additional collateral would not be required.

The Restricted Asset / RBC Impact is as follows:

1. The retained asset lent to the counterparty should be identified as a restricted asset. This loaned asset shall be captured on general interrogatory (GI) line 25.04 or GI line 25.05 based on whether the security lending arrangement is considered to be a ‘conforming’ security lending program. Amounts reported on these lines flow to LR017 (Off-Balance Sheet and Other Items), lines 1 and 2. Items captured in GI line 25.04 (conforming) receive a 0.0020 RBC charge. Items captured in GI line 25.05 (nonconforming) receive a 0.0126 RBC charge. There is no current disclosure on the type of collateral received for these off-balance sheet programs. As such, regulators cannot verify from the financial statements whether the program complies with the “conforming” program requirements. However, as the collateral cannot be sold/repledged, if the collateral complies with the conforming requirements, there would be no change to that assessment over the duration of the transaction. ***(Note 1)***
2. As the collateral asset is not recognized on book of the lender, there is no RBC asset (C-1) charge. As the collateral asset is not recognized, there is no restricted asset reporting or RBC restricted asset charge. The restricted asset charge is placed on the asset that is lent but still retained on the books as discussed above in paragraph 1d. ***(Note 2)***

**Note 1:** Should the type of collateral received in these programs be captured in a financial statement disclosure to allow for regulator verification of the “conforming” program guidelines? Additionally, it has been noted that the admittance calculation focuses solely on the fair value comparison of the collateral received to the security lent. However, there is no current guidance that assesses admittance based on the quality/type of collateral received. Under the current guidance, residuals or low-quality assets could be received and there is no documentation of this type of collateral for certain sec lending and repo programs. Even if these programs would not qualify as conforming, there is a question on whether admittance restrictions should exist based on the collateral received from the counterparty.

**Note 2:** NAIC staff believes there is inconsistent application of the current guidance as there is a disconnect in language between RBC and the Blanks on whether the collateral received or the lent asset is identified as a restricted asset. The blanks instructions in GI 25.04 and GI 25.05 identify the “Amount of Collateral.” The lines in RBC identify “Loaned to Others.” This inconsistency in terminology likely causes confusion on whether the amount reported should be the lent security or the collateral received in exchange. NAIC staff suggest clarifying terminology for consistency purposes, clarifying that the loaned asset retained on book should be the amount reported as restricted that flows through all schedules.

1. ***Lending Entity Can Sell / Repledge Collateral Received – (Also Applies to Cash Collateral)***
2. Reporting entity lends a security under a secured borrowing agreement. The reporting entity retains the lent security on books and codes it as a restricted asset.
3. Reporting entity lender recognizes collateral received from the counterparty on its book and recognizes a liability to return the collateral. (This collateral is reported on Schedule DL.) If security collateral is captured directly on the investment schedules, the collateral is **not** coded as a restricted asset. *(See paragraph 2f.)*
4. If the fair value of the collateral received drops below 100% of the fair value of the loaned security, then the reporting entity is to nonadmit a portion of loaned security (which is still reported on the books). The amount nonadmitted should be the difference between the collateral and the security reported on the books. (This calculation is done at any point in time – so for a lent $100 bond, if the fair value of the bond declines to $90, then the collateral comparison would be done to the current FV of the bond, and not the FV at the time the security was lent. So, if collateral was received at $102, and declined to $90 (matching the bond), nonadmittance would not be required.) The comparison is also completed in aggregate by counterparty, so if the collateral for one security was to appreciate in value, and the collateral for another was to decline, as long as the combined collateral value continued to represent 100% of the fair value of the loaned securities, additional collateral would not be required. ***(Note 3 & Note 4)***

The Restricted Asset / RBC Impact is as follows:

