

Adoptions by the Statutory Accounting Principles (E) Working Group

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**Revisions to the
As of March 2022, Accounting Practices and Procedures Manual**

On **October 24, 2022**, the Statutory Accounting Principles (E) Working Group adopted the following revisions to the *As of March 2022 Accounting Practices and Procedures Manual*. Documents associated with these revisions are linked to the reference items in bold text.

Ref #	SSAP/ Appendix	Title	Summary
INT 22-02	SSAP No. 9 SSAP No. 101	Third Quarter 2022 Reporting of the Inflation Reduction Act – Corporate Alternative Minimum Tax Effective September 30, 2022	This INT provides accounting and disclosure guidance for the third quarter 2022 financial statements related to the CAMT. Because a reporting entity is unlikely to be able to make a reasonable estimate, the INT provides exceptions to reporting for Sept. 30. It also includes disclosure information. INT 22-02 will be automatically nullified on Dec. 1, 2022.

[https://naiconline.sharepoint.com/teams/frsstatutoryaccounting/national meetings/a. national meeting materials/2022/7-summer nm/adoptions/adoptions 8.10.2022 toc.docx](https://naiconline.sharepoint.com/teams/frsstatutoryaccounting/national%20meetings/a.national%20meeting%20materials/2022/7-summer%20nm/adoptions/adoptions%208.10.2022%20toc.docx)

Interpretation of the Statutory Accounting Principles (E) Working Group

INT 22-02: Third Quarter 2022 Reporting of the Inflation Reduction Act - Corporate Alternative Minimum Tax

INT 22-02 Dates Discussed

October 6, 2022; October 24, 2022

INT 22-02 References

Current:

SSAP No. 9—Subsequent Events

SSAP No. 101—Income Taxes

INT 22-02 Issue

Key Provisions of the Inflation Reduction Act

1. The Inflation Reduction Act (Act) was enacted on August 16, 2022, and included a new corporate alternative minimum tax (CAMT). The Act and the CAMT go into effect for tax years beginning after 2022. Reporting entities shall refer to the Act and the resulting regulations and other tax guidance to determine application, but a non-authoritative high-level summary based on information at the time of initial INT discussion regarding the CAMT is as follows:

- a. The CAMT is 15% of the corporation's "adjusted financial statement income" for the tax year, reduced by corporate alternative minimum foreign tax credit.
- b. The CAMT will only apply to corporations (determined on an affiliated group basis) with average adjusted financial statement income in excess of \$1 billion for the three prior tax years. This threshold is reduced to \$100 million in the case of certain foreign-parented corporations. When a corporation becomes subject to the CAMT, it remains an applicable to the CAMT, even if its average adjusted financial statement income is less than \$1 billion, unless an exception applies.
- c. A corporation's adjusted financial statement income is the amount of net income or loss the corporation reports on its applicable financial statement. The income is adjusted for various purposes including certain adjustments in the case of consolidated returns or for foreign income.
- d. The Act includes references to the tax codes which provides a hierarchy for determining the "applicable financial statement." At a high level, the first choice is U.S. generally accepted accounting principles (GAAP) financial statements; the second choice is international financial reporting standards (IFRS) financial statements. If GAAP and IFRS financial statements are not available, the financial statements filed by the taxpayer with any other regulatory or government body is acceptable. If the taxpayer is part of an affiliated group of corporations filing a consolidated return, the adjustable financial statement income for the group considers the group's applicable financial statement.
- e. To determine its U.S. federal income tax liability, a corporation will need to compute taxes under both systems—the regular tax system and the CAMT system. The CAMT is payable to the extent the tentative CAMT exceeds the regular corporate income tax. Any CAMT

paid is available indefinitely as a credit carryover that could reduce future regular tax in future years if the regular tax liability is in excess of CAMT tax liability.

- f. The Act directs the Treasury to issue regulations and other guidance relate to implementing the CAMT, so several issues are pending detailed clarifications including clarifying the definition of an applicable corporation, and providing guidance on the starting point for, and adjustments to, adjusted financial statement income, as well as the handling of separate company tax returns when required under current tax law that are unique to the insurance industry.

Interpretation Issues

2. This interpretation is focused on addressing third quarter 2022 transition accounting and reporting aspects of the new CAMT. While most insurers will not be subject to the CAMT, for those that know that they are subject, and those that could be subject to the CAMT, there are a variety of reporting uncertainties, particularly regarding reporting for third quarter 2022.

