

Statutory Issue Paper No. 42

Sale of Premium Receivables

STATUS

Finalized March 16, 1998

Original SSAP and Current Authoritative Guidance: SSAP No. 42

Type of Issue:

Common Area

SUMMARY OF ISSUE

1. Current statutory accounting guidance on the transfer or factoring of premium receivables with recourse is limited to the guidance provided in minutes of the Emerging Accounting Issues Working Group of the Accounting Practices and Procedures (EX4) Task Force (Emerging Accounting Issues Working Group). GAAP accounting provides guidance on accounting for sales of receivables with recourse. The purpose of this issue paper is to establish statutory accounting principles for the sale or factoring of premium receivables that are consistent with the Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy (Statement of Concepts).

SUMMARY CONCLUSION

2. For purposes of this issue paper, receivables shall only include amounts due to the reporting entity for premium receivables (uncollected premium, agent's balance receivables and bills receivables). As used in this paper, receivables do not represent amounts due to the reporting entity generated by the sale of invested assets.

3. A transfer of receivables can take the form of a transfer with recourse or a transfer without recourse:

- a. Recourse shall be defined as the right of a transferee of receivables to receive payment from the transferor of those receivables for (i) failure of the debtors to pay when due, (ii) the effects of prepayments, or (iii) adjustments resulting from defects in the eligibility of the transferred receivables, for example defects in the legal title of the transferred receivables. When the transferor has the right to repurchase ("call") or the transferee has the right to require the transferor to repurchase (a "put") the transferred receivables, the transfer shall be considered to have recourse.
- b. Without recourse shall be defined as the transferor surrendering all of the future economic implications of the risks and rewards embodied in the transferred receivables.

4. A transfer of receivables with recourse shall not be recognized as a sale. A transfer of receivables without recourse shall only be recognized if the transferor receives cash for the receivables. The sale shall be recognized when cash is received.

5. If a transfer qualifies to be recognized as a sale, the difference between (a) the sales price and (b) the receivables transferred shall be recognized as a gain or loss. If receivables are sold with servicing retained and the stated servicing fee is less than a current (normal) servicing fee rate (a servicing fee rate that is representative of servicing fee rates most commonly used in comparable servicing agreements covering similar types of receivables) or no servicing fee is specified, the gain or loss recognized by the sale of receivables shall be adjusted to recognize the deviation of the stated servicing fee rate from the commonly used servicing fee rate and a liability shall be established to provide for a normal servicing fee

in each subsequent servicing period, which shall not be less than the estimated servicing costs. When the stated servicing fee is greater than a normal servicing fee the gain or loss shall not be adjusted and the excess servicing fee revenues shall not be recorded currently but shall be recorded when realized.

6. If the conditions of subparagraph 3b. are not met, or the transfer is for other than cash, the receivables shall remain on the transferor's financial statements. A liability shall be established in an amount equal to the greater of the carrying amount of the receivables transferred or the amount of the proceeds received. To the extent that the proceeds received are less than the carrying amount of receivables transferred, a loss shall be recorded. The carrying amount of the receivable balance shall be evaluated at each reporting period and adjusted for any uncollectible amounts. The liability shall be relieved as the transferee receives cash. When the proceeds received are greater than the receivables transferred the liability shall be relieved on a pro rata basis as the receivables are collected.

Disclosures

7. For transfers of receivables reported as sales, the transferor's financial statements shall disclose (a) the proceeds to the transferor and (b) the gain or loss recorded on the sale.

DISCUSSION

8. The conclusion above rejects paragraph 83 of *FASB Statement No. 125, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (FAS 125) to the extent that it permits sales recognition for sales of receivables with recourse provisions.

9. Deferring the recognition of a gain for transfers of receivables which do not meet the criteria in subparagraph 3b. or are for other than cash is consistent with the conservatism concept in the Statement of Concepts. In addition, it prevents the recognition of income before the earnings process is completed as prescribed in the recognition concept of the Statement of Concepts. The receipt of cash for the transfer of receivables that were either admitted assets or non-admitted assets when there are no recourse provisions involved represents a completed transaction and as such the receivable is deemed to have been collected.

Drafting Notes/Comments

- Securitization of investments is addressed in *Issue Paper No. 86—Securitization*.
- Reinsurance receivables are addressed in *Issue Paper No. 75—Property and Casualty Reinsurance*.
- Related party transactions are addressed in *Issue Paper No. 25—Accounting for and Disclosures about Transactions with Affiliates and Other Related Parties*.

RELEVANT STATUTORY ACCOUNTING AND GAAP GUIDANCE

Statutory Accounting

10. Current statutory accounting guidance on the sale or factoring of premium receivables with recourse is limited to the guidance provided in the June 10, 1991 minutes of the Emerging Accounting Issues Working Group. This guidance relates to the accounting for “Intercompany Related Receivable Sales”. The minutes provide guidance as follows: “The working group concluded that, in most instances, this type of transaction should be treated as a loan or financing arrangement and FAS 77 should be used for guidance, particularly as it may relate to affiliates and also to transactions between affiliates.”

RELEVANT LITERATURE

Statutory Accounting

- Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy
- Emerging Accounting Issues Working Group of the Accounting Practices and Procedures (EX4) Task Force minutes of the June 10, 1991 meeting

Generally Accepted Accounting Principles

- *FASB Statement No. 125, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*

State Regulations

- No additional guidance obtained from state statutes or regulations.

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