1. The retained asset lent to the counterparty should be identified as a restricted asset. This loaned asset shall be captured on GI line 25.04 or GI line 25.05 based on whether the security lending agreement is considered to be a ‘conforming’ security lending program. Amounts reported on these lines flow to LR017 (Off-Balance Sheet and Other Items), lines 1 and 2. Items captured in GI line 25.04 (conforming) receive a 0.0020 RBC charge. Items captured in GI line 25.05 (nonconforming) receive a 0.0126 RBC charge. ***(Note 5)***
2. The current collateral recognized on the balance sheet is subject to the corresponding asset (C-1) RBC charge. (This occurs directly from the investment schedule, or indirectly from Schedule DL if the program is administered by a third-party administrator.) The RBC charge depends on the form of the collateral. (This recognition occurs regardless of whether the original collateral is reinvested.)
3. The collateral reported on book as it can be sold/repledged, is not coded as a restricted asset as there is an offsetting liability recognized for the obligation to return the collateral. Identifying both the lent security and the on-book collateral as restricted assets, particularly with the offsetting liability to return the collateral would result in a double-counting of restricted asset charges for the same transaction.
4. On day 1, both the collateral asset received and liability to return are recognized at fair value. Subsequently, the asset is measured pursuant to the applicable SSAP and the liability to return shall be adjusted as needed to reflect the current fair value of the collateral originally received. If the collateral received is reinvested, the resulting asset shall be accounted for pursuant to the applicable SSAP. As the measurement method for the collateral asset on book may not reflect fair value, this may result in a disconnect between the collateral asset and liability to return reported, but the reporting entity’s liability to return the collateral shall always reflect the full obligation (fair value) to return collateral originally received.

**Note 3**: As the collateral can be sold/repledged, there is a question on the application of the admittance provisions in paragraphs 91-92 of SSAP No. 103. That guidance is focused on the fair value of the original collateral received in comparison to the fair value of the security lent. Once the collateral has been reinvested, the reporting entity is responsible for the reinvestment risk and the counterparty is not responsible for fair value changes of the reinvested security. Although a position could be taken that the fair value of the collateral originally received should continue to be compared to the fair value of the lent security to determine if more collateral needs to be provided, with the current financial statement reporting, this information is not captured to allow assessments once the collateral has been reinvested allowing regulators to verify the admittance provisions.

**Note 4**: With regards to the admittance calculation, there is also a question on application when the original collateral still covers 100% of the BACV of the loaned security but does not meet the requirement for 100% of the loaned security’s fair value. As an example, if the loaned security at amortized cost has a BACV of $90, but had a fair value of $100 when loaned, the guidance in paragraph 91 requires collateral of $102 at the onset of the transaction. If the original collateral was to decrease in fair value to $98, it would no longer comply with the guidance in paragraph 91 and nonadmittance of the loaned security for $2 is expected under the guidance ($100 - $98). However, as the loaned security is reported at BACV of $90, the collateral still covers the full reported value of the loaned security. If the counterparty was to default, the reporting entity would eliminate the loaned security ($90) and the liability to return the collateral ($98) from the books and retain the collateral asset as their own. This transaction would result in an $8 gain for the reporting entity. If the loaned security had been nonadmitted by $2 prior to the default due to the FV decline of the collateral, there would have been a surplus hit of $2 for the nonadmittance. Upon the counterparty default, in addition to the $8 gain, there would have then been a surplus bump of $2 with the elimination of the nonadmitted asset. *(It is noted that if the fair value for the collateral asset had been retained, the reporting entity would have had a greater gain, but they are still fully covered based on how the loaned asset is reported.)* NAIC staff requests confirmation of the admittance guidance and its application from regulators, particularly when the fair value of the collateral continues to cover the BACV of the loaned security.

**Note 5**: As the collateral received can be sold/repledged, there is a question on the application of the “conforming security lending” collateral requirements. From a broad review of financial statements, collateral reported on Schedule DL was identified as outside of the conforming parameters, but the security lending program was identified as “conforming” with the lower RBC charge. NAIC staff recommend clarification on the application of the “conforming” requirements. Particularly, if the intent is to permit a lower RBC charge due to the liquidity / stability of certain types of collateral, then it may be appropriate to require the collateral to always comply with the “conforming” provisions regardless of if it has been reinvested by the reporting entity.