3. The CAMT is effective for the tax years on or after 2023.

4. Both statutory accounting principles and U.S. GAAP require the effects of tax changes on deferred taxes, including the valuation allowance (future realizability of existing DTAs) in the period in which the legislation is enacted (third quarter 2022). *SSAP No. 101—Income Taxes*, paragraph 7.e. requires the statutory valuation allowance adjustment as a direct reduction in the gross DTA if, based on the weight of available evidence, it is more likely than not that some or all of the gross DTAs will not be realized. Gross DTA less the statutory valuation allowance results in adjusted gross DTAs. The statutory valuation allowance adjustment is not reported as a separate line in the statutory financial statements (it is an off-balance sheet item that reduces the gross DTAs). The statutory valuation allowance is disclosed.

5. The statutory accounting calculation for admissible DTAs is determined using adjusted gross DTAs (gross DTAs reduced by the valuation allowance). For statutory accounting, admittance of adjusted gross DTAs in *SSAP No. 101* depends on a three-component calculation, for which the second step limits admittance of adjusted gross DTAs to those that are expected to be realized in a timeframe that does not exceed three years. The actual number of years permitted depends on specifics for each reporting entity (type and other information about the reporting entity), but the maximum timeframe is three years. The last step admits DTAs which can be offset by DTLs.

6. Guidance in *SSAP No. 9—Subsequent Events* requires consideration of Type I and Type II¹ subsequent events through the date of the statutory financial statements and the date of issuance of the audited financial statements, or the date in which audited financial statements are available to be issued. For subsequent events identified after the statutory financial statements are filed (example, March 1), but before the audited financial statements are issued (example, June 1), reporting entities are generally required by their domestic state to amend their filed statutory financial statements to ensure that the statutory financial statements and the audited financial statements are consistent. Under this guidance, as additional information is made available on the impact of the Act, or information becomes available to update estimates and assessments, under existing statutory accounting guidance in *SSAP No. 9*, reporting entities would need to identify updated estimates as a Type I subsequent event in the audited financial statements.

¹ A Type I subsequent event relates to an event or transaction that provides additional evidence with respect to conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements. Under *SSAP No. 9*, entities shall recognize in the financial statements the effects of all material Type I subsequent events. A Type II subsequent event pertains to events or transactions that provide evidence to conditions that did not exist at the balance sheet date but arose after that date. Type II events are disclosed in the financial statements.

Issue 1 – Consideration of the Act for Third Quarter 2022 Financial Statements

7. During the period of enactment (third quarter 2022) reporting entities filing statutory financial statements would normally have to consider the applicability of the CAMT and if applicable, determine the impact on the statutory valuation allowance as well as assess DTAs for admissibility (e.g., realization timeframe). These elements will be collectively referred to as “calculations impacted by the Act” or “calculations impacted by the CAMT.”

8. This interpretation will address the issue for what reporting entities are required to report or disclose regarding the calculations impacted by the CAMT for September 30, 2022, financial statements.

Issue 2 – Consideration of Subsequent Events for Third Quarter 2022 Financial Statements

9. SSAP No. 9 requires consideration of subsequent events through the date of the statutory financial statements and the date of issuance of the audited financial statements, or the date in which audited financial statements are available to be issued.

10. For reporting entities that materially revise or establish calculations impacted by the CAMT subsequent to September 30, 2022 (including the statutory valuation allowance, the timing of determination of net admitted DTAs, and the determination of the applicability of the CAMT), this interpretation will address the extent a Type I or Type II subsequent event assessment is required for third quarter 2022 financial reporting.

INT 22-02 Discussion

11. The Statutory Accounting Principles (E) Working Group consensuses to the noted issues are included below.

Response: Issue 1 – Consideration of the Act for Third Quarter 2022 Financial Statements

12. Reporting entities that are aware they will be subject to the CAMT would normally reflect the effects of the Act on the calculations impacted by the CAMT if reasonably estimable for third quarter 2022. Because of the timing of the adoption of the Act and the considerable number of unknown variables for September 30, 2022, reporting, the Working Group has determined that a reasonable estimate is not determinable for third quarter 2022 interim financial statements for the calculations impacted by the CAMT.

