

# Statutory Issue Paper No. 158

## Unaffiliated Common Stock

### STATUS

Finalized November 15, 2018

Original SSAP: SSAP No. 30; Current Authoritative Guidance: SSAP No. 30R

### Type of Issue:

Common Area

### SUMMARY OF ISSUE

1. The guidance within this issue paper introduces substantive revisions to *SSAP No. 30—Unaffiliated Common Stock* (SSAP No. 30) pursuant to the Statutory Accounting Principles (E) Working Group’s (Working Group) Investment Classification Project. The Investment Classification Project reflects a comprehensive review to address a variety of issues pertaining to definitions, measurement and overall scope of the investment SSAPs.
2. The substantive revisions to SSAP No. 30 (illustrated in Exhibit A) under the Investment Classification Project, detailed within this issue paper, reflect the following key elements:
  - a. Improves the common stock definition, with identification of the items that technically do not meet the definition, but warrant common stock treatment.
  - b. Revises the guidance to include closed-end funds and unit investment trusts within scope.
  - c. Suggests reporting enhancements to capture NAIC designations on D-2-2, allowing RBC to be driven from underlying risk of fund holdings (if determined appropriate by Capital Adequacy (E) Task Force).

### DISCUSSION

3. This issue paper intends to provide information on discussions that occurred when considering revisions to SSAP No. 30 under the Investment Classification Project, as well as the adopted revisions.

#### Common Stock Definition

4. The historical definition of common stock within SSAP No. 30 is “securities which represent a residual ownership in a corporation.” This definition has been identified as generally consistent with market terms, including the NASDAQ and FASB Codification definitions for common stock:
  - a. NASDAQ Definition: Securities that represent equity ownership in a company. Common shares let an investor vote on such matters as the election of directors. They also give the holder a share in a company’s profits via dividend payments or the capital appreciation of the security. Units of ownership of a public corporation with junior status to the claims of secured/unsecured creditors, bondholders and preferred shareholders in the event of liquidation.
  - b. FASB Codification: A stock that is subordinate to all other stock of the issuer.
5. Although the historical definition of common stock in SSAP No. 30 is comparable to market terms, the actual scope of SSAP No. 30 has historically included investments that are not considered “common

stocks” but may be captured in the definition of an “equity security.” The FASB Codification, reflecting the revisions from *ASU 2016-01, Financial Instruments*, defines an equity security in Topic 320 (Investments: Debt and Equity Securities) as:

Any security representing an ownership interest in an entity (for example, common, preferred, or other capital stock) or the right to acquire (for example, warrants, rights, forward purchase contracts, and call options) or dispose of (for example, put options and forward sale contracts) an ownership interest in an entity at fixed or determinable prices. The term equity security does not include any of the following:

- i. Written equity options (because they represent obligations of the writer, not investments)
- ii. Cash-settled options on equity securities or options on equity-based indexes (because those instruments do not represent ownership interests in an entity)
- iii. Convertible debt or preferred stock that by its terms either must be redeemed by the issuing entity or is redeemable at the option of the investor.

6. Although the FASB definition of an “equity security” captures some investments that are currently identified within the scope of SSAP No. 30, the FASB “equity security” definition also captures investments that are not captured within SSAP No. 30, and are addressed within other SSAPs.

7. Consistent with comments received from interested parties, this issue paper recommends revisions to SSAP No. 30 to align the scope format to be consistent with the structure of *SSAP No. 26R—Bonds*. With this approach, securities that do not meet the common stock definition, but that have been identified to be captured within the scope of SSAP No. 30 will be specifically identified and reflected as examples of “common stock.”

### **Scope of SSAP No. 30 – Closed-End Funds and Unit Investment Trusts**

8. The key substantive revision detailed within this issue paper is the expansion of SSAP No. 30 to include SEC registered Investment Companies. This revision expands the previous inclusion of “mutual funds” (SEC registered open-end investment companies) to also include SEC registered closed-end funds and unit investment trusts within scope of SSAP No. 30.

#### *Closed-End Funds / Unit Investment Trusts*

9. SSAP No. 30 includes “mutual funds” and “exchange traded funds” within the listing of securities captured in scope, but SSAP No. 30 makes no mention of “closed-end funds” or “unit investment trusts,” which are two other types of “investment companies” registered with the SEC. The term “mutual fund” represents an investment in an open-end investment company, and the use of this specific term in SSAP No. 30 results in the exclusion of investments in closed-end investment companies and unit investment trusts.

10. Per the SEC, an “investment company” is a company (corporation, business trust, partnership, or limited liability company) that issues securities and is primarily engaged in the business of investing in securities. An investment company invests the money it receives from investors on a collective basis, and each investor shares in the profits and losses in proportion to the investor's interest in the investment company. The performance of the investment company will be based on (but it won't be identical to) the performance of the securities and other assets that the investment company owns.

11. The federal securities laws categorize investment companies into three basic types:
  - Mutual funds - legally known as open-end companies;
  - Closed-end funds (CEF) - legally known as closed-end companies;
  - Unit Investment Trusts (UITs) - legally known as unit investment trusts.
  
