

Statutory Issue Paper No. 163

Working Capital Finance Investment Updates

STATUS

Finalized May 20, 2020

Original SSAP: SSAP No. 105; Current Authoritative Guidance: SSAP No. 105R

Type of Issue:

Common Area

SUMMARY OF ISSUE

1. This issue paper introduces substantive revisions to SSAP No. 105—*Working Capital Finance Investments* to change some of the existing accounting and program requirements. This item is specific for Working Capital Finance investments (WCFI) which comply with the program requirements and have been designated by the NAIC Securities Valuation Office (SVO).

SUMMARY CONCLUSION

2. The substantive revisions to SSAP No. 105 (illustrated in Exhibit A), reflect the following elements:

- a. Functionally Equivalent Foreign Regulators – Removed the requirement that the SVO determine if the International Finance Agent is the functional equivalent of the U.S. Regulator.
- b. Commingling Prohibitions – Removed the finance agent prohibitions on commingling.
- c. Requirements for Filer to Certify First Priority Perfected Interest – Removed requirements, with revisions allowing the SVO to determine if first priority perfected interest has been obtained.
- d. Finance Agent Validation Requirements – The independent review requirements were broadened to allow independent review of the finance agent by either audit or through an internal control report.
- e. Default Date – Changed the default provisions from 15 to 30 days so the default date and the cure period are consistent. This has the effect of changing the date of nonadmission for an investment in default for a period up to 30 days instead of up to 15 days.
- f. Investor Rights Edit – Removed duplicative text regarding exercise of investor rights.

3. This issue paper provides historical information on the consideration of revisions for working capital finance program issuances acquired as investments, as well as some of the initially adopted guidance. SSAP No. 105 permits admittance of NAIC Securities Valuation Office designated WCFI programs that meet specific requirements.

Working Capital Finance Investments Overview

4. Bills receivable, in general, are an asset class that has been historically nonadmitted by statutory accounting. They were nonadmitted prior to codification and explicitly nonadmitted in *SSAP No. 20—Nonadmitted Assets*.

5. When SSAP No. 105 was developed, SSAP No. 20 was amended to allow working capital finance investments as admitted assets to the extent they conform to the requirements of SSAP No. 105 (see Relevant Statutory Accounting). Some of the WCFI program requirements are to provide protections that help to distinguish these programs from factoring, forfaiting, invoice discounting and other similar programs which have been historically nonadmitted in SSAP No. 20. SSAP No. 105 details that eligible confirmed supplier receivables must not: include insurance or insurance related assets; be impaired or in default at the time of purchase; or have a maturity longer than one year from the date of invoice. In addition, there are restrictions that preclude admission of affiliated WCFI investments.

6. SSAP No. 105 provides that working capital finance investments represent a confirmed short-term obligation¹ to pay a specified amount owed by one party (the obligor) to another (typically a supplier of goods), generated as a part of a working capital finance investment program currently designated by the NAIC Securities Valuation Office (SVO). Pursuant to the long-term working capital finance investment program, a short-term obligation has been transferred by the entity entitled to payment (typically a supplier of goods) to a third-party investor.

7. Working capital finance investments held by a reporting entity represent a right for the reporting entity to receive future payments. This issue paper provides details on the updates to the SSAP No. 105 accounting and reporting guidelines for the right to receive payment under working capital finance programs that meet particular criteria.

Background

8. SSAP No. 105 requires an SVO program designation of NAIC 1 or NAIC 2 (See definitions in relevant statutory accounting) in order to admit working capital finance investments. This was an intentional choice by the Working Group and the Valuation of Securities (E) Task Force during the initial development of guidance in 2012 to limit the admissibility to high quality programs and obligors. High quality programs in existence at the time of the original development of SSAP No. 105 and the some of the requirements of these programs which were administered by larger banks were reviewed.

9. During the original development of SSAP No. 105, the single group reporting entities that had been successfully investing in these types of assets for a number of years, agreed that a high level of investor sophistication to enter and monitor the transactions is required. Also, during the original development of SSAP No. 105, some regulators expressed concerns regarding the ability of smaller entities to monitor the investments in such programs on an ongoing basis. That concern was the basis of the recommendation reflected in the original Issue Paper No. 147 presented to the Working Group to note that such investments which do not fit into traditional categories, may require department of insurance approval.

10. When SSAP No. 105 was developed, the Capital Adequacy (E) Task Force also determined a capital charge for the receivables which varied based on the NAIC designations on the new Schedule BA reporting lines which were developed for these investments.

11. The subsequent industry 2019 proposal developed under discussion by the Working Group proposed to move the investments to Schedule DA — Short-term Investments. During the subsequent review, the Working Group indicated a preference to maintain the long-term programs on annual statement BA where lines and columns would allow proper reporting of the risk-based capital charge. While the program issuances are limited to short-term investments, the long-term program which continually has new balances is what receives the designation.

¹ All references to short-term obligations in this issue paper refer to obligations not exceeding one year.