13. Because reasonable estimates of calculations impacted by the CAMT are not determinable, reporting entities shall not recognize impacts related to CAMT for third quarter 2022 financial statements, but shall make the following disclosures regarding the CAMT and the Act:

- a. The Act was enacted during the reporting period on August 16, 2022.
- b. A statement regarding whether the reporting entity (or the controlled group of corporations of which the reporting entity is a member) has determined if it expects to be liable for CAMT in 2023. For example:
 - i. The reporting entity (or the controlled group of corporations of which the reporting entity is a member) has determined that it does not expect to be liable for CAMT in 2023.
 - ii. The reporting entity (or the controlled group of corporations of which the reporting entity is a member) has not determined as of the reporting date if it will be liable

for CAMT in 2023. The third quarter 2022 financial statements do not include an estimated impact of the CAMT because a reasonable estimate cannot be made.

- iii. The reporting entity (or the controlled group of corporations of which the reporting entity is a member) has determined that it expects to be liable for CAMT in 2023. The third quarter 2022 financial statements do not include an estimated impact of the CAMT, because a reasonable estimate cannot be made.

Response: Issue 2 – Consideration of Subsequent Events for Third Quarter 2022 Financial Statements

14. For third quarter 2022 reporting, CAMT updated estimates or other calculations affected by the Act determined subsequent to third quarter statutory financial statement or filing date shall not be recognized as Type I subsequent events. Meaning, amended financial statements are not required to reflect updated estimates subsequent to the third quarter filing date and prior to the filing the third quarter financial statements. With the disclosure required under Issue 1, additional subsequent event disclosure (such as what would be required for Type II event) is not required.

15. Reporting entities shall be working in good faith to complete the accounting for the changes adopted under the Act.

INT 22-02 Status

16. The consensuses in this interpretation were adopted to provide reporting guidance regarding the calculations impacted by the CAMT and provide limited-scope, limited-time exceptions to the valuation allowance and DTA calculations in response to legislation under SSAP No. 101 as well as Type I subsequent event requirements in SSAP No. 9 for September 30, 2022, statutory reporting. As detailed, the exceptions to SSAP No. 101 and SSAP No. 9 are effective for third quarter 2022. Due to the short-term nature of the SSAP No. 9 exception, this interpretation will be automatically nullified on December 1, 2022, and will be included as a nullified INT in Appendix H – Superseded SSAPs and Nullified Interpretations in the *As of March 2023 Accounting Practices and Procedures Manual*.

17. Further discussion is planned.

**Revisions to the
As of March 2022, Accounting Practices and Procedures Manual**

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Ref #	SSAP/ Appendix	Title	Summary
INT 22-02	SSAP No. 9 SSAP No. 101	<p>Interpretation (INT) 22-02: Third Quarter 2022 through First Quarter 2023 Reporting of the Inflation Reduction Act – Corporate Alternative Minimum Tax</p> <p style="text-align: center;"><i>Interpretation</i></p> <p>Effective Immediately (December 13, 2022)</p>	Revisions extend INT 22-02 for Dec. 31, 2022, and first quarter 2023 statutory financial statements. This INT provides an exception that does not require entities to assess valuation allowance and deferred tax asset impacts, tax estimates from the Inflation Reduction Act CAMT for third-quarter 2022 through first-quarter 2023. It also provides subsequent event exceptions and disclosures.
2021-25	SSAP No. 19 SSAP No. 73	<p>Leasehold Improvements After Lease Termination</p> <p style="text-align: center;"><i>SAP Clarification</i></p> <p>Effective Immediately (December 13, 2022)</p>	Revisions clarify that leasehold improvements shall be immediately expensed upon lease termination unless limited exceptions are met.
2022-09	SSAP No. 86	<p>ASU 2022-01 – Fair Value Hedging – Portfolio Layer Method</p> <p style="text-align: center;"><i>New SAP Concept</i></p> <p>Effective January 1, 2023 (Early adoption permitted)</p>	Revisions adopt with modification derivative guidance from <i>ASU 2017-12, Derivatives and Hedging</i> and <i>ASU 2022-01, Fair Value Hedging – Portfolio Layer</i> to incorporate the portfolio layer method and partial-term hedges for statutory accounting.
2022-10	SSAP No. 36	<p>ASU 2022-02 – Troubled Debt Restructurings and Vintage Disclosures</p> <p style="text-align: center;"><i>SAP Clarification</i></p> <p>Effective Immediately (December 13, 2022)</p>	Revisions reject <i>ASU 2022-02, Troubled Debt Restructurings and Vintage Disclosures</i> and identifies that retained guidance reflects superseded U.S. generally accepted accounting principles (GAAP).