12. Key elements of SEC registered investments, divided by type of fund, include:
  - a. Selling Shares / Secondary Market / Price:
    - i. *Mutual Fund*: Shares are generally sold on a continuous basis, although some funds will stop selling when they reach a certain level of assets under management. Shares are acquired from the fund itself, or through a broker for the fund. Shares of mutual funds cannot be purchased from other investors on a secondary market, such as the NYSE or NASDAQ. The price that investors pay for mutual fund shares is the fund's approximate net asset value (NAV) per share plus any fees that the fund may charge at purchase, such as sales charges, also known as sales loads.
    - ii. *Closed-End*: Shares are not continuously available for sale. Rather, a fixed number of shares are sold at one time (initial public offering), after which the shares trade on a secondary market, such as the NYSE or NASDAQ. The price is determined by the market and may be greater or less than the shares' NAV, with a commission paid when purchased and sold. The procedures for buying/selling CEFs are the same for buying/selling stocks, and there are no minimums on purchases or sales. Information on market prices of closed-end funds is publicly available, and information on the NAV can be obtained from the issuer and from certain third-party sources / publications.
    - iii. *Unit Investment Trust*: A UIT typically will make a one-time "public offering" of only a specific, fixed number of units (like closed-end funds). Many UIT sponsors, however, will maintain a secondary market, which allows owners of UIT units to sell them back to the sponsors and allows other investors to buy UIT units from the sponsors.
  - b. Redeemable / Non-Redeemable: (The term redeemable focuses on whether the fund will reacquire the shares from the holder at the investor's request.)
    - i. *Mutual Fund*: Redeemable - When mutual fund investors want to sell their fund shares, they sell them back to the fund, or to a broker acting for the fund, at the current NAV per share, minus any fees the fund may charge, such as deferred sales loads or redemption fees.
    - ii. *Closed-End*: Not redeemable - A closed-end fund is not required to buy shares back from investors upon request. However, closed-end funds may offer to repurchase shares at specified intervals (interval funds). As noted above, CEFs are traded on an exchange and can be liquidated at the current market price. (As the holder cannot redeem these investments directly with the fund, this issue paper proposes to require a fair value measurement for CEF, whereas investments that can be redeemed directly with a fund for net asset value (NAV) would be permitted to be reported at NAV.)
    - iii. *Unit Investment Trust*: Redeemable - Issues redeemable securities (or "units"), like a mutual fund, which means that the UIT will buy back an investor's "units," at the investor's request, at the approximate NAV.

- c. Management / Registration and Liquid / Illiquid Investments
- i. *Mutual Funds*: The investment portfolios of mutual funds are typically managed by separate entities (investment advisers) that are registered with the SEC. In addition, mutual funds themselves are registered with the SEC and subject to SEC regulation.
  - ii. *Closed-End*: Managed by separate entities (investment advisors) that are registered with the SEC. CEFs funds are permitted to invest in a greater amount of “illiquid” securities than are mutual funds. (An illiquid security generally is considered to be a security that cannot be sold within seven days at the approximate price used by the fund in determining NAV.)
  - iii. *Unit Investment Trust*: A UIT will have a termination date (a date when the UIT will terminate and dissolve) that is established when the UIT is created (although some may terminate more than fifty years after they are created). In the case of a UIT investing in bonds, for example, the termination date may be determined by the maturity date of the bond investments. When a UIT terminates, any remaining investment portfolio securities are sold and the proceeds are paid to the investors. A UIT does not actively trade its investment portfolio. That is, a UIT buys a relatively fixed portfolio of securities (for example, five, ten, or twenty specific stocks or bonds), and holds them with little or no change for the life of the UIT. Because the investment portfolio of a UIT generally is fixed, investors generally know what they are investing in for the duration of their investment. Investors will find the portfolio securities held by the UIT listed in its prospectus. A UIT does not have a board of directors, corporate officers, or an investment adviser to render advice during the life of the trust.

13. Information reviewed from the Closed-End Fund Association identified ETFs as very similar to closed-end funds. A key difference noted between closed-end funds and ETFs was that ETFs may be a passive investment vehicle (tracks the performance of an index or benchmark), whereas a closed-end fund is actively managed (investment makes portfolio decisions with the objective of outperforming, not just tracking an index or benchmark).

14. In researching to determine if there was an explicit reason for the prior exclusion of CEFs and UITs from SSAP No. 30, NAIC staff did not find any documented information detailing why “mutual funds” (open-end investment companies) were captured within SSAP No. 30, and the other SEC registered investment companies (CEFs and UITs) were not identified within scope of SSAP No. 30. NAIC staff believes a correlation may have been previously made between “closed-end funds” and “partnerships” captured in scope of *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*. In reviewing current documentation regarding CEFs, NAIC staff does not believe that CEFs should be considered similar to non-SEC registered partnerships. Rather, the following characteristics seems to support the inclusion of registered CEF within scope of SSAP No. 30, similar to mutual funds:

- a. CEFs are subject to laws and oversight by the SEC and the exchanges where they are listed.
- b. CEFs must provide a written prospectus containing complete disclosure about the fund when the shares are initially offered to the public (IPO). Following the IPO, other disclosure documents, including annual and semiannual reports and the proxy statement provide info to the investors.
- c. After an IPO, CEFs trade on a stock exchange or over-the-counter market at market prices.

- d. CEFs are designed to reflect “bond CEFs” (representing 61% of the CEF market) or “equity CEFs” (representing 39% of the CEF market).
- e. Info on CEFs, including NAV, market price and discounts/premiums are found in stock market tables and on major financial websites.
- f. Investment returns are received from share price appreciation/depreciation or distributions. Distributions can occur from ordinary dividends (interest and dividend income from securities in the portfolio), capital gains (profits from selling securities held in the portfolio) and from return of capital. Although the “return of capital” may seem similar to a non-SEC registered partnership structure, for CEFs, this occurs when the fund is acting as a pass-through and one of the underlying holdings has a return of capital. (This was noted when the CEF was holding master limited partnerships and the CEF merely passes this payment to the shareholders.) (MLP are also captured in SSAP No. 30 if trading as common stock.) It was also noted that a CEF may have a managed distribution policy when they “return capital” to maintain a stable regular distribution over the long-term so the fund’s distributions are matched to its total return.