DISCUSSION

Development of Statutory Accounting Guidance

12. SSAP No. 105 was originally effective in 2014 and was controversial as it was developed at the request of a single life entity. At that time, some Working Group members objected to the development of a new SSAP, reporting changes and specific asset class risk-based capital (RBC) charges at the behest of a single company. The discussion at that time noted that the permitted practice concept was intended to address such situations.

13. In 2018, the reporting entity that participates in these programs requested modifications to the adopted program and submitted a proposal for consideration.

14. As of year-end 2018, WCFI reported in the annual statement Schedule BA - Other Invested Assets was limited to the same life entity that originally requested the development of SSAP No. 105. This company reported a total of \$258 million in a total of seven WCFI programs for 2017 and \$224 million in a total of six WCFI programs for 2018. The total of these amounts is immaterial to the reporting entity. No reporting entities disclosed any prescribed or permitted practices varying from SSAP No. 105 in annual statement Note 1 for 2017 or 2018.

15. The Valuation of Securities (E) Task Force exposed the industry proposal and held discussion on in the third quarter of 2018. The Task Force approved referral to the Statutory Accounting Principles (E) Working Group, which was also supported by the life industry at the 2019 Spring National Meeting. The referral was also forwarded to the Working Group with Valuation of Securities (E) Task Force Memos.

16. The industry proposed ten revisions to SSAP No. 105 affecting the following key aspects:

- a. Changes to program and or obligor credit quality requirements
- b. Changes to program administration and/or documentation
- c. Changes to regulatory compliance requirements
- d. Changes to statutory reporting requirements.

17. On August 3, 2019, the Working Group received the referral from the Task Force and directed NAIC staff to proceed with drafting revisions for subsequent exposure using six of the ten industry recommendations.

Review of Items Not Supported by the Working Group:

18. During the August 2019 discussion the following four industry proposed revisions were presented, but not captured in the direction for revisions to SSAP No. 105.

- a. Possible Domestic Regulator Approval – The statement that the reporting entity may need to seek approval from the domestic regulator was maintained.
- b. Only High-Quality Obligators – The current requirement which restricts designations of programs and obligors to being of high quality (NAIC 1 or NAIC 2) was maintained.
- c. Unrated subsidiaries / Credit substitution - The industry proposed credit substitution methodology for unrated subsidiaries was not incorporated in the exposed revisions. The industry proposal had two aspects:
 - i. Credit substitution for unrated subsidiary obligors of a rated obligor – Industry proposed to attribute the credit strength of the rated parent to the unrated subsidiary

obligor without the rated parent being a guarantor of the unrated subsidiary's WCFI obligations. This aspect envisions the rated entity having some of its own obligations in the program

- ii. Credit Substitution of rated obligor for its unrated subsidiaries which are key transaction participants, but not obligors. The industry proposal was to create criteria to allow the "program" to obtain an acceptable NAIC designation by evaluating if the unrated "key transaction participant" is able to perform its functions. Industry proposed several different ways to attribute the rated entity's credit rating to the unrated entity including:
 - (a) Documented operational control of unrated obligor, or
 - (b) An important inter-relationship with unrated obligor, or
 - (c) If the unrated key transaction participants are reasonably expected to perform their functions.
- d. Change Reporting Schedule - The Working Group did not change the reporting requirements to move the WCFI investments from Schedule BA – Other Assets, to Schedule DA – Short term Investments.

19. Some of the discussion points that were discussed which resulted in the Working Group not directing the inclusion of four of the industry proposed revisions were as follows:

- a. Possible Domestic Regulator Approval – The statement that the reporting entity may need to seek approval from the domestic regulator was maintained as previously noted in Issue Paper No. 147. The Issue Paper documents the possible requirement for domestic regulator approval was an intentional decision because of concerns regarding the ability of smaller entities to monitor the investments in such programs on an ongoing basis.
 - i. It was also noted that the current guidance in SSAP No. 105 is not an explicit requirement, but only identifies that a domiciliary commissioner **may** require a company to receive initial permission (see final action in paragraph 23).
 - ii. The agenda item noted that the industry proposal noted:
 - (a) that these investments may not fit into the normal investment law categories.
 - (b) the asset class is not for most insurers as it requires relationships with finance agents beyond the traditional dealer insurer.
 - (c) the investor needs specialized knowledge, asset management operations and the ability to book and supervise the assets.
 - (d) the filing fees require sizable commitments to justify the costs, which would make it cost prohibitive for smaller players.
 - iii. As a counterpoint to the decision not to change the guidance in the SSAP No. 105, the Fall 2019 industry comments noted that state approval is not a practical risk mitigant. In addition, the speaker present at the meeting commented that he questioned the evaluation criteria that would be used by a state.