Ref #	SSAP/ Appendix	Title	Summary
2022-13	SSAP No. 25 SSAP No. 97	<p data-bbox="586 247 902 317">Related Parties – Footnote Updates</p> <p data-bbox="639 348 849 384"><i>SAP Clarification</i></p> <p data-bbox="613 415 875 485">Effective Immediately (December 13, 2022)</p>	<p data-bbox="967 264 1469 468">Revisions identify foreign open-end investment funds as a fund in which ownership percentage is not deemed to reflect control unless the entity actually controls with the power to direct the underlying company.</p>

[https://naiconline.sharepoint.com/teams/frsstatutoryaccounting/national meetings/a. national meeting materials/2022/fall - december/adoptions/adoptions 12.13.2022 toc.docx](https://naiconline.sharepoint.com/teams/frsstatutoryaccounting/national%20meetings/a.%20national%20meeting%20materials/2022/fall%20-%20december/adoptions/adoptions%2012.13.2022%20toc.docx)

Interpretation of the Statutory Accounting Principles (E) Working Group

INT 22-02: Third Quarter 2022 through First Quarter 2023 Reporting of the Inflation Reduction Act - Corporate Alternative Minimum Tax

INT 22-02 Dates Discussed

October 6, 2022; October 24, 2022, November 16, 2022; December 13, 2022

INT 22-02 References

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SSAP No. 9—Subsequent Events

SSAP No. 101—Income Taxes

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- a. The CAMT is 15% of the corporation’s “adjusted financial statement income” for the tax year, reduced by corporate alternative minimum foreign tax credit.
- b. The CAMT will only apply to “applicable corporations” (determined on an affiliated group basis) with average adjusted financial statement income in excess of \$1 billion for the three prior tax years. This threshold is reduced to \$100 million in the case of certain foreign-parented corporations. When a corporation becomes subject to the CAMT, it remains an applicable corporation for purposes of the CAMT, even if its average adjusted financial statement income is less than \$1 billion, unless an exception applies.
- c. A corporation's adjusted financial statement income is the amount of net income or loss the corporation reports on its applicable financial statement. The income is adjusted for various purposes including certain adjustments in the case of consolidated returns or for foreign income.
- d. The Act includes references to the tax codes which provides a hierarchy for determining the “applicable financial statement.” At a high level, the first choice is U.S. generally accepted accounting principles (GAAP) financial statements; the second choice is international financial reporting standards (IFRS) financial statements. If GAAP and IFRS financial statements are not available, the financial statements filed by the taxpayer with any other regulatory or government body is acceptable. If the taxpayer is part of an affiliated group of corporations filing a consolidated return, the adjustable financial statement income for the group considers the group's applicable financial statement.
- e. To determine its U.S. federal income tax liability, an applicable corporation will need to compute taxes under both systems—the regular tax system and the CAMT system. The CAMT is payable to the extent the tentative CAMT exceeds the regular corporate income

tax. Any CAMT paid is available indefinitely as a credit carryover that could reduce future regular tax in future years if the regular tax liability is in excess of CAMT tax liability.

- f. The Act directs the Treasury to issue regulations and other guidance relate to implementing the CAMT, so several issues are pending detailed clarifications including clarifying the definition of an applicable corporation, and providing guidance on the starting point for, and adjustments to, adjusted financial statement income, as well as the handling of separate company tax returns when required under current tax law that are unique to the insurance industry.

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2. This interpretation is focused on addressing third quarter 2022 transition accounting and reporting aspects of the new CAMT. While most insurers will not be subject to the CAMT, for those that know that they are subject, and those that could be subject to the CAMT, there are a variety of reporting uncertainties, particularly regarding reporting for third quarter 2022.