15. The proposal in this issue paper to capture CEFs and UITs in scope of SSAP No. 30, is specific to these SEC registered “investment company” structures. This limits the proposal to only investments that are registered under the *Investment Company Act of 1940*. This proposal purposely continues the exclusion of private funds from the scope of SSAP No. 30. Pursuant to the SEC, “private funds” are pooled investment vehicles that are excluded from the definition of investment company under the Investment Company Act by Section 3(c)1 or 3(c)7 of that Act. The term “private fund” generally includes funds commonly known as hedge funds and private equity funds. With the proposal detailed in this issue paper, private fund investments, if held by reporting entities, would continue to be excluded from the scope of SSAP No. 30.

- a. Private fund advisors are often required to register with the SEC and are required to comply with applicable provisions of the *Investment Advisors Act of 1940*. (These provisions provide the SEC with information on private funds they manage - including size, leverage, liquidity and types of investors.) The “investment advisor” registration is not synonymous with registration of an investment vehicle as an investment company under the *Investment Company Act of 1940*. A private fund advisor that registers with SEC under the *advisors act* would not impact the reporting of private equity / hedge funds managed by the investment advisor. Hence, even if the investment advisor was registered with the SEC, funds issued by the registered investor would continue to be excluded from SSAP No. 30 unless the fund was an SEC registered investment.

### Scope of SSAP No. 30 – Nonpublic Stock Warrants

16. Comments received from interested parties noted that SSAP No. 30 should be expanded to include stock warrants on non-public common stock. These comments noted that interested parties have wondered why only publicly traded stock warrants are included in SSAP No. 30.

17. From a review of *Issue Paper No. 30—Investments in Common Stock, (excluding investments in common stock of subsidiary, controlled or affiliated entities)* (finalized March 1998), The exclusion of nonpublic stock warrants seems to have been incorporated from historical guidance included in the *Purposes and Procedures Manual of the NAIC Securities Valuation Office* when SSAP No. 30 was first adopted. Pursuant to Issue Paper No. 30, paragraph 30: (Applicable Excerpts Only)

18. The *Purposes and Procedures Manual of the NAIC Securities Valuation Office - Section 5 - Procedures for Valuing Common Stocks and Stock Warrants* contains the following guidance:

- (A) Common Stocks of Companies Not Classified as Being Subsidiaries, Controlled or Affiliated, Under Section 5(B).

- (a) Association values for publicly traded common stocks and warrants, including, where permitted by law or regulation of an insurer's state of domicile, shares against which exchange traded call options are outstanding, and where the requirements of Section 5(C)(1) are met, shall be equal to market value at date of statement, excepting that, where permitted by law or regulation of an insurer's state of domicile, shares loaned to others shall be valued at the market value at date of statement if the Acceptable Collateral, as hereinafter defined, is pledged as security for the loan and except as set forth in the following sentence, the Acceptable Collateral pledged as security is, at the inception of the loan, in an amount equal to 102% of the market value of the loaned shares. In event that foreign shares are the subject of the loan and the denomination of the currency of the Acceptable Collateral is other than the denomination of the currency of the loaned foreign shares, the amount of Acceptable Collateral which shall be pledged shall be an amount equal to 105% of the market value of the loaned shares. A decline in value of the Acceptable Collateral or an increase in the value of the loaned shares during the term of the loan shall not result in disqualification from valuation in accordance with the above if, during the term the loan is outstanding, additional Acceptable Collateral is posted any time the amount of Acceptable Collateral declines to 100% of the market value of the loaned shares (or 102% of the market value of the loaned shares if Acceptable Collateral in an amount equal to 105% was required to be posted at the inception of the loan) in an amount equal to the difference between the 102% or 105% initially required to be posted and 100% or 102%, respectively. For purpose of this provision, Acceptable Collateral shall mean cash and cash equivalents and shall include securities issued by the U.S. Government or its agencies. Any shortfall in the amount of the actual Acceptable Collateral posted and the required 102% or 105%, as applicable, shall be deducted from the otherwise determined statement value.
- (C) Stock Warrants.
- (1) Stock Warrants.
- All warrants which are exercisable on the date of the Statement shall be valued at Association Value as defined below whether or not physically attached to any other security (See (D), hereunder, for the valuation of warrants exercisable into securities which are restricted as to transferability.)
- (a) For publicly traded warrants (other than exchange traded) the Association Value shall be equal to market value.
- (b) The Association Value for a warrant having no public market which is currently exercisable into shares of common stock which have no public market shall be the difference resulting from the subtraction from the analytically determined Association Value of the stock of the exercise price for the warrant.
- (c) The Association Value for a warrant having no public market which is currently exercisable into shares of common stock which have a counterpart public market but which are themselves restricted shall be the difference resulting from the subtraction from the value of the common shares as determined under the procedures of Section 5(D) below of the exercise price for the warrant.

- (d) Warrants having no public market and for which the first exercise date is subsequent to the date of the statement shall have no value for statement purposes.
- (D) Common Stocks Having a Public Market Which Are Issued Under an Investment Letter or Are Otherwise Restricted as to Transferability.