- b. Only High-Quality Obligors – The current requirement which restricts designations of programs and obligors to being of high quality was maintained. The Working Group was not in favor of lowering the credit quality of the acceptable obligors from NAIC 1 (highest quality) and NAIC 2 (high quality) to allow NAIC designations of 3 (medium quality) and NAIC 4 (low quality) (See definitions in relevant statutory accounting).
- i. The descriptions of NAIC designations in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* note that both NAIC designations of 3 and 4 have speculative elements.
 - ii. Assets that reflect “factored receivables” are nonadmitted in statutory accounting. This program is the sole exception to the factored receivable rule. By lowering the allowable credit standards, an expanded class of factored receivables would be admitted, further deviating from statutory accounting concepts.
 - iii. The SAPWG created SSAP No. 105 to allow admission for only high-quality programs, from high quality obligors. Allowing obligors with lower credit assessments would be a fundamental change in program requirements.
- c. Unrated subsidiaries / Credit substitution – The industry proposed credit substitution methodology for unrated subsidiaries was not incorporated in the exposed revisions. The industry proposal was noted in the discussion as complex, broad and difficult to apply. Further, credit substitution does not adequately address credit risk for an unrated affiliate. SVO staff memos also highlighted the difficulty in applying the industry proposed credit substitution methodology. Excerpts from the Valuation of Securities (E) Task Force October 2018 memo to the Working Group note the following:
- SVO evaluated whether analytical discretion would enable it to designate WCFI programs with unrated obligors of a rated or designated parent. SVO evaluated whether operational and strategic linkages between a rated parent and unrated obligor can provide a basis to attribute the credit rating of one entity to the other. It concluded that no principle exists to permit an assumption that a legal entity can be held responsible for the debt of another without having contractually agreed to do so. While WCFI arrangements may be inherently different than the credit situations SVO assesses SVO lacks the experiential basis to opine on the idea that the difference permits attribution.**
- d. Change Reporting Schedule – The Working Group did not change the reporting requirements to move the WCFI investments from Schedule BA – Other Assets, to Schedule DA – Short term Investments. Key points noted were:
- i. Reporting on Schedule BA was intentional because the long-term programs are designated, even though the different investments are short-term. Issue Paper No. 147, documents the VOSTF recommendation for Schedule BA reporting. The Task Force discussed the relative benefits between Schedule BA and DA and concluded that WCFIs should be reported as Other Invested Assets and that Schedule BA provides an enhanced disclosure framework deemed more appropriate for the investment.
 - ii. Annual statement lines and RBC charges have already been established on Schedule BA.
 - iii. Capital Adequacy (E) Task Force reviewed the asset class and requires specific designations (relatively low - just slightly higher than a bond of similar credit risk). RBC charges are based on the NAIC SVO WCFI program designation. The current

RBC charges based on program designation would not be functional if the reporting was moved to Schedule DA, because that schedule does not include designations which are needed for RBC.

Review of Items Proposed for Inclusion in SSAP No. 105:

20. On December 7, 2019, the Working Group exposed substantive revisions to SSAP No. 105 to incorporate industry revisions to program requirements, as previously directed by the Working Group during the 2019 Summer National Meeting.

21. The substantive revisions to SSAP No. 105 that were exposed for comment reflected the following elements:

- a. Functionally Equivalent Foreign Regulators - Removed the requirement that the SVO determine if the International Finance Agent is the functional equivalent of the U.S. Regulator. Removing this element was supported by the SVO, which noted that determining functional equivalence is not an analytical issue.
- b. Commingling Prohibitions - Removed the finance agent prohibitions on commingling. Removal of this requirement was supported by the SVO. SVO staff noted if commingling were not a requirement it would consider commingling risk, when present, as a structural deficiency and balance it against the requirement that the Finance Agent be NAIC 1 or NAIC 2.
- c. Investor Rights Edit - Removed duplicative text regarding exercise of investor rights. This revision was to improve readability and eliminate redundancy.
- d. Requirements for filer to Certify Perfected Interest – Removed requirements, with revisions allowing the SVO to determine if a first priority perfected interest in accordance with uniform commercial code (UCC) requirements for each annual submission has been obtained. In deciding to make this revision the following key points were deemed relevant:
 - i. It was noted that the SVO staff has indicated that UCC first priority perfected interest criteria are typically determined when contracting a program and similar objectives can be accomplished in more ways than the UCC lien process. Requiring the UCC lien process was viewed as overly prescriptive.
 - ii. The definition in SSAP No. 105 of a confirmed supplier receivable requires a first priority perfected interest and, SVO analytical staff should be able to determine if first priority interest has been achieved
- e. Finance Agent Validation Requirements – The independent review requirements were broadened to allow independent review of the finance agent by either audit or through one of two types of internal control report. This is a lower threshold, than the existing requirements, but one that still provides some type of independent program review.
- f. Default Date - Changed the default provisions from 15 to 30 days so the default date and the cure period are consistent. This has the effect of changing the date of nonadmission for an investment in default for a period up to 30 days instead of up to 15 days. Key discussion points are:
 - i. Waiting 30 days for a short-term asset can be material in relation to the life of the asset.