3. The CAMT is effective for the tax years on or after 2023.

4. Both statutory accounting principles and U.S. GAAP require the effects of tax changes on deferred taxes, including the valuation allowance (future realizability of existing DTAs) in the period in which the legislation is enacted (third quarter 2022). *SSAP No. 101—Income Taxes*, paragraph 7.e. requires the statutory valuation allowance adjustment as a direct reduction in the gross DTA if, based on the weight of available evidence, it is more likely than not that some or all of the gross DTAs will not be realized. Gross DTA less the statutory valuation allowance results in adjusted gross DTAs. The statutory valuation allowance adjustment is not reported as a separate line in the statutory financial statements (it is an off-balance sheet item that reduces the gross DTAs). The statutory valuation allowance is disclosed.

5. The statutory accounting calculation for admissible DTAs is determined using adjusted gross DTAs (gross DTAs reduced by the valuation allowance). For statutory accounting, admittance of adjusted gross DTAs in *SSAP No. 101* depends on a three-component calculation, for which the second step limits admittance of adjusted gross DTAs to those that are expected to be realized in a timeframe that does not exceed three years. The actual number of years permitted depends on specifics for each reporting entity (type and other information about the reporting entity), but the maximum timeframe is three years. The last step admits DTAs which can be offset by DTLs.

6. Guidance in *SSAP No. 9—Subsequent Events* requires consideration of Type I and Type II¹ subsequent events through the date of the statutory financial statements and the date of issuance of the audited financial statements, or the date in which audited financial statements are available to be issued. For subsequent events identified after the statutory financial statements are filed (example, March 1), but before the audited financial statements are issued (example, June 1), reporting entities are generally required by their domestic state to amend their filed statutory financial statements to ensure that the statutory financial statements and the audited financial statements are consistent. Under this guidance, as additional information is made available on the impact of the Act, or information becomes available to update estimates and assessments, under existing statutory accounting guidance in *SSAP No. 9*, reporting entities would need to identify updated estimates as a Type I subsequent event in the audited financial statements.

¹ A Type I subsequent event relates to an event or transaction that provides additional evidence with respect to conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements. Under *SSAP No. 9*, entities shall recognize in the financial statements the effects of all material Type I subsequent events. A Type II subsequent event pertains to events or transactions that provide evidence to conditions that did not exist at the balance sheet date but arose after that date. Type II events are disclosed in the financial statements.

Issue 1 – Consideration of the Act for Third Quarter 2022 Financial Statements

7. During the period of enactment (third quarter 2022) reporting entities filing statutory financial statements would normally have to consider the applicability of the CAMT and if applicable, determine the impact on the statutory valuation allowance as well as assess DTAs for admissibility (e.g., realization timeframe). These elements will be collectively referred to as “calculations impacted by the Act” or “calculations impacted by the CAMT.”

8. This interpretation will address the issue for what reporting entities are required to report or disclose regarding the calculations impacted by the CAMT for September 30, 2022, financial statements.

Issue 2 – Consideration of Subsequent Events for Third Quarter 2022 Financial Statements

9. SSAP No. 9 requires consideration of subsequent events through the date of the statutory financial statements and the date of issuance of the audited financial statements, or the date in which audited financial statements are available to be issued.

10. For reporting entities that materially revise or establish calculations impacted by the CAMT subsequent to September 30, 2022 (including the statutory valuation allowance, the timing of determination of net admitted DTAs, and the determination of the applicability of the CAMT), this interpretation will address the extent a Type I or Type II subsequent event assessment is required for third quarter 2022 financial reporting.

INT 22-02 Discussion

11. The Statutory Accounting Principles (E) Working Group consensuses to the noted issues are included below.

Response: Issue 1 – Consideration of the Act for Third Quarter 2022 Financial Statements

12. Reporting entities that are aware they will be subject to the CAMT would normally reflect the effects of the Act on the calculations impacted by the CAMT if reasonably estimable for third quarter 2022. Because of the timing of the adoption of the Act and the considerable number of unknown variables for September 30, 2022, reporting, the Working Group has determined that a reasonable estimate is not determinable for third quarter 2022 interim financial statements for the calculations impacted by the CAMT.

13. Because reasonable estimates of calculations impacted by the CAMT are not determinable, reporting entities shall not recognize impacts related to CAMT for third quarter 2022 financial statements, but shall make the following disclosures regarding the CAMT and the Act:

- a. The Act was enacted during the reporting period on August 16, 2022.
- b. A statement regarding whether the reporting entity (or the controlled group of corporations of which the reporting entity is a member) has determined if it expects to be liable for CAMT in 2023. For example:
 - i. The reporting entity (or the controlled group of corporations of which the reporting entity is a member) has determined that it does not expect to be liable for CAMT in 2023.
 - ii. The reporting entity (or the controlled group of corporations of which the reporting entity is a member) has not determined as of the reporting date if it will be liable

for CAMT in 2023. The third quarter 2022 financial statements do not include an estimated impact of the CAMT because a reasonable estimate cannot be made.