Restricted common stocks (which for purposes of this section, are defined as restricted shares of an unaffiliated issuer held for a period of less than three years prior to the date of valuation) shall be valued by insurers in their Annual Statements on a basis which they are prepared to justify to the SVO staff. (Restrictions shall be considered to have expired for common stocks held at least three years prior to the date of valuation, and the regular valuation basis shall apply.) Such values shall be reviewed by the SVO staff as to the reasonableness of the valuation basis used. The results of the SVO staff's review will be made available to insurance departments and upon request to insurers holding said restricted common stocks.

Warrants exercisable into such restricted common stocks will be valued on the same special basis.

All restricted common stocks and warrants exercisable into the same should be appropriately noted in the Annual Statement, as required, in Schedule D- Part 2- Section 2.

Market values, where used in the determination of Association Values carried in the SVO manual, are not intended for use in valuing restricted common stocks, warrants as described in this section. Values for such restricted common stocks, warrants will not be carried in the SVO publication.

18. A stock warrant is a security that entitles the holder to buy the underlying stock of the issuing company at a fixed price (exercise price) until the warrant's expiration date. Key characteristics:

- a. Warrants are generally long-term, and can have expiration dates that expire several years in the future.
- b. When a warrant is exercised, the shares are issued directly by the company at the exercise price. (The warrant holder would turn the warrant into the issuing company with payment for the exercise price and receive the common stock directly from the company.)
- c. Whether a warrant is exercised depends on whether the exercise price is less than the current stock price. (For example, if the warrant's exercise price is \$20, and the common stock price is only \$10, the warrant holder would not choose to exercise the warrant.)
- d. A warrant is profitable if the stock price exceeds the cost of the warrant plus the exercise price. (For example, if a warrant cost \$2 and the exercise price is \$20, the warrant would only be profitable if the common stock shares were trading above \$22.)
- e. If a warrant is not exercised before the expiration date, perhaps because the stock price was less than the exercise price, then the warrant would expire worthless, and the holder of the warrant would lose any investment to acquire the warrant.

19. NAIC staff believes that publicly-traded stock warrants were permitted as the trading value (fair value) would reflect market expectations of the future value of the warrant. Although a warrant may not be likely to be exercised, if publicly traded, the holder would have a verifiable value, as well as the ability to liquidate the warrant (at the current public trading value) if the holder did not think it would be become profitable before the exercise date.

20. It is noted there is greater liquidity risk in permitting non-publicly traded stock warrants in scope of SSAP No. 30, as the insurer does not have the same ability to sell the warrant if they do not believe it will become profitable before the exercise date. Furthermore, if the warrant is not publicly traded, the fair value (reporting value) of the warrant would not be clearly known or verifiable. There is also concern with the reporting of assets on the statutory financial statements that may not actually “materialize” into assets available for policyholder claims. As detailed, stock warrants expire worthless if they are not exercised before the expiration date, and unless the warrant’s exercise price is less than the current stock price, a stock warrant is not likely to be exercised.

21. Guidance for warrants, other than publicly-traded stock warrants captured in SSAP No. 30, is reflected in *SSAP No. 86—Derivatives*. Warrants meet the definition of a derivative and are defined in SSAP No. 86 as follows:

“Warrants” are instruments that give the holder the right to purchase an underlying financial instrument at a given price and time or at a series of prices and times outlined in the warrant agreement. Warrants may be issued alone or in connection with the sale of other securities, for example, as part of a merger or recapitalization agreement, or to facilitate divestiture of the securities of another business entity.

22. The following information for stock warrants is currently in the P&P Manual, in Part 5 – Section 1: Pricing of Unaffiliated Investments. This section pertains to SVO Valuation Methodologies and does not impact how an investment is reported (e.g., underlying SSAP or admitted) under the AP&P Manual:

### **c) SVO Valuation Methodologies**

#### **(iii) Analytical Determinations of Fair Value**

Where a fair value cannot be obtained from a public source, the SVO shall attempt to determine a fair value analytically in accordance with the procedures discussed below.

#### **(H) Stock Warrants**

The fair value of a warrant convertible into private common stock for the year in which the warrant has been purchased by the reporting insurance company shall be the cost of the warrant to such reporting insurance company.

For any subsequent year, the fair value of a warrant convertible into private common stock shall be the difference between the Association Value of the common stock as determined pursuant to either Paragraph (E) or (G) of this section, as applicable, and the exercise price. The result is then discounted for illiquidity.

The fair value for a warrant with no public market, exercisable into shares of common stock that do have a public market, shall be the difference between the value of the common stock and the exercise price of the warrant. In the case of a warrant exercisable into restricted common stock, the fair value shall be the difference between the common stock share price determined pursuant to paragraph (I) below and the exercise price.

Warrants for which the first exercise date is subsequent to the date of the NAIC Financial Statement Blank shall have no value unless a publicly available price can be obtained for NAIC Financial Statement Blank purposes.

23. After considering non-public stock warrants, the Working Group agreed to retain public stock warrants in scope of SSAP No. 30, and include non-public stock warrants in scope of SSAP No. 86. Minor revisions will be captured in SSAP No. 86 to clarify the statutory accounting guidance:

“Warrants” are instruments that give the holder the right to purchase an underlying financial instrument at a given price and time or at a series of prices and times outlined in the warrant agreement. Warrants may be issued alone or in connection with the sale of other securities, for



example, as part of a merger or recapitalization agreement, or to facilitate divestiture of the securities of another business entity. Publicly traded stock warrants are captured in scope of SSAP No. 30. All other warrants, including non-publicly traded stock warrants, shall be captured in scope of SSAP No. 86.