1. **Securities Borrowing – Entity Borrows a Security and Provides Collateral in Exchange**
2. Reporting entity borrower retains security collateral provided to counterparty on book and codes it as a restricted asset. (If providing cash in exchange for the borrowed security, then the cash is derecognized with a receivable for the return.) ***(Note 6)***
3. Reporting entity borrower does not recognize the borrowed security on their books, unless the reporting entity sells the borrowed security or the counterparty defaults. If the reporting entity sells the borrowed security, the cash received or reinvested asset is recognized with an obligation (liability) to return the borrowed security. Pursuant to paragraph 94 of SSAP No. 103, assets equivalent to the fair value of the borrowed security shall be coded as a restricted asset. Specific guidance exists in SSAP No. 103 for when borrowed securities are used to settle a short-sale. (A counterparty default would always result with an unwinding of the transaction with each party reporting the asset they have in their possession as their resulting asset.) ***(Note 7 & 8)***

The Restricted Asset / RBC Impact is as follows:

1. The retained asset (provided as collateral to a counterparty) is still on the reporting entity’s investment schedules and should continue to receive the RBC asset C-1 charge. It should also be coded as a restricted asset. Due to the reporting lines available, it could be coded as “collateral held under securities lending agreements” or as an “other” restricted asset and captured in GI 26.32. If captured as a collateral within a security lending agreement, would be captured on GI line 25.04 or GI line 25.05 based on whether it is from a ‘conforming’ security lending program. Amounts reported on these lines flow to LR017 (Off-Balance Sheet and Other Items), lines 1 and 2. Items captured in GI line 25.04 (conforming) receive a 0.0020 RBC charge. Items captured in GI line 25.05 (nonconforming) receive a 0.0126 RBC charge. If reported as an “other” restricted asset, it would be captured on GI 26.32 with a 0.0126 RBC charge.
2. There would be no RBC impact for the borrowed security unless it is sold. At that time, the reinvested asset would be recognized and subject to an RBC asset C-1 charge. This asset (or an equivalent of other assets) would be identified as restricted. This is likely “collateral held under security lending agreement” and reported based on conforming /nonconforming in GI line 25.04 (0.0020 factor) or 25.05 (0.0126 factor).

**Note 6**: A security borrowing transaction is the flipside of the security lending transaction, with the reporting entity operating on the opposite side as borrower instead of lender. With this dynamic, it is presumed that the same restricted asset categories, and whether it is a conforming program, would be determinants in reporting the restricted asset and in the resulting RBC charge. NAIC staff requests confirmation of this assessment. (A security borrowing is the transaction, and it is accounted for as a “secured borrowing” – this terminology can be confusing when discussing the design.)

**Note 7**: The guidance for a security borrowing could result with restricted asset reporting for both the collateral provided (if not cash collateral) as well as for the reinvested borrowed securities that the reporting entity has sold. NAIC staff notes that this could be a double hit of restricted asset charges and recommends comments on paragraph 94 of SSAP No. 103 on the elimination of the restricted asset requirement for the assets received from the sale of the borrowed security. It is noted that the reporting entity would already have a liability recognized to return the borrowed security to the counterparty.

**Note 8**: For security borrowing transactions, it is identified that both a receivable and payable from the counterparty could be recognized. A receivable - if cash was originally provided as collateral for the return of the cash - and a payable - if the reporting entity sold the borrowed security for the obligation to return the security. This dynamic could result in a netting of the transactions under SSAP No. 64. If netted, then the regulators would not be able to identify these aspects within the financial statements, but the provisions that permit netting under SSAP No. 64 (legal right to offset) may be present.

**Repurchase Agreements**

Repurchase agreements, by definition, are agreements in which a reporting entity sells a security and simultaneously agrees to repurchase the security or a substantially similar security at a stated date and price. Repurchase agreements are functionally similar to securities lending. These transactions are generally captured as “secured borrowings” due to the requirement to repurchase the security transferred but could qualify as ”sale” transactions. As very few (if any) are captured as sales under statutory accounting, this assessment will only focus on those captured as ”secured borrowings.”

Reporting entities can operate on both sides of repurchase agreements. If the reporting entity is selling a security and receiving cash (cash taker), it is considered a repurchase agreement. If the reporting entity is buying a security and providing cash (cash provider) it is considered a reverse repurchase agreement. SSAP No. 103 is explicit that only short-term repo agreements (with a stated short-term maturity date of 365 days or less) are allowed as admitted assets. Long-term repo agreements (with maturity dates in excess of 365 days) are nonadmitted.