- iii. The reporting entity (or the controlled group of corporations of which the reporting entity is a member) has determined that it expects to be liable for CAMT in 2023. The third quarter 2022 financial statements do not include an estimated impact of the CAMT, because a reasonable estimate cannot be made.

Response: Issue 2 – Consideration of Subsequent Events for Third Quarter 2022 Financial Statements

14. For third quarter 2022 reporting, CAMT updated estimates or other calculations affected by the Act determined subsequent to third quarter statutory financial statement or filing date shall not be recognized as Type I subsequent events. Meaning, amended financial statements are not required to reflect updated estimates subsequent to the third quarter filing date and prior to the filing the third quarter financial statements. With the disclosure required under Issue 1, additional subsequent event disclosure (such as what would be required for Type II event) is not required.

15. Reporting entities shall be working in good faith to complete the accounting for the changes adopted under the Act.

INT 22-02 Status

16. The consensuses in this interpretation were adopted on October 24, 2022, to provide reporting guidance regarding the calculations impacted by the CAMT and provide limited-scope, limited-time exceptions to the valuation allowance and DTA calculations in response to legislation under SSAP No. 101 as well as Type I subsequent event requirements in SSAP No. 9 for September 30, 2022, statutory reporting. As detailed, the exceptions to SSAP No. 101 and SSAP No. 9 are effective for third quarter 2022.

17. On December 13, 2022, the Working Group adopted a consensus to extend this interpretation for December 31, 2022, and first quarter 2023 statutory financial statements. For application as of year-end 2022 and first quarter 2023:

- a. Consistent with paragraphs 12 and 13, the Working Group has concluded that a reasonable estimate is not determinable for December 31, 2022, and March 31, 2023, therefore impacts related to the CAMT in the year-end 2022 and March 31, 2023, financial statements are not required.
- b. The reporting entity shall include disclosures in paragraph 13 in the year-end 2022 and March 31, 2023, financial statements. In addition, the reporting entity shall disclose the following:
 - i. If, based on information regarding the projected adjusted financial statement income for 2023, the entity or the controlled group of corporations of which the reporting entity is a member has determined if it is an “applicable corporation” to determine if CAMT exceeds the regular federal income tax payable. That is, disclose if the reporting entity (or the controlled group of corporations of which the reporting entity is a member) has determined if average “adjusted financial statement income” is above the thresholds for 2023 tax year that they expect to be required to perform the CAMT calculations. This disclosure is about being applicable corporation, not if the entity is required to pay.

- c. Consistent with paragraph 14, CAMT updated estimates or other calculations affected by the Act determined subsequent to filing the December 31, 2022, and March 31, 2023, financial statements shall not be recognized as Type I subsequent events.
 - d. For year-end 2022 financial statements, the subsequent event exception is expanded to encompass events that occur prior to the issuance of statutory financial statements as well as events that occur before the date the audited financial statements are issued, or available to be issued. This provision intends to prevent reporting entities from having to amend statutory financial statements from material Type I subsequent events as a result of updated information / estimates received after the reporting date of year-end 2022 statutory financial statements pertaining to the accounting for the enactment of the Act.
18. With the extension, this interpretation will be automatically nullified on June 15, 2023.
19. No. further discussion is planned.

[https://naiconline.sharepoint.com/teams/frsstatutoryaccounting/national meetings/a. national meeting materials/2022/fall - december/adoptions/int 22-02-dec 13 adoption.docx](https://naiconline.sharepoint.com/teams/frsstatutoryaccounting/national%20meetings/a.%20national%20meeting%20materials/2022/fall-december/adoptions/int%2022-02-dec%2013%20adoption.docx)

**Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A**

Issue: Leasehold Improvements After Lease Termination

Check (applicable entity):

	P/C	Life	Health
Modification of Existing SSAP	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
New Issue or SSAP	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Interpretation	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Description of Issue:

During 2019, the Working Group adopted substantive revisions to *SSAP No. 22—Leases*, which created SSAP No. 22R. The updated guidance rejected financing lease treatment that was adopted in U.S. GAAP but incorporated language from ASC Topic 842, which kept SSAP No. 22R as consistent as possible with the principal concepts in the U.S. GAAP standard. The Working Group has addressed several additional FASB Accounting Standard Updates (ASU) since the initial adoption of Topic 842 and NAIC staff have received numerous inquiries from SAP reporting entities since the adoption of the substantive revisions to SSAP No. 22R.