### Reporting Enhancements for SSAP No. 30 Securities

24. The guidance in this issue paper supports the prior Working Group decisions to not include more equity/fund investments in *SSAP No. 26R—Bonds* (such as mutual funds or exchange-traded funds) beyond what is currently permitted. As detailed in SSAP No. 26R, paragraph 4, only specific SVO-Identified investments are captured within scope of SSAP No. 26R:

4. The definition of a bond, per paragraph 3, does not include equity/fund investments, such as mutual funds or exchange-traded funds. However, the following types of SVO-identified investments are provided special statutory accounting treatment and are included within the scope of this statement. These investments shall follow the guidance within this statement, as if they were bonds, unless different treatment is specifically identified in paragraphs 23-29.

- a. Exchange traded funds (ETFs), which qualify for bond treatment, as identified in Part Six, Section 2 of the *Purposes and Procedures Manual of the NAIC Investment Analysis Office*. (SVO-identified ETFs are reported on Schedule D – Part 1.)
- b. Bond mutual funds which qualify for the Bond List, as identified in Part Six, Section 2 of the *Purposes and Procedures Manual of the NAIC Investment Analysis Office*. (SVO-identified bond mutual funds are reported on Schedule D – Part 1.)

25. Although this issue paper does not propose revisions to reclassify additional mutual funds as SSAP No. 26R securities (reported as long-term bonds on Schedule D-1), this issue paper does support the consideration of reporting revisions to permit NAIC designations for mutual funds reported in scope of SSAP No. 30 (on Schedule D-2-2) based on the underlying holdings of the fund. As noted by interested parties, this reporting revision would have the potential to combine sound financial reporting standards with the flexibility for a more risk-sensitive RBC regime further reflective of underlying fund holdings. Although this issue paper supports the inclusion of NAIC designations on D-2-2 for funds, this issue paper does not propose any measurement method revisions, or changes in admittance requirements, for funds captured within scope of SSAP No. 30 based on the reported NAIC designation.

26. Although this issue paper supports the inclusion of NAIC designations on Schedule D-2-2, the Statutory Accounting Principles (E) Working Group does not have the ability to incorporate the reporting and RBC changes. Rather, if the Working Group supports the concept to report NAIC designations on Schedule D-2-2, the changes necessary to incorporate these revisions will need to be considered and adopted by the Blanks (E) Working Group, the Valuation of Securities (E) Task Force and the Capital Adequacy (E) Task Force.

27. During the 2018 Spring National Meeting, the Working Group considered comments from Vanguard requesting that more bond mutual funds be captured in scope of SSAP No. 26R. These comments identified that only bond mutual funds that hold 100% government securities qualify to be on the SVO-Identified Bond Mutual Fund listing, and Vanguard suggested that bond funds with other holdings (non U.S. government) should be considered for inclusion, and allowed in scope of SSAP No. 26R. The Vanguard comments noted that there is inconsistency in reporting by requiring non U.S. government bond fund investments to be in scope SSAP No. 30, and indicated that all investment-grade bond mutual funds should be eligible for bond-like treatment consistent with the current treatment of SVO-Identified Bond ETFs. Vanguard also noted that revising the methodology would not require substantive changes, but that only modest revisions would be needed.

28. After considering the comments received from Vanguard, the Working Group agreed not to consider expanding the provisions in SSAP No. 26R to allow additional bond mutual funds within scope of that standard. The following was captured in support of this decision:

- a. In accordance with prior Working Group comments from the discussion of SSAP No. 26R, equity / fund investments do not fit in SSAP No. 26R. These investments are not bonds and do not represent a creditor relationship whereby there is a fixed scheduled for one or more future payments. The inclusion of the specifically noted SVO-Identified investments are specific exceptions, and there is no current Working Group member support to expand the equity / fund investments in scope of SSAP No. 26R.
- b. The long-term bond schedule (Schedule D-1) is not conducive to the reporting of funds, and questions often arise on the proper completion of Schedule D-1 for the SVO-Identified ETFs and Bond Mutual Funds captured in SSAP No. 26R and reported on that schedule. (For example, several columns on Schedule D-1 are not applicable for funds - e.g., interest rate, par value, maturity date, etc.) If there was a desire for mutual funds to be reported similarly to SVO-Identified ETFs, rather than expanding the listing of funds permitted to be reported on Schedule D-1, further exacerbating these reporting issues, it would be recommended that all funds (including the SVO-Identified ETFs and Bond Mutual Funds captured in SSAP No. 26R) be captured within SSAP No. 30. (ETFs not on the SVO-Listing are already captured in SSAP No. 30.) If this approach was taken, it would allow similar investments to be reported on the same schedule and would eliminate the reporting issues. If consideration was to be given to this approach, revisions could be incorporated to move the specific measurement value permitted for the SVO-Identified funds (systematic value) from SSAP No. 26R to SSAP No. 30. With the proposal to capture NAIC designations on Schedule D-2-2, if the funds captured in SSAP No. 26R were moved to SSAP No. 30, it is expected that corresponding revisions would be considered by the Capital Adequacy (E) Task Force to revise the RBC accordingly for the investments that were previously on D-1.
- c. The existing guidance that allows SVO-Identified funds to be reported in scope of SSAP No. 26R, on Schedule D-1, has historically resulted with inconsistent reporting across companies for similar investments. This is because some reporting entities did not identify that specific ETFs or bond mutual funds were on the SVO-Identified listings. As such, funds that qualified for SSAP No. 26R have continued to be reported by some companies as if they were in scope of SSAP No. 30, on Schedule D-2-2. It is anticipated that if specific mutual funds were noted as qualifying for SSAP No. 26R, then inconsistencies in reporting would be expanded as some reporting entities would continue to report the fund on Schedule D-2-2.
- d. The Working Group noted that the proposal to allow NAIC designations on Schedule D-2-2 could provide the same benefits noted by commenters without requiring a reclassification of certain securities from SSAP No. 30 to SSAP No. 26R. With this proposed designation reporting change, mutual funds could be reported with an NAIC designation based on their underlying holdings, creating consistency in reporting which would allow the Capital Adequacy (E) Task Force to adjust risk-based capital charges if deemed appropriate.

