Statutory Issue Paper No. 28

Short-Term Investments

STATUS
Finalized March 16, 1998

Original SSAP: SSAP No. 2; Current Authoritative Guidance: SSAP No. 2R

Type of Issue:
Common Area

SUMMARY OF ISSUE

1. Short-term investments are investments which generally are in the form of bonds, commercial paper, money market instruments, repurchase agreements, and collateral and mortgage loans, whose maturity dates (or repurchase dates) at the time of acquisition were one year or less. Current statutory accounting guidance requires short-term investments to be carried in the same manner as similar long-term investments. Any premium or discount is amortized on a straight-line basis through the maturity date of the investment. This is different from GAAP which does not have the classification of short-term investments.

2. The purpose of this issue paper is to define short-term investments and to establish statutory accounting principles and related reporting that is consistent with the Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy (Statement of Concepts).

SUMMARY CONCLUSION

3. All investments with remaining maturities (or repurchase dates under repurchase agreements) of one year or less at the time of acquisition (excluding those investments classified as cash equivalents as defined in *Issue Paper No. 2—Definition of Cash* (Issue Paper No. 2)) shall be considered short-term investments. Short-term investments include, but are not limited to, bonds, commercial paper, money market instruments, repurchase agreements, and collateral and mortgage loans which meet the above criteria. Short-term investments shall not include certificates of deposit with contractual maturities of one year or less at the time of acquisition. In accordance with Issue Paper No. 2, these investments shall be classified as cash.

4. All short-term investments shall be accounted for in the same manner as similar long-term investments. Investments in money market funds shall be reported in accordance with the guidance in the Procedures for Valuing Common Stocks and Stock Warrants section of the *Purposes and Procedures Manual of the NAIC Securities Valuation Office*.

5. The following disclosures shall be made for short-term investments in the notes to the financial statements:

   a. Fair values in accordance with *Issue Paper No. 33—Disclosures about Fair Value of Financial Instruments;*

   b. Concentrations of credit risk in accordance with *Issue Paper No. 27—Disclosure of Information about Financial Instruments with Concentration of Credit Risk*;

   c. Basis at which the short-term investments are stated.

DISCUSSION

6. The conclusion above rejects *FASB Statement No. 115*, *Accounting for Certain Investments in Debt and Equity Securities* (FAS 115), for those securities which have maturities of one year or less from the date of acquisition. The conclusion above is consistent with existing statutory guidance.

7. The above conclusion requires separate classification of those investments held by a reporting entity which have maturity dates of one year or less at the time of their acquisition from those with maturity dates of over one year at acquisition. The Statement of Concepts states that "*the cornerstone of solvency measurement is financial reporting. Therefore, the regulator's ability to effectively determine relative financial condition using financial statements is of paramount importance to the protection of policyholders.*"

8. GAAP classifies securities with original maturities of ninety days or less as cash equivalents and those over ninety days in one of the following categories in accordance with FAS 115: 1) trading; 2) available-for-sale; 3) held-to-maturity. Issue Paper No. 2 defines cash as "*a medium of exchange that a bank will accept for deposit and allow an immediate credit to the depositor's account*." Moreover, statutory accounting guidance does not recognize the GAAP classification of investments contained in FAS 115.

9. Negotiable certificates of deposit with a contractual maturity of one year or less at acquisition will no longer be classified as short-term investments. This change was made to address inconsistencies in the guidance between the Accounting Practices and Procedures Manuals for Property and Casualty Insurance Companies and Life and Accident and Health Insurance Companies (P&C and Life/A&H Accounting Practices and Procedures Manuals) and the *Purposes and Procedures Manual of the NAIC Securities Valuation Office* (SVO Purposes and Procedures). The P&C and Life/A&H Accounting Practices and Procedures Manuals require all nonnegotiable certificates of deposit to be classified as cash and negotiable certificates of deposit to be classified as short-term investments or bonds depending on the length to maturity at acquisition. The SVO Purposes and Procedures requires both negotiable and nonnegotiable certificates of deposit to be submitted to the SVO and valued under the general provisions for valuing bonds.

Drafting Notes/Comments

- Bonds and other long-term investments are addressed in separate issue papers.

RELEVANT STATUTORY ACCOUNTING AND GAAP GUIDANCE

Statutory Accounting

10. Statutory accounting guidance is contained in the P&C and Life/A&H Accounting Practices and Procedures Manuals, Chapter 5, *Cash and Short-term Investments*. Chapter 5 states:

> Short-term Investments
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> Short-term investments are generally in the form of bonds, commercial paper, money market instruments, repurchase agreements, or collateral and mortgage loans whose maturities (or repurchase dates under repurchase agreements) at time of acquisition were one year or less.
>
> The accounting for short-term investments is the same as for similar long-term investments except that the method of accrual and amortization is always straight line and the assets are always valued at book value or market value.