NAIC staff received a question about the treatment of leasehold improvements in situations where a leased property is purchased by the lessee during the lease term and noted that there is no explicit guidance for these situations in *SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements* nor *SSAP No. 73—Health Care Delivery Assets and Leasehold Improvements in Health Care Facilities*. In these scenarios, it was identified that the reporting entity had acquired the property that was initially subject to a lease; however regardless of the scenario, amortization of leasehold improvements is only permitted over the shorter of the estimated useful life of the improvement or the lease term (as defined in SSAP No. 22R). In a normal lease termination, one where the lessee does not acquire said property, any remaining leasehold improvements shall be immediately expensed. This agenda item has been drafted to clarify this guidance, to eliminate future questions and ensure consistent application.

Existing Authoritative Literature:

Guidance for property improvements and integral equipment is included in *SSAP No. 40R—Real Estate Investments*.

SSAP No. 40R (underlines added for emphasis):

18. Recognition of profit on sales of real estate investments shall be accounted for in accordance with FASB Statement No. 66, Accounting for Sales of Real Estate (FAS 66), except as modified in paragraph 20 of this statement, FASB Emerging Issues Task Force No. 87-9, Profit Recognition on Sales of Real Estate with Insured Mortgages or Surety Bonds, FASB Emerging Issues Task Force No. 87-29, Exchange of Real Estate Involving Boot, FASB Interpretation No. 43, Real Estate Sales an interpretation of FASB Statement No. 66 (FIN 43) and FASB Emerging Issues Task Force No. 00-13, Determining Whether Equipment is “Integral Equipment” Subject to FASB Statements No. 66 and No. 98(INT 06-13). This statement applies to all sales of real estate including real estate with property improvements or integral equipment. The terms “property improvements” and “integral equipment” refer to any physical structure or equipment attached to the real estate that cannot be removed and used separately without incurring significant costs, such as an office building. Additionally, this guidance applies to all transfers of financial assets that are in substance real estate.

31. This statement adopts FASB Interpretation No. 43, Real Estate Sales, an Interpretation of FASB Statement No. 66 (FIN 43), which clarifies that the phrase “all real estate sales” includes sales of real estate with property improvements or integral equipment that cannot be removed and used separately from the real estate without incurring significant costs. This statement adopts FASB Emerging Issues Task Force No. 84-17, Profit Recognition on Sales of Real Estate with Graduated Payment Mortgages or Insured Mortgages, FASB Emerging Issues Task Force No. 89-13, Accounting for the Cost of Asbestos Removal, FASB Emerging Issues Task Force No. 89-14, Valuation of Repossessed Real Estate, FASB Emerging

Issues Task Force No. 90-8, Capitalization of Costs to Treat Environmental Contamination, FASB Emerging Issues Task Force No. 95-23, The Treatment of Certain Site Restoration/Environmental Exit Costs When Testing a Long-Lived Asset for Impairment, FASB Emerging Issues Task Force 97-11: Accounting for Internal Costs Relating to Real Estate Property Acquisitions, FASB Emerging Issues Task Force No. 98-8: Accounting for Transfers of Investments That Are in Substance Real Estate and FASB Emerging Issues Task Force No. 00-13, Determining Whether Equipment is “Integral Equipment” Subject to FASB Statements No. 66 and No. 98, which clarifies the term “integral equipment” as used in this statement.

Leasehold improvements are discussed in SSAP No. 19 and in SSAP No. 73.

SSAP No. 19:

5. Leasehold improvements that increase the value and enhance the usefulness of the leased asset meet the definition of assets established in SSAP No. 4. Within that definition, such items also meet the criteria defining nonadmitted assets. Accordingly, such assets shall be reported as nonadmitted assets and charged against surplus. These nonadmitted assets shall be amortized against net income over the shorter of their estimated useful life or the remaining lease term as defined in SSAP No. 22R. Leasehold improvements that do not meet the definition of assets shall be charged to expense when acquired.