### Effective Date

29. The adoption of this issue paper by the Statutory Accounting Principles (E) Working Group, and the substantively-revised statement of statutory accounting principles (SSAP) occurred on November 15, 2018. The substantive revisions to SSAP No. 30R are detailed in Exhibit A of this issue paper, and reflected in the substantively-revised *SSAP No. 30R—Unaffiliated Common Stock*. The effective date of the guidance

will be identified in the SSAP. Users of the *Accounting Practices & Procedures Manual* should note that issue papers are not represented in the Statutory Hierarchy (see Section IV of the Preamble) and therefore the conclusions reached in this issue paper should not be applied until the corresponding SSAP has been adopted by the Plenary of the NAIC.

## **RELEVANT STATUTORY ACCOUNTING AND GAAP GUIDANCE**

### **Statutory Accounting**

- *SSAP No. 30R—Unaffiliated Common Stock*

**EXHIBIT A – Substantive Revisions to SSAP No. 30R—Unaffiliated Common Stock****SCOPE OF STATEMENT**

1. This statement establishes statutory accounting principles for common stocks.
2. Investments in common stock of subsidiaries, controlled or affiliated entities (investments in affiliates) are not within the scope of this statement. They are addressed in *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities* (SSAP No. 97).

**SUMMARY CONCLUSION**

3. Common stocks (excluding investments in affiliates) are securities which represent a residual/subordinate ownership in a corporation, ~~and shall include~~ This definition includes:
  - a. Publicly traded common stocks
  - b. Common stocks that are not publicly traded
  - c. Common stocks restricted as to transfer of ownership<sup>1</sup>
4. In addition, the following equity<sup>2</sup> investments are captured within scope of this statement:
  - ~~b.a.~~ Master limited partnerships trading as common stock and American deposit receipts only if the security is traded on the New York, ~~American~~, or NASDAQ exchanges
  - ~~e.b.~~ Publicly traded common stock warrants
  - ~~d.c.~~ Shares of SEC registered Investment Companies<sup>3</sup> captured under the Investment Company Act of 1940 (open-end investment companies (mutual funds), closed-end funds and unit investment trusts), regardless of the types or mix of securities owned by the fund (e.g., bonds, or stocks<sup>4</sup>, ~~money market instruments~~), except for Bond Mutual Funds which qualify for bond treatment, as identified in Part Six, Section 2, of the Purposes and Procedures Manual of the NAIC Investment Analysis Office
    - ~~i.~~ Bond Mutual Funds which qualify for bond treatment, as identified in Part Six, Section 2, of the Purposes and Procedures Manual of the NAIC Investment Analysis Office;

<sup>1</sup> Restricted stock shall be defined as a security for which sale is restricted by governmental or contractual requirement (other than in connection with being pledged as collateral), except where that requirement terminates within one year or if the holder has the power by contract or otherwise to cause the requirement to be met within one year. Any portion of the security that can be reasonably expected to qualify for sale within one year is not considered restricted. Regardless of redemption timeframe, FHLB capital stock is considered restricted stock until actual redemption by the FHLB.

<sup>2</sup> Unless as specifically noted, the equity investments identified within scope are subject to the provisions of this standard as if they were common stock investments.

<sup>3</sup> Non-SEC registered investment companies (e.g., private investment companies or hedge funds) are excluded from the scope of this statement.

<sup>4</sup> Money market mutual funds are considered cash equivalents under SSAP No. 2R.

- ~~ii. Money Market Mutual Funds on the U.S. Direct Obligations/Full Faith and Credit Exempt List, as identified in Part Six, Section 2, of the *Purposes and Procedures Manual of the NAIC Investment Analysis Office*<sup>5</sup>;~~
- e.d. Exchange Traded Funds, except for those identified for bond or preferred stock treatment, as identified in Part Six, Section 2, of the *Purposes and Procedures Manual of the NAIC Investment Analysis Office*
- f.e. ~~Common stocks that are not publicly traded, including e~~Equity interests in certified capital companies in accordance with *INT 06-02: Accounting and Reporting for Investments in a Certified Capital Company (CAPCO)*
- ~~g. Common stocks that are restricted as to transfer of ownership. Restricted stock shall be defined as a security for which sale is restricted by governmental or contractual requirement (other than in connection with being pledged as collateral), except where that requirement terminates within one year or if the holder has the power by contract or otherwise to cause the requirement to be met within one year. Any portion of the security that can be reasonably expected to qualify for sale within one year is not considered restricted. Regardless of redemption timeframe, FHLB capital stock is considered restricted stock until actual redemption by the FHLB.~~

4.5. ~~Common stocks~~Investments within scope of this statement meet the definition of assets as defined in *SSAP No. 4—Assets and Nonadmitted Assets* and are admitted assets to the extent they conform to the requirements of this statement.