- ii. Fifteen (15) days was previously chosen to be consistent with settlement guidance in *SSAP No. 21—Other Admitted Assets*, which nonadmits and reclassifies receivables for securities not settled within 15 days.
- iii. The “cure period” on confirmed supplier receivables is not to exceed 30 days, therefore, the Working Group agreed that it may make sense for the default date and the end of the cure period to be consistent.

22. At the 2020 Spring National Meeting, the Working Group reviewed the issue paper and the January 2020 comments on the exposed item. Comments received from industry advocated for inclusion of the four items that the Working Group opted to exclude from the additional revisions to the revised Statement. Key elements noted in the industry comments included the following:

- a. Absent all 10 of the industry proposed revisions, investments in working capital finance programs will remain low.
- b. Industry advocated that its proposed credit substitution mechanism to allow unrated subsidiaries was suitable for NAIC implementation to allow not only lower rated subsidiaries but also un-rated subsidiaries. The commenters maintained that the absence of mention of non-rated subsidiaries as acceptable obligors, did not preclude them from allowing unrated obligors. However, the current SSAP No. 105 program requirements explicitly require obligors to be of high credit quality,
- c. The industry comments advocated that lower rated investments should be allowed as the as statutory risk-based capital requirements reflect investment quality decisions in capital calculations.
- d. The industry comments advocated that domiciliary regulator prior approval for investment is a transfer of transaction review from staff to state insurance departments. The commenters noted that when, if regulators are concerned about the asset class, they can uniformly limit investment as a whole. Given the high costs to a small industry investor, coupled with the fact that dealers would unlikely choose to document such investments bilaterally with small industry investors, already limits access to the assets to large industry investors (see final action in paragraph 23).
- e. The industry commented that Schedule BA reporting is both cumbersome and expensive and in the view of the industry commenters, the more appropriate schedule would be Schedule DA.

23. During the 2020 Spring National Meeting, after considering the interested parties’ comments, the Working Group identified the revisions as a substantive change, re-exposed revisions to SSAP No. 105, and exposed this Issue Paper. On May 20, 2020, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed revisions to *SSAP No. 105—Working Capital Finance Investments* and *Issue Paper 163: Working Capital Finance Investment Updates* with an additional modification discussed on the call. As part of the May 20, 2020 adoption action, the Working Group and designated an effective date for the revisions of June 30, 2020

- a. The modification removed this sentence from SSAP No. 105R, paragraph 16, “Initial permission to invest in Working Capital Finance Investment Programs may be required by the domiciliary commissioner.” Accordingly, the related discussion in Issue Paper No. 163 was also updated.

- b. This modification was part of the original request from industry and was recommended by a regulator member of the Working Group who noted that it may be confusing to regulators and cause extra work which would be duplicative since these programs are also subject to SVO office review. Therefore, the Working Group adopted 7 of the 10 industry modifications.
- c. The Working Group also directed notification of the revisions to the Valuation of Securities (E) Task Force.

RELEVANT STATUTORY ACCOUNTING

- 24. Existing guidance in *SSAP No. 105—Working Capital Finance Investments*.
- 25. *SSAP No. 20—Nonadmitted Assets* was amended by SSAP No. 105 to allow working capital finance investments as admitted assets to the extent they conform to the requirements of SSAP No. 105.

4. Consistent with paragraph 2, the following assets shall be nonadmitted:

a. Deposits in Suspended Depositories—Amounts on deposit with suspended depositories may not be fully recoverable. Any amounts not reasonably expected to be recovered shall be written off in accordance with SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets (SSAP No. 5R). Amounts in excess of that written off shall be nonadmitted as they are not available to satisfy obligations to policyholders;

b. Bills Receivable Not for Premium and Loans Unsecured or Secured by Assets That Do Not Qualify As Investments—In accordance with SSAP No. 5R, amounts determined to be uncollectible or otherwise impaired shall be written off. Amounts in excess of that written off are not considered to be properly collateralized as there are no underlying assets which would otherwise be admitted assets. Such amounts shall be nonadmitted as they may be of questionable economic value if needed to fulfill policyholder obligations. Receivables arising from working capital finance programs designated by the Securities Valuation Office are subject to the guidance in SSAP No. 105;

(Rest of paragraph omitted for brevity)

- 26. *Purposes and Procedures Manual of the NAIC Investment Analysis Office* provides the following on NAIC Designations:

- a. NAIC 1 is assigned to obligations exhibiting the highest quality. Credit risk is at its lowest and the issuer's credit profile is stable. This means that interest, principal or both will be paid in accordance with the contractual agreement and that repayment of principal is well protected. An NAIC 1 obligation should be eligible for the most favorable treatment provided under the NAIC Financial Regulation Standards and Accreditation Program.
- b. NAIC 2 is assigned to obligations of high quality. Credit risk is low but may increase in the intermediate future and the issuer's credit profile is reasonably stable. This means that for the present, the obligation's protective elements suggest a high likelihood that interest, principal or both will be paid in accordance with the contractual agreement, but there are suggestions that an adverse change in circumstances or economic, financial or business conditions will affect the degree of protection and lead to a weakened capacity to pay. An NAIC 2 obligation should be eligible for relatively favorable treatment under the NAIC Financial Regulation Standards and Accreditation Program.
- c. NAIC 3 is assigned to obligations of medium quality. Credit risk is intermediate and the issuer's credit profile has elements of instability. These obligations exhibit speculative elements. This means that the likelihood that interest, principal or both will be paid in accordance with the contractual agreement is reasonable for the present, but an exposure to an adverse change in circumstances or economic, financial or business conditions would

create an uncertainty about the issuer's capacity to make timely payments. An NAIC 3 obligation should be eligible for less favorable treatment under the NAIC Financial Regulation Standards and Accreditation Program.

- d. NAIC 4 is assigned to obligations of low quality. Credit risk is high and the issuer's credit profile is volatile. These obligations are highly speculative, but currently the issuer has the capacity to meet its obligations. This means that the likelihood that interest, principal or both will be paid in accordance with the contractual agreement is low and that an adverse change in circumstances or business, financial or economic conditions would accelerate credit risk, leading to a significant impairment in the issuer's capacity to make timely payments. An NAIC 4 obligation should be accorded stringent treatment under the NAIC Financial Regulation Standards and Accreditation Program.

Effective Date

27. As issue papers are not represented in the Statutory Hierarchy (see Section IV of the Preamble), the subsequent consideration and adoption of this issue paper will not have any impact of the effective date of the substantive revisions adopted to SSAP No. 105 by the Working Group on May 20, 2020.

EXHIBIT A – Substantive Revisions to SSAP No. 105—Working Capital Finance Investments.**Statement of Statutory Accounting Principles No. 105****Working Capital Finance Investments**

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for working capital finance investments held by reporting entities. This statement amends *SSAP No. 20—Nonadmitted Assets* (SSAP No. 20) to allow working capital finance investments as admitted assets to the extent they conform to the requirements of this statement.

SUMMARY CONCLUSION

2. Working capital finance investments represent a confirmed short-term obligation¹ to pay a specified amount owed by one party (the obligor) to another (typically a supplier of goods), generated as a part of a working capital finance investment program currently designated by the NAIC Securities Valuation Office. Pursuant to the working capital finance investment program, this short-term obligation has been transferred by the entity entitled to payment (typically a supplier of goods) to a third-party investor.

3. Working capital finance investments held by a reporting entity represent a right of the reporting entity to receive future payment. This Statement provides accounting and reporting guidelines for the right to receive payment under working capital finance programs that meet particular criteria.

Working Capital Finance Program - Definitions and Conditions

4. A “working capital finance program” is an open account program under which an investor may purchase interests, or evidence thereof, in commercial non-insurance receivables. A working capital finance program is created for the benefit of a commercial investment-grade obligor and its suppliers of goods or services, and facilitated by a finance agent.

5. A working capital finance program transfers a right to payment to an investor from a short term obligation and arises from transactions among:

- a. a buyer of goods or services that becomes an obligor to the supplier of goods or services,
- b. the supplier(s) of those goods or services,
- c. a finance agent, and
- d. an investor.

6. A “working capital finance investment” is an interest in payment(s) from a confirmed supplier receivable issued pursuant to a working capital finance program. The payment (maturity) date must not exceed one year from the date of invoice from the supplier to the obligor. This investment is created when

¹ All references to short-term obligations in this statement to refer to obligations not exceeding one year.

the investor purchases from a working capital finance program that is currently designated as NAIC “1” or “2” by the NAIC Securities Valuation Office, any of the following:

- a. One or more confirmed supplier receivables;
- b. in case of a participation, a participation interest in one or more confirmed supplier receivables issued by the finance agent or lead lender holding confirmed supplier receivables; or
- c. a certificate, note or other interest manifestation, documented in a way that is verifiable ~~by regulators~~, representing a legally enforceable interest in a right to ~~payment~~ payment either directly to the investor or from a trust, other special purpose entity or pool holding confirmed supplier receivables.

7. “Obligor” is the party that purchases the goods or services that generates the original supplier receivable ~~(and which is the~~ payable for ~~that~~ the Obligor). The obligor must ~~be a single entity, which has~~ have an NAIC designation of “1” or “2” or a Credit Rating Provider equivalent. The obligor must confirm the supplier receivable described in paragraph 11 as described in the confirmation process in paragraphs 12-~~13~~4.

8. “Supplier” is the party that sells the goods or services to the obligor. The supplier sells the confirmed supplier receivable in accordance with the terms of the working capital finance program designated by the NAIC Securities Valuation Office at a price agreed to by the finance agent and/or investor.

9. “Investor” is the party purchasing a working capital finance investment in accordance with the terms of the working capital finance program designated by the NAIC Securities Valuation Office.

