

# **FASB125 annex with guidance notes**

## PSA/ISMA Global Master Repurchase Agreement

### FASB 125

On June 28, 1996, the US Financial Accounting Standards Board issued Statement No. 125, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* ("FASB 125"), which institutes new accounting rules for US generally accepted accounting principles ("GAAP") applicable to all transactions involving transfers of financial assets, including repurchase agreements and buy/sell back transactions and transfers of collateral constituting financial assets in connection with secured financing transactions.

Under FASB 125, the accounting for repurchase transactions may change depending on the terms of the transaction. In particular, if a repo seller does not have the right to substitute securities or terminate the transaction on short notice, the repo buyer will generally be required to record both the securities as well as an obligation to return the securities, thereby "grossing up" its balance sheet. The repo seller will generally be required to reclassify the repo securities from securities inventory to receivable for securities pledged as collateral.

Paragraph 8 of the November 1995 version of the GMRA provides that the parties to a repurchase transaction can agree to "substitute" new securities for the purchased securities by varying the terms of the transaction and to "substitute" new margin securities for margin securities already delivered. In order to enable ISMA members and other market participants affected by the new accounting standard to mitigate the potential impact of FASB 125 on their balance sheets, a significant number of ISMA's US members and members of The Bond Market Association (formerly PSA) ("TBMA") active in the international repo markets requested that ISMA and TBMA publish a standard provision that allows (i) a repo seller to vary the terms of a transaction under paragraph 8 of the GMRA by notice to the buyer or gives the seller the right to terminate a transaction prior to maturity if the buyer does not agree to such variation; and (ii) a party which has transferred margin securities to provide cash margin in exchange for securities equivalent to those margin securities if the parties do not agree to a substitution of the margin securities. Market participants also preferred not fundamentally to alter the existing trading practices and economic expectations of the repo market.

Enclosed are suggested provisions for inclusion in part 2 of Annex I (supplemental terms and conditions) of the GMRA (where parties have already entered into the GMRA, they may prefer to amend the agreement by including the provisions in a side letter). The new provisions are intended both to provide for a right of "substitution" or termination on the part of the repo seller and to prescribe a methodology for quantifying economic loss suffered by the repo buyer as a direct consequence of the repo seller's exercise of that right. The provision is intended to make the repo buyer economically "whole". In other words, the repo buyer or transferee would not suffer economically because the loss provision is intended to place the buyer or transferee in the same position it would have been had the transferor not exercised its right. The provisions also provide a right of "substitution" for the original transferor of margin securities.

In the case of a variation of a transaction, the provision contains a short time frame: notice of variation must be provided by 12 p.m. (London time) for variation to occur on the same business day, and if notice of variation is given after 12 p.m. London time, variation would occur on the next business day. The ISMA CRD repo sub-committee views such period as the minimum time frame necessary to effect the exercise of the contractual right and determine the appropriate dollar amount consistent with the contractual "make whole" provision. Parties may agree on different notice periods.

The suggested provision is based on a similar provision published by TBMA for its New York law governed Master Repurchase Agreement. ISMA has not independently verified that the provisions meet the requirements of FASB 125. As always ISMA and TBMA recommend that market participants consult with their legal and accounting advisers concerning the desirability of use of the provision and the other requirements of FASB 125.

**Amendment to paragraph 8 of the GMRA for FASB 125 for inclusion  
in part 2 of Annex I**

(e) In the case of any Transaction for which the Repurchase Date is not the Business Day immediately following the Purchase Date and with respect to which Seller does not have any existing right to vary the Transaction, Seller shall have the right (subject to the proviso to this sub-paragraph) by notice to Buyer (such notice to be given at or prior to 12 p.m. (London time) on that Business Day) to vary that Transaction in accordance with sub-paragraphs (a) and (b) above, provided however that Buyer may elect by close of business on the Business Day notice is received (or by close of business on the next Business Day if notice is received after 12 p.m. (London time) on that day) not to vary that Transaction. If Buyer elects not to vary the Transaction, Seller shall have the right, by notice to Buyer, to terminate the Transaction on the Business Day specified in that notice, such Business Day (unless the parties otherwise agree) not to be later than two Business Days after the date of the notice.

(f) If Seller exercises its right to vary the Transaction or to terminate the Transaction under sub-paragraph (e) above, notwithstanding paragraph 10(h), Seller shall be required to pay to Buyer by close of business on the Business Day of such variation or termination an amount equal to -

- (i) Buyer's actual cost (including all fees, expenses and commissions) of (aa) entering into replacement transactions; (bb) entering into or terminating hedge transactions; and (cc) terminating or varying transactions with third parties in connection with or as a result of such variation or termination; and
- (ii) to the extent that Buyer does not enter into replacement transactions, the loss incurred by Buyer directly arising or resulting from such variation or termination,

in each case as determined and calculated in good faith by Buyer.

(g) Where one party (the **Requesting Party**) has requested the other party to transfer Equivalent Margin Securities to it in exchange for the transfer to the other party of new Margin Securities in accordance with paragraph 8(d) but the other party does not agree to the request, if the Requesting Party so elects by written notice specifying the Equivalent Margin Securities to be transferred and the Business Day on which those Equivalent Margin Securities are to be transferred (such Business Day (unless the parties otherwise agree) not to be later than two Business Days after the date of the notice) the other party shall, unless otherwise agreed, transfer those Equivalent Margin Securities to the Requesting Party in exchange for the transfer to the other party of Cash Margin of an amount equal to the Market Value of the Equivalent Margin Securities so transferred.