### Acquisitions and Sales

5.6. At acquisition, common stocks shall be reported at their cost, including brokerage and other related fees. Common stock acquisitions and dispositions shall be recorded on the trade date. Private placement stock transactions shall be recorded on the funding date. A reporting entity may become qualified for use of equity method accounting by an increase in the level of ownership. In this situation, the reporting entity shall add the cost of acquiring additional interest in the investee to the current basis of the previously held interest and shall apply the equity method, as prescribed in *SSAP No. 97*, prospectively, as of the date the investment becomes qualified for equity method accounting.

~~6.7.~~ A reporting entity can subscribe for the purchase of stock, but not be required to make payment until a later time. Transactions of this nature are common in the formation of corporations. Common stock acquired under a subscription represents a conditional transaction in a security authorized for issuance but not yet actually issued. Such transactions are settled if and when the actual security is issued and the exchange or National Association of Securities Dealers (NASD) rules that the transactions are to be settled. Common stock acquired under a subscription shall be recorded as an admitted asset when the reporting entity or its designated custodian or transfer agent takes delivery of the security and the security is recorded in the name of the reporting entity or its nominee (i.e., the accounting for such common stock acquisitions shall be on the settlement date).

### Balance Sheet Amount

7.8. Investments in scope of this standard~~unaffiliated common stocks~~ shall be valued~~reported~~ at fair value. For FHLB capital stock, which is only redeemable at par, the fair value shall be presumed to be par, unless considered other-than-temporarily impaired. Mutual funds, unit-invested funds, and exchange traded funds without a readily determinable fair value are permitted to be reported at net asset value if permitted as a practical expedient pursuant to the guidance in SSAP No. 100R. Closed-end funds are not permitted to

<sup>5</sup> Pursuant to *SSAP No. 2R*, effective December 31, 2017, money market mutual funds shall be reported as cash equivalents and valued at fair value (net asset value allowed as a practical expedient).

be reported at net asset value and shall be reported at fair value. Changes in fair value (or net asset value, as permitted) shall be recorded as unrealized gains or losses.

~~8.9.~~ For reporting entities required to maintain an Asset Valuation Reserve (AVR), the accounting for unrealized capital gains and losses shall be in accordance with *SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve* (SSAP No. 7). For reporting entities not required to maintain an AVR, unrealized capital gains and losses shall be recorded as a direct credit or charge to surplus.

### **Impairment**

~~9.10.~~ For any decline in the fair value of a common stock which is determined to be other than temporary <sup>(INT 06-07)</sup> the common stock shall be written down to fair value as the new cost basis and the amount of the write down shall be accounted for as a realized loss. For those reporting entities required to maintain an AVR, realized losses shall be accounted for in accordance with SSAP No. 7. Subsequent fluctuations in fair value shall be recorded as unrealized gains or losses. Future declines in fair value which are determined to be other than temporary shall be recorded as realized losses. A decline in fair value which is other than temporary includes situations where a reporting entity has made a decision to sell a security at an amount below its carrying value.

### **Income**

~~10.11.~~ Dividends on common stock shall be recorded as investment income on the ex-dividend date with a corresponding receivable to be extinguished upon receipt of cash (i.e., dividend income shall be recorded on stocks declared to be ex-dividends on or prior to the statement date).

~~11.12.~~ For reporting entities required to maintain an AVR, the accounting for realized capital gains and losses on sales of common stock shall be in accordance with SSAP No. 7. For reporting entities not required to maintain an AVR, realized gains and losses on sales of common stock shall be reported as realized gains/losses in the statement of operations.

### **Stock Splits, Stock Dividends, Payment in Kind Dividends, and Stock Exchanges**

~~12.13.~~ Stock splits, stock dividends, payment in kind dividends, and stock exchanges shall be accounted for in accordance with *SSAP No. 95—Nonmonetary Transactions* (SSAP No. 95).

### **FHLB Capital Stock**

~~13.14.~~ FHLB capital stock is held by reporting entities that are members of an FHLB. Each reporting entity must acquire FHLB capital stock for membership and maintain capital stock holding sufficient to support its business activity (borrowings<sup>6</sup>) in accordance with the respective FHLB's capital plan. The price of FHLB capital stock cannot fluctuate, and all FHLB capital stock must be purchased, repurchased or transferred at its par value. FHLB capital stock is restricted for redemption in accordance with the FHLB capital plan and shall be coded as restricted within the financial statements (e.g., investment schedules and general interrogatories).

~~14.15.~~ Acquisition of FHLB capital stock allows members to conduct business activity (borrowings) from an FHLB. The amount of capital stock acquired determines the reporting entity's eligible borrowing amount. At a minimum, all borrowings from an FHLB (regardless of structure) must also be fully collateralized in accordance with the FHLB capital plan, which determines the amount of collateral required by type of pledged instrument. Collateral pledged to an FHLB shall be coded as restricted within the

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<sup>6</sup> Membership in an FHLB allows reporting entities to take advances / borrow from the FHLB. These borrowings can be structured in a variety of ways, for example: debt, funding agreements, repurchase agreements, securities lending, etc. Borrowings from an FHLB shall be reflected in the financial statements in accordance with the SSAP that addresses the substance of the agreement.

financial statements (e.g., investments schedules and general interrogatories). Collateral pledged to an FHLB is considered an admitted asset if all of the following conditions are met:

- a. the asset would have been admitted under SSAP No. 4;
- b. the pledging insurer continues to receive the income on the pledged collateral;
- c. the pledging insurer can remove and substitute other securities with little or advance notice to the FHLB as long as the insurer complies with related investment quality and market value provisions; and
- d. there has been no uncured default or event to indicate an impairment or loss contingency for the pledged assets.