10. The “finance agent” is a bank, financial institution, other financial intermediary, or service provider that facilitates the working capital finance program, arranges the sale, assignment or transfer of the confirmed supplier receivable to the investor for a fee and administers the payment mechanism. In the case of participation, the finance agent must inform the reporting entity investor of a default or event of default as soon as it becomes aware of such default or event of default. For the working capital finance program to qualify under this SSAP, the finance agent must meet the requirements of either paragraph 10.a. or 10.b.:

- a. The finance agent is directly regulated by, or falls under the supervision of, a financial regulator of its domiciliary country provided that such country appears on the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* List of Jurisdictions Eligible for Netting ~~and that the Securities Valuation Office determines that the regulator is the functional equivalent of the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, or the Federal Deposit Insurance Corporation;~~ or
- b. Payments from the obligor must ~~1)~~ be paid directly to the reporting entity (investor) or into an account maintained by a regulated financial institution for the benefit of investors in the working capital finance program and, in either case, ~~cannot flow through~~ the finance agent cannot be the beneficiary of such payment ~~and 2) there can be no commingling of payments or assets with those of the obligor, supplier, servicer or trust administrator or other investors.~~

11. A “confirmed supplier receivable” is a first priority perfected security interest or right to payment of a monetary obligation from the obligor arising from the sale of goods or services from the supplier to the obligor the payment of which has been confirmed by the obligor committing and stating that the obligations under the agreement and any payment shall not be affected by the invalidity, unenforceability, existence, performance or non-performance of the underlying commercial trade transaction or any related contract or

undertaking nor that it will not protest, delay, or deny, nor offer nor assert any defenses, personal or otherwise, against payment to the supplier or any party taking claims, interests, or rights to payments made by the supplier.

- a. The confirmed supplier receivable must be sold, assigned or otherwise transferred in a manner that results in an absolute, irrevocable and legally enforceable obligation that has been confirmed by the Obligor.
- b. In the case of a participation, the certificates or other evidence of participation provide an absolute, irrevocable, and legally enforceable obligation of the finance agent or holder of the confirmed supplier receivable to pay to the reporting entity investor all of the amounts due to it under the confirmed supplier receivable, without reduction or delay arising from any claims that the finance agent may have against the reporting entity investor. ~~The reporting entity investor's ability to exercise its rights as creditor, or to direct the finance agent to exercise the rights of a creditor on its behalf, shall not be subject to the discretion of the finance agent or other lenders or investors.~~ The reporting entity investor's ability to exercise its rights as creditor, or to direct the finance agent to exercise the rights of a creditor on its behalf, shall not be subject to, other than during a cure period not to exceed thirty days, the discretion of the finance agent or other lenders or investors.

Confirmation Process

12. In the case of a purchase, the investor shall verify, prior to the sale that the obligor has confirmed the respective amounts, payment dates and related invoice numbers' specified dates and has waived all defenses to payment. In the case of a participation, the finance agent must verify that the obligor has confirmed the respective amounts, payment dates and related invoice [reference](#) numbers' specified due dates, and has waived all defenses to payment in accordance with the confirmation process.

13. The obligor must commit and state that upon confirmation of a supplier receivable it is obligated to pay to the investor, the finance agent, or any third party acting as agent or trustee for the investor, a sum equal to the full amount of that confirmed supplier receivable(s) on a date certain stated in the confirmation and that it waives any right of setoff or other defenses to avoid or delay the full and timely payment of that Confirmed Supplier Receivable. The documents establishing the working capital finance program or the confirmation must state and confirm that the obligation to pay must be independent of any other contracts or claims that might be raised in defense arising from any transaction financed in connection with the [WCFPWCFI program](#), the confirmed supplier receivable, or any other courses of performance or courses of dealing with the supplier.

~~14. — In the case of participation, the investor must certify that it has a commercially reasonable belief that its participation interest meets the Uniform Commercial Code's standards for creating and preserving first priority security interests in the payments due and in the confirmed supplier receivables. Commercially reasonable belief shall mean the SVO deems the investor's belief reasonable in light of the systems, policies, or practices commonly recognized in the field of investing in participations. The investor must be able to demonstrate to a regulator or to the SVO, upon either's request, the basis for its commercially reasonable belief that the WCFP creates and preserves the investor's ability to enforce a first priority perfected security interest in the confirmed supplier receivables.~~

~~15. — In the case of a certificate, note, or other manifestation, capable of verification, representing a right to payment from a trust, other special purpose entity, or special purpose pool holding confirmed supplier receivables, the investor must certify that it has a commercially reasonable belief that the documents establishing and governing the working capital finance program create and preserve interests in the confirmed supplier receivables capable of being enforced by the trustee or other entity holding confirmed supplier receivables as first priority perfected security interests under the Uniform Commercial Code. The~~