There is no current concept for a “conforming repurchase agreement” and incorporating this concept, allowing for a lower RBC charge, was the request of the ACLI to the Life RBC Working Group.

1. **Repurchase Agreement – Reporting Entity Sells Security and Receives Cash / Collateral**
2. Reporting entity (cash taker) retains sold security on book and codes it as a restricted asset. This would remain an asset of the reporting entity unless the reporting entity defaults under the terms of the secured borrowing agreement. If that occurs, the reporting entity would derecognize the asset and eliminate the obligation to return the cash collateral per subparagraph (b).
3. Reporting entity recognizes cash received and obligation to return cash. (If security collateral is received, it is off-balance sheet unless that collateral is sold by the reporting entity. If sold, the reporting entity recognizes the proceeds from the sale and the obligation to return the collateral to the repo counterparty.) This process for security collateral received under a repurchase agreement is different from securities lending. Under security lending, if collateral received can be sold or repledged, even if it is not sold or repledged, the collateral is reported on balance sheet with an obligation to return. The disclosure guidance for repurchase agreements varies significantly from securities lending transactions as Schedule DL does not apply to repurchase agreements. As such, for repurchase agreements, there is no detail that identifies collateral held when the collateral can be sold/repledged. ***(Note 9)***

1. For repurchase agreements the reporting entity should receive proceeds (collateral) with a fair value of at least 95% of the fair value of the sold security. So, if the security has a FV of $100, proceeds (collateral) of $95 is required. If the FV of the proceeds (collateral) is not sufficient, then nonadmittance of the “sold” security for the amount of the shortfall is required. So, if only 93% collateral was received, the security “sold” but still reporting on-book would only be admitted for $98 with nonadmittance of $2. ***(Note 10)***

The Restricted Asset / RBC Impact is as follows:

1. The retained asset (sold to the counterparty) is still on the investment schedule and should continue to receive the RBC asset (C-1) charge. It should also be coded as a restricted asset as “subject to repurchase agreements” and captured in GI 26.21. This would then be captured in LR017 on line 3, “subject to repurchase agreements” and would receive a 0.0126 RBC charge. Under SSAP No. 103, repo agreements must be short-term to be admitted. If the repo agreement extends beyond 365 days, then the asset sold (retained on the book) would be identified as a nonadmitted asset.
2. The cash proceeds (collateral) would be recorded as cash and flow through on Schedule E - Part 1 - Cash to LR012 with a .0039 RBC charge. If the cash is used to acquire another security, then the acquired security would be reported on the investment schedules and flow through to RBC accordingly based on the investment.

**Note 9**: Due to the similarities in overall function between securities lending and repurchase agreements, NAIC staff supports consistent accounting, reporting and disclosures. NAIC staff recommends expanding Schedule DL to capture repurchase agreements, and a reassessment of the repurchase agreement disclosures to determine whether the level of detail should be retained.

**Note 10:** The same concept issues exist for the nonadmittance of reported securities under repo transactions than what exist under the securities lending transactions. Under current guidance, if the fair value of the sold security was to increase, more proceeds (collateral) is required or the sold security is subject to nonadmittance. If collateral was reinvested, the comparison would have to be based on the original collateral received and not the reinvested collateral. Also, there is the question on nonadmittance when the collateral received still covers the BACV of the sold security.

