

AEG deliberations on

Repurchase agreements

Status: no final recommendations yet

UNSD/ESCAP Workshop on 1993 System of National Accounts
Update 19 – 22 April 2005, Bangkok, Thailand

Repurchase agreements are part of reverse transactions (transactions in hybrid instruments), including

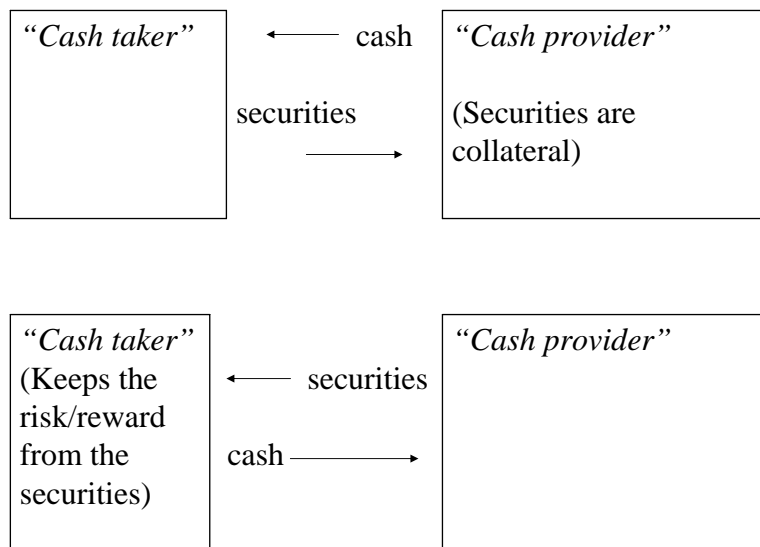
- securities lending,
- gold swaps and
- gold loans

Common feature:

involve legal transfer of ownership, but risk and reward remain with the original owner

Security repurchase agreements

A securities repurchase agreement (repo) is an arrangement involving the sale (surrender) of securities at a specified price with a commitment to repurchase (return) the same or similar securities at a fixed price on a specified future date or with an open maturity.



Why not treat security repurchase agreements as sale?

SNA: In most cases, the securities do not change hands and the buyer does not have the right to sell them, so it is unclear even in a legal sense whether a change of ownership has taken place. Therefore, in the SNA, a repurchase agreement is treated as a newly created financial asset that is not related to the underlying securities.

SNA treats repurchase agreements as collateralized loans instead of transactions in the instrument.

Collateralized loan approach

cash taker

cash provider

Cash	- 100		
Security	+ 100		
.....	
Cash	+ 100	Loan +100	Cash -100
			Loan +100
	100	100	0
			0

Problem: on-selling

Collateralized loan approach + on-selling = double counting

Many countries' accounting rules require that the cash provider report a "short" or negative position if it on-sells the security outright.

Also CPIS recommendation

Business accounting for repos

The dual nature of repos (sale contra borrowing) is recognized by FASB:

"...transfers of financial assets with repurchase commitments, such as repurchase agreements and securities lending transactions, should be accounted for as secured borrowing if the transfers were assuredly temporary, and as sales if the transfers were not assuredly temporary."

IAS recommendation: simultaneously as collateralized loan and transaction in the underlying instrument ("Four ways reporting")

Alternative statistical approaches

- A. Outright sale
- B. Collateralized loan approach
- C. 'Four ways reporting'
- D. Financial derivative approach

A. Outright sale

Company 1-B (security issuer) Company 2-A (cash taker)

Cash	100	Security	100		Cash	- 100	
.....				Security	+ 100
					Cash	+ 100	
					Security	-100	

Company 3-B (cash provider)

Company 4-C (security holder)

Cash	-100			Cash	-100	
	+100			Security	+100	
Security	+100					
	-100					

A. Outright sale

Pro arguments

- No double counting (one holder of the securities)
- No misstatement of external debt

Contra arguments

- Does not show the realities (as loans)
- No information of exposure
- Inconsistency between interest flows and stocks

B. Collateralized loan approach w/short-selling

Company 1-B (security issuer)

Company 2-A (cash taker)

Cash	100	Security	100		Cash	- 100		
					Security	+ 100		
.....		
					Cash	+ 100	Loan	+ 100

Company 3-B (cash provider)

Company 4-C (security holder)

Cash	-100			Cash	-100		
	+100			Security	+100		
Security	-100						
Loan	+ 100						

12

B. Collateralized loan w/short selling

Country B

Cash (D)	+100	Security (2A)	100
Security (1-B)	-100		
Loan (2A)	+100		

Pro arguments

- Recognizes the transaction as loan
- Better description of exposure
- More consistency between interest flows and stocks

Contra arguments

- Negative stock (“sells a security it does not have”)
- Wrong IIP-statement or double counting of the security

13

C. “Four ways reporting”

Company 1-B (security issuer) Company 2-A (cash taker)

Cash	100	Security	100		Cash	- 100	
					Security	+ 100	
.....	
					Cash	+ 100	Loan
					Security	- 100	+ 100
					Other accts.		
					receivable	+ 100	

Company 3-B (cash provider)

Company 4-C (security holder)

Cash	-100	Other accts.			Cash	-100	
	+100	payable	+ 100		Security	+100	
Security	+ 100						
	-100						
Loan	+ 100						

14

C. "Four ways reporting"

Country B

Cash (D)	+100	Security (2A)	+ 100
Security (1-B)	0	Other accts.	
Loan (2A)	+100	Payable (C)	+ 100

Pro arguments

- Correct net IIP positions
- Avoids negative stocks ("short positions")

Contra arguments

- On balance recording of off balance items
- Grossed up positions
- Loss of transparency of exposure
- Unusual with valuation changes in other accts. receivable/payable¹⁵

D. Financial derivative approach

Company 2-A (cash taker)

Company 3-B (cash provider)

Cash	- 100				
Security	+ 100				
.....				
Cash	+ 100			Security	+ 110
Security	- 100			Cash	- 100
Financial derivative	10	Net worth	+ 10	Financial derivative	+ 10
				Net worth	0

off balance

off balance

Security	+ 110	Cash	+ 100		Cash	100	Security	+110
		Net off balance position	+ 10				Net off balance position	- 10

16

D. Financial derivative approach

Pro arguments

- No double counting
- No misstatement of external debt
- Exposure shown off balance

Contra arguments

- Does not show the realities (as loans)
- Accountants and market practitioners do not accept the approach since risk is not transferred

IMF paper

- REPO: BOP Committee: collateralized loan – negative asset if on-sold
- SECURITIES LENDING: no transaction, negative asset if on-sold
- “...But if “The four-way-approach” were to become widely adopted, or used for statistical purposes, it would overcome some of the problems inherent with repos and securities lending”
- GOLD SWAP (gold for foreign exchange): no conclusion
- GOLD LOANS AND DEPOSITS: no conclusion

AEG recommendations

The group noted the present state of discussion on this subject and looked forward to further elaboration by the IMF.