~~investor must be able to demonstrate the basis for such belief to a regulator or to the SVO upon either's request. Commercially reasonable belief shall mean the SVO deems the investor's belief reasonable in light of the systems, policies, and practices commonly recognized in the field of investing in securitizations, loan-backed, structured, or trust-issued securities.~~

Program Requirements

~~16.14.~~ The working capital finance program investor must provide in its annual filing with the Securities Valuation Office ~~an annual audit of the consolidated financial statements of which the finance agent is part, which does not report any qualifications related to servicing, and~~ one of the following:

- a. An annual independent report according to Statement on Standards for Attestation Engagements (SSAE) No. 16 (or functional equivalent), reporting on controls at a service organization related to the administration of the investment; or
- b. An annual audit of the financial statements and internal controls of the consolidated group of which the finance agent is part, which does not note any material weaknesses related to servicing working capital financial investments.

The NAIC Securities Valuation Office would review the materiality of the report findings in making their determination of the assignment of a designation.

~~17.15.~~ If the credit rating of the working capital finance program or obligor falls to non-investment grade (below the equivalent of NAIC designation "1" or "2"), the reporting entity shall nonadmit, the working capital finance investments obtained under the related working capital finance program and/or the related obligor. Due to the short-term nature of these investments, once an investment is nonadmitted due to the credit rating of the working capital finance program or the obligor, those investments will continue to be nonadmitted.

~~18.16.~~ Reporting entity investors must have the ability to monitor the working capital finance program and the credit-related activities of the obligor. Reporting entity investors must provide information as requested to the state of domicile indicating that they have the ability to monitor on an ongoing basis the activities of the working capital finance program. ~~Initial permission to invest in Working Capital Finance Investment Programs may be required by the domiciliary commissioner.~~

~~19.17.~~ All contracts or agreements that are a part of or that together constitute a working capital finance program must provide that if a dispute arises among any of the parties under any of the contracts or agreements that are a part of or that together constitute the working capital finance program, each party agrees that the dispute will be submitted to a court of competent jurisdiction in the United States or a constituent state thereof or of an alternative dispute resolution process recognized thereby. All contracts or agreements that are a part of or that together constitute a working capital finance program must provide that any dispute arising under any of the contracts or agreements that are a part of or that together constitute the working capital finance program must be resolved pursuant to the laws of the United States or a constituent state thereof that address the substance of the dispute but excluding those laws addressing conflicts of law.

Exclusions

~~20.18.~~ A working capital finance investment excludes any receivables financed through:

- a. Factoring: the purchase of receivables in bulk from a supplier where the receivables represent the payment obligations of potentially thousands of buyers to a single supplier, in which the buyers have no relationship with or contractual obligation to pay the factor and retain all legal defenses to payment they may have against the supplier;

- b. Forfaiting: the purchase of one or a series of receivables from exporters by a forfaiter to enable the exporter (seller) to finance a commercial transaction with a buyer in which the Obligor has no relationship with or contractual obligation to pay the forfaiter and retains all legal defenses to pay it may have against the seller; or
- c. Invoice discounting: the advancement of funds by a finance company to a business entity with the funds advanced limited to a defined percentage of the business entity's eligible and outstanding receivables.

~~21.~~19. Eligible Confirmed Supplier Receivables must not:

- a. Include insurance or insurance related assets;
- b. Be impaired or in default at the time of purchase;
- c. Have a payment (maturity) date longer than one year from the date of the invoice from the Supplier to the Obligor giving rise to the confirmed supplier receivable, and the maturity date must not be subject to change or rolling; nor
- d. Include any receivable of any parent or affiliate of the reporting entity investor, and neither the Obligor nor any Supplier may be affiliated with the reporting entity investor. Working Capital Finance Investments that have obligors or vendors that are affiliated with the investor are ineligible, and therefore, nonadmitted assets.

Accounting and Reporting

~~22.~~20. The right to receive payment generated by a working capital finance investment issued under a working capital finance program is considered to meet the definition of an asset as defined in *SSAP No. 4—Assets and Nonadmitted Assets*, and is an admitted asset to the extent the investment conforms to the requirements set forth in this Statement and the *Purposes and Procedures Manual of the NAIC Investment Analysis Office*. For programs that comply with all of these elements, working capital finance investments shall be valued and reported in accordance with this Statement, the *Purposes and Procedures Manual of the NAIC Investment Analysis Office*, and the designation assigned in the NAIC Valuations of Securities product. Programs that do not comply with the elements set forth in this Statement, or the provisions set forth in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* are nonadmitted. Working capital finance investments are reported as other invested assets in the financial statements.

~~23.~~21. A working capital finance investment shall be recorded on the trade date. At acquisition, the Working Capital Finance Investment shall be initially reported at cost, excluding brokerage and other related fees, and all other costs (internal costs, or costs paid for origination, purchase or commitment to purchase such investments), which shall be expensed as incurred.