**Reverse Repurchase Agreement – Reporting Entity Buys Security and Provides Cash / Collateral**

1. Reporting entity (cash provider) acquires security from counterparty but does not report the security on their investment schedule. (The reporting entity would recognize the asset if the counterparty defaulted on the agreement.) ***(Note 11)***
   1. If the reporting entity sells the acquired security, the reporting entity would recognize the cash proceeds from the sale and an obligation to return the security to the counterparty. If the cash proceeds are reinvested, then the acquired investment would be on the applicable investment schedule.
2. Reporting entity derecognizes the cash provided to acquire the security and recognizes a receivable for the cash return. This is captured as a short-term investment on Schedule E-2. If the reverse repo agreement was long-term, it shall be nonadmitted.
   1. If the reporting entity provides security in exchange for the security (instead of cash), the security would remain on the reporting entity’s investment schedules, coded as a restricted asset.
3. For reverse repurchase agreements the reporting entity should receive securities with a fair value of at least 102% of the purchase price (cash or securities transferred). So, if the cost of the transaction is $100, the reporting entity should receive securities worth $102. ***(Note 12)***

The Restricted Asset / RBC Impact is as follows:

1. The acquired asset is not reported unless the counterparty defaults or unless the reporting entity sells the acquired assets. Unless one of these things occurs, there is no RBC impact for the acquired asset under a reverse repo. (If those transactions occur, then the RBC is determined by the resulting security reported on the investment schedule.)
2. The receivable for the return of the cash collateral would be recorded as a short-term investment on Schedule E – Part 2 and flow through to LR012 with a .0039 RBC charge. This receivable would also be coded as restricted as an “asset subject to a reverse repurchase agreement” on GI 26.23. This would flow to LR017 line 6 and would receive a 0.0126 RBC charge. ***Note 13***

**Note 11**: The SSAP No. 103 guidance for reverse repo transactions does not have an explicit nonadmittance component if the % threshold is not met. Clarification on what should occur if the adequate collateral is not received / retained is recommended. Additionally, it has been noted that there is no current guidance that assesses admittance based on the quality/type of collateral received. Under the current guidance, residuals or low-quality assets could be received and there is no documentation of this type of collateral for certain sec lending and repo programs. Even if these programs would not qualify as conforming, there is a question on whether admittance restrictions should exist based on the collateral received from the counterparty.

**Note 12:** SAP does not currently capture details on securities acquired upon the sale of the asset acquired under a reverse repo. The note disclosures only detail aggregate amounts.

**Note 13:** The guidance does not explicitly indicate that the short-term receivable recorded for reverse repurchase transactions should be coded as a restricted asset and taken to GI 26.23. However, as the restricted asset note detailed in SSAP No. 1 and GI 26.23 both capture “assets subject to reverse repurchase agreements,” this reference can only refer to the short-term receivable as there is no other asset reported on the books from the transaction. Assessment may be warranted on identification of restricted assets on reverse repurchase transactions.

**Appendix A – “Conforming” Securities Lending Guidance from RBC Instructions**

Line (1) Securities lending programs that have all of the following elements are eligible for a lower off-balance sheet charge:

1. A written plan adopted by the Board of Directors that outlines the extent to which the insurer can engage in securities lending activities and how cash collateral received will be invested.
2. Written operational procedures to monitor and control the risks associated with securities lending. Safeguards to be addressed should, at a minimum, provide assurance of the following:
   1. Documented investment guidelines, including, where applicable, those between lender and investment manager with established procedure for review of compliance.
   2. Investment guidelines for cash collateral that clearly delineate liquidity, diversification, credit quality, and average life/duration requirements.
   3. Approved borrower lists and loan limits to allow for adequate diversification.
   4. Holding excess collateral with margin percentages in line with industry standards, which are currently 102% (or 105% for cross currency loans).
   5. Daily mark-to-market of lent securities and obtaining additional collateral needed to ensure that collateral at all times exceeds the value of the loans to maintain margin of 102% of market.
   6. Not subject to any automatic stay in bankruptcy and may be closed out and terminated immediately upon the bankruptcy of any party.
3. A binding securities lending agreement (standard “Master Lending Agreement” from Securities Industry and Financial Markets Association) is in writing between the insurer, or its agent on behalf of the insurer, and the borrowers.
4. Acceptable collateral is defined as cash, cash equivalents, direct obligations of, or securities that are fully guaranteed as to principal and interest by, the government of the United States or any agency of the United States, or by the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation and NAIC 1-designated securities. Affiliate-issued collateral would not be deemed acceptable. In all cases the collateral held must be permitted investments in the state of domicile for the respective insurer.

Collateral included in General Interrogatories, Part 1, Line 25.04 of the annual statement should be included on Line (1).