### Disclosures

~~15.16~~ The following disclosures regarding common stocks shall be made in the financial statements:

- a. Basis at which the common stocks are stated; and
- b. A description, as well as the amount, of common stock that is restricted outside of FHLB agreements and the nature of the restriction. (Disclosures of FHLB capital stock are captured in paragraph ~~16.17~~.)
- c. For each balance sheet presented, all common stocks in an unrealized loss position for which other-than-temporary declines in value have not been recognized,
  - i. The aggregate amount of unrealized losses (that is, the amount by which cost or amortized cost exceeds fair value) and
  - ii. The aggregate related fair value of common stocks with unrealized losses.
- d. The disclosures in (i) and (ii) above should be segregated by those common stocks that have been in a continuous unrealized loss position for less than 12 months and those that have been in a continuous unrealized loss position for 12 months or longer using fair values determined in accordance with *SSAP No. 100R—Fair Value*.
- e. As of the most recent balance sheet presented, additional information should be included describing the general categories of information that the investor considered in reaching the conclusion that the impairments are not other-than-temporary.
- f. When it is not practicable to estimate fair value, the investor should disclose the following additional information, if applicable, as of each date for which a statement of financial position is presented in its annual financial statements:
  - i. The aggregate carrying value of the investments not evaluated for impairment, and
  - ii. The circumstances that may have a significant adverse effect on the fair value.

### FHLB Disclosures

~~16.17~~ For FHLB agreements, the following information shall be disclosed in the financial statements for current and prior year and between general account and separate account activity. The information in the disclosures shall be presented gross even if a right to offset per SSAP No. 64 exists.

- a. General description of FHLB agreements, with information on the nature of the agreement, type of borrowing (advances, lines of credit, borrowed money, etc.) and use of the funding.
- b. Amount of FHLB capital stock held, in aggregate, and classified as follows: i) membership stock (separated by Class A and Class B); ii) Activity Stock; and iii) Excess Stock. For membership stock, report the amount of FHLB capital stock eligible for redemption<sup>7</sup> and the anticipated timeframe for redemption: i) less than 6 months, ii) 6 months to 1 year, iii) 1 year to 3 years, and iv) 3 to 5 years.
- c. Amount (fair value and carrying value) of collateral pledged to the FHLB as of the reporting date. In addition, report the maximum amount of collateral pledged to the FHLB at any time during the current reporting period. (Maximum shall be determined on the basis of carrying value, but with fair value also reported)
- d. Aggregate amount of borrowings at the reporting date from the FHLB, reflecting compilation of all advances, loans, funding agreements, repurchase agreements, securities lending, etc., outstanding with the FHLB, and classify whether the borrowing is in substance: i) debt (*SSAP No. 15—Debt and Holding Company Obligations*), ii) a funding agreement (*SSAP No. 52—Deposit-Type Contracts*), or iii) Other. For funding agreements, report the total reserves established. Report the maximum amount of aggregate borrowings from an FHLB at any time during the current reporting period, the actual or estimated maximum borrowing capacity as determined by the insurer, with a description of how the borrowing capacity was determined, and whether current borrowings are subject to prepayment penalties.

~~17~~18. The disclosures in paragraphs ~~15~~16.c. through ~~15~~16.f. shall be included in the annual audited statutory financial reports only. The FHLB disclosures in paragraph ~~16~~17 are required in all interim and annual financial statements regardless if the activity is materially different from the activity reported during the prior reporting period. Refer to the Preamble for further discussion regarding disclosure requirements.

### Relevant Literature

~~18~~19. This statement adopts *ASU 2016-07, Investments - Equity Method and Joint Ventures*, modified to reflect statutory terms including the definition of control and statutory reporting concepts. This statement rejects *ASU 2018-03, Recognition and Measurement of Financial Assets and Financial Liabilities*, and *ASU 2016-01, Financial Instruments – Overall and FASB Statement No. 115, Accounting for Certain Investments in Debt and Equity Securities*.

### Effective Date and Transition

~~19~~20. This statement is effective for years beginning January 1, 2001. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*. Revisions adopted to this statement in October 2013 amending SSAP No. 15 and SSAP No. 52 to incorporate FHLB disclosure information are initially effective for interim and annual reporting periods after January 1, 2014. Revisions adopted to this statement in November 2018, incorporating closed-end funds and unit-investment trusts within scope, are initially effective January 1, 2019.

<sup>7</sup> For FHLB membership stock to be eligible for redemption, written notification must have been provided to the FHLB prior to the reporting date.



**REFERENCES****Other**

- *Purposes and Procedures Manual of the NAIC Investment Analysis Office*
- NAIC Valuation of Securities product prepared by the Securities Valuation Office

**Relevant Issue Papers**

- *Issue Paper No. 30—Investments in Common Stock (excluding investments in common stock of subsidiary, controlled, or affiliated entities)*
- *Issue Paper No. 158—Unaffiliated Common Stock*