~~24.~~22. After initial acquisition, the Working Capital Finance Investment shall be reported at amortized cost until the specified maturity date, unless the investment, or a portion thereof, is deemed uncollectible or when an other-than-temporary impairment has occurred. In the event that a working capital finance investment is purchased by a reporting entity investor at a premium (amount to be received by the entity under the confirmed supplier receivable is less than the price paid for the investment), the excess paid by the reporting entity investor in comparison to the amount receivable under the confirmed supplier receivable must be immediately expensed.

~~25.~~23. For reporting entities required to maintain an Interest Maintenance Reserve (IMR), the accounting for realized capital gains and losses from working capital finance investments 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 IMR, realized gains and losses from working capital finance investments

shall be reported as net realized capital gains or losses in the statement of income. For reporting entities not required to maintain an AVR, unrealized gains and losses shall be recorded as a direct credit or charge to unassigned funds (surplus).

~~26-24.~~ A Working Capital Finance Investment may provide for a prepayment penalty or acceleration fee in the event the working capital finance investment is liquidated prior to its scheduled termination date. Such fees shall be reported as investment income when received.

~~27-25.~~ *SSAP No. 34—Investment Income Due and Accrued* shall be followed for determining and recording investment income earned on working capital finance investments acquired at a discount. In accordance with *SSAP No. 34—Investment Income Due and Accrued*, investment income shall be reduced for amounts that have been determined to be uncollectible, however amounts more than 15 days overdue are nonadmitted.

Default

~~28-26.~~ A working capital finance investment payment that is uncollected by the reporting entity within ~~fifteen~~ thirty days after the due date shall be considered in default and nonadmitted. If the reporting entity has any other working capital finance investment assets from the same defaulting counterparty, all other working capital finance investments from that counterparty shall be nonadmitted. All working capital finance investments from a counterparty identified in default shall be evaluated for impairment.

Impairment

~~29-27.~~ An other-than-temporary impairment^(INT 06-07) shall be considered to have occurred if it is probable that the reporting entity will be unable to collect all amounts due according to the contractual terms of a confirmed supplier receivable including the payment on the established due date. Pursuant to this guidance, assessment of other-than-temporary impairment shall include an evaluation of the financial condition and short-term prospects of the obligor. If it is determined that a decline in the fair value of a working capital finance investment below book/adjusted carrying value is due to an other-than-temporary impairment, an impairment loss shall be recognized as a realized loss equal to the entire difference between the working capital finance investment's carrying value and fair value as of the reporting period for which the assessment is made. Fair value shall be determined in accordance with *SSAP No. 100R—Fair Value* (SSAP No. 100R), and reflect the price to sell the asset in an orderly market between market participants. As such, the fair value shall reflect the assumptions market participants will use in pricing the asset, including assumptions about risk.

~~30-28.~~ For reporting entities required to maintain an AVR/IMR, the entire amount of the realized loss from the other-than-temporary impairment shall be recorded through the AVR, in accordance with SSAP No. 7.

~~31-29.~~ Upon recognition of an other-than-temporary impairment, the fair value of the working capital finance investment on the measurement date shall become the new cost basis of the working capital finance investment and the new cost basis shall not be adjusted for subsequent recoveries in fair value. Once an investment is determined to be other-than-temporarily impaired, until all expected payments are received, the reporting entity must re-evaluate the investment quarterly and reassess fair value, with recognized realized losses for the difference between the book/adjusted carrying value and the current fair value. This process shall continue until either all expected payments are received, or the entity has recognized a realized loss for the entire uncollected carrying value.

Disclosures

~~32-30.~~ The financial statements shall include the following disclosures:

- a. Fair value in accordance with SSAP No. 100R.

- b. Concentrations of credit risk in accordance with SSAP No. 27—Off-Balance-Sheet and Credit Risk Disclosures (SSAP No. 27) in the annual audited statutory financial reports only.
- c. Information regarding the aggregate book/adjusted carrying value of working capital finance investment by designation including gross assets with nonadmitted and net admitted amounts annually. (Note that programs designated 3-6 are nonadmitted.)

	Gross Asset CY	Non-Admitted Asset CY	Net Admitted Asset CY
WCFI Designation 1			
WCFI Designation 2			
WCFI Designation 3			
WCFI Designation 4			
WCFI Designation 5			
WCFI Designation 6			
Total			

- d. Annual and quarterly information regarding the aggregate book/adjusted carrying value maturity distribution on the underlying working capital finance investments by the categories of maturities up to 180 days and 181 to 365 days.
- e. Any events of default of working capital finance investments during the reporting period.

~~33.31.~~ Refer to the Preamble for further discussion regarding disclosure requirements.

Effective Date and Transition

~~34.32.~~ This statement is effective for years on or after January 1, 2014. [Substantive revisions documented in Issue Paper No. 163—Working Capital Finance Investments Updates are effective for financial reporting periods on or after June 30, 2020.](#) 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*.

- *Issue Paper No. 147—Working Capital Finance Investments*
- [Issue Paper No. 163—Working Capital Finance Investments Updates](#)