11. Guidance for investments in money market funds is contained in the SVO Purposes and Procedures. Section 5(A) - Procedures for Valuing Common Stocks and Stock Warrants, states:

Shares of mutual funds, except for certain money market funds as defined by 17 CFR 270.2a-7 under the Investment Company Act of 1940 (15 U.S.C. 80a-1 et seq.) and further defined in section 5(A)(a)(i) and 5(A)(a)(ii), regardless of the types or mix of securities owned (bonds, stock, money market instruments, or other type of investments) by the fund, are considered to be common shares which should be reported on Schedule D-Part 2-Section 2.

(i) A money market fund shall not require a reserve if the fund meets all of the following conditions:

(1) The fund shall maintain a money market fund rating in the highest category from an SVO recognized rating agency; and

(2) The fund shall maintain a constant net asset value per share at all times; and

(3) The Fund shall allow a maximum of seven day redemption of proceeds; and

(4) (a) The fund shall invest 100% of its total assets in U.S. treasury bills, notes, and bonds and collateralized repurchase agreements comprised of those obligations at all times (see Section 5(F) for a list of qualifying Funds), or

(b) The fund shall invest 100% of its total assets in certain securities listed in Section 6(B)(g)(i) and collateralized repurchase agreements comprised of those obligations at all times (see Section 5(G) for a list of qualifying Funds).

(ii) A money market fund shall establish a reserve using the bond class one reserve factor if the fund meets all of the following conditions:

(1) The fund shall invest at least 95% of its total assets in exempt securities listed in Section 6A(a), short-term debt instruments with a maturity of 397 days or less, class one bonds, and collateralized repurchase agreements comprised of those securities at all times (see Section 5(H) for a list of qualifying Funds): and

(2) The fund shall maintain a money market fund rating in the highest category by an SVO approved rating agency: and

(3) The fund shall maintain a constant net asset value per share at all times: and

(4) The fund shall allow a maximum of seven day redemption of proceeds:

(iii) A money market fund which qualifies for reserve exemption pursuant to Section 5(A)(a)(i) or inclusion in the bond class one reserve category pursuant to Section 5(A)(a)(ii) shall be reported on Schedule DA-Part 1.

(iv) In order to qualify for a reserve exemption pursuant to Section 5(A)(a)(i) or inclusion in the bond class one reserve category pursuant to Section 5(A)(a)(ii), a money market fund shall submit documentation on forms provided by the SVO staff. The forms shall include sufficient information to demonstrate compliance with the above requirements.

(v) In order to maintain the qualifications for exemption or inclusion in the bond class one reserve category, the fund shall report annually, current fund information to the SVO staff by November 15. In addition, the fund shall report to the SVO any change in investment policy which requires notice to shareholders.

12. Section 2(C)(7) of the SVO Purposes and Procedures indicates the following requirements for certificates of deposit: "Certificates of Deposit (negotiable and non-negotiable) will be considered under the general provisions of Section 2(B)."

Generally Accepted Accounting Principles

13. GAAP does not make the distinction between short-term and long-term investments. All investments in equity securities that have readily determinable fair values and all investments in debt securities follow FAS 115, which states:

a. Debt and equity securities that the enterprise has the positive intent and ability to hold to maturity are classified as held-to-maturity securities and reported at amortized cost.

b. Debt and equity securities that are bought and held principally for the purpose of selling them in the near term are classified as trading securities and reported at fair value, with unrealized gains and losses included in earnings.

c. Debt and equity securities not classified as either held-to-maturity securities or trading securities are classified as available-for-sale securities and reported at fair value, with unrealized gains and losses excluded from earnings and reported in a separate component of shareholders' equity.

RELEVANT LITERATURE

Statutory Accounting

- Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy
- Accounting Practices and Procedures Manual for Life and Accident and Health Insurance Companies, Chapter 5, *Cash and Short-term Investments*
- Accounting Practices and Procedures Manual for Property and Casualty Insurance Companies, Chapter 5, *Cash and Short-term Investments*
- *Issue Paper No. 2—Definition of Cash*
- *Issue Paper No. 5—Definition of Liabilities, Loss Contingencies and Impairments of Assets*
- *Purposes and Procedures Manual of the NAIC Securities Valuation Office*, Section 2 and Section 5

Generally Accepted Accounting Principles

- *FASB Statement No. 115, Accounting for Certain Investments in Debt and Equity Securities*

State Regulations

- No additional guidance obtained from state statutes or regulations.