SSAP No. 73:

9. Furniture, medical equipment and fixtures, and leasehold improvements shall be depreciated over their estimated useful lives but for a period not to exceed three years, except for a leasehold improvement which shall be amortized against net income over the shorter of its estimated useful life or the remaining lease term, using methods detailed in SSAP No. 19.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): The Working Group adopted substantive revisions in agenda item 2016-02 to SSAP No. 22 to incorporate language from *ASU 2016-02, Leases (Topic 842)*, which retained the treatment of leases as operating leases by the lessor but incorporated some of the new language and guidance from ASU 2016-02.

Information or issues (included in *Description of Issue*) not previously contemplated by the Working Group:
None

Convergence with International Financial Reporting Standards (IFRS):

The intent of Topic 842 is to make U.S. GAAP lease treatment more closely resemble that of IFRS lease treatment in *IFRS 16—Leases*.

Staff Recommendation:

NAIC staff recommend that the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to SSAP No. 19 and SSAP No. 73 to ensure that the guidance for the leasehold improvements matched the treatment provided in SSAP No. 40R—*Real Estate Investments*. These edits will clarify that amortization of leasehold improvements will immediately end when a lease is terminated and will require that any remaining, unamortized leasehold improvement balance be immediately expensed. This will include scenarios where the lease terminates naturally or when the lessee purchases a property it was leasing. It is presumed that the purchase of a property from a third party would include the leasehold improvements as part of the full purchase price.

SSAP No. 19:

5. Leasehold improvements that increase the value and enhance the usefulness of the leased asset meet the definition of assets established in SSAP No. 4. Within that definition, such items also meet the criteria defining nonadmitted assets. Accordingly, such assets shall be reported as nonadmitted assets and charged against surplus. These nonadmitted assets shall be amortized against net income over the shorter

of their estimated useful life or the remaining lease term, as defined in SSAP No. 22R. Leasehold improvements that do not meet the definition of assets shall be charged to expense when acquired. [The amortization of leasehold improvements \(including property improvements and integral equipment\) shall cease, with any remaining amount immediately expensed, in any event in which the lease is terminated in advance of the lease term. This includes situations in which leased real estate is acquired by the reporting entity lessor. If leased real estate is acquired, recognition of the real estate shall follow the provisions in SSAP No. 40R—Real Estate Investments.](#)

SSAP No. 73:

9. Furniture, medical equipment and fixtures, and leasehold improvements shall be depreciated over their estimated useful lives but for a period not to exceed three years, except for a leasehold improvement which shall be amortized against net income over the shorter of its estimated useful life or the remaining lease term, using methods detailed in SSAP No. 19. [The amortization of leasehold improvements \(including property improvements and integral equipment\) shall cease, with any remaining amount immediately expensed, in any event in which the lease is terminated in advance of the lease term. This includes situations in which leased real estate is acquired by the reporting entity lessor. If leased real estate is acquired, recognition of the real estate shall follow the provisions in SSAP No. 40R—Real Estate Investments.](#)

Staff Review Completed by Jake Stultz, September 2021

Status:

On December 11, 2021, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to SSAP No. 19 and SSAP No. 73 to ensure that the guidance for the leasehold improvements matches the treatment provided in SSAP No. 40. These edits clarify that amortization of leasehold improvements will immediately end when a lease is terminated and will require that any remaining, unamortized leasehold improvement balance be immediately expensed. This will include scenarios where the lease terminates naturally or when the lessee purchases a property it was leasing.

On April 4, 2022, the Statutory Accounting Principles (E) Working Group reviewed comments on prior exposed revisions which intended to clarify that in any scenario in which a lease terminates early, all remaining leasehold improvements shall be immediately expensed. The Working Group directed NAIC staff to continue to work with interested parties to refine the guidance for subsequent consideration.

On August 10, 2022, the Statutory Accounting Principles (E) Working Group exposed this agenda item, incorporating proposed revisions after considering comments from interested parties shown highlighted in gray below. The changes provide an explicit exception to companies that provide direct healthcare. It is limited to situations where the real estate lease agreement has a purchase option that contains language that allows leasehold improvements necessary for the functionality of specific health care delivery assets to be excluded from the purchase cost of the real estate.

SSAP No. 19:

5. Leasehold improvements that increase the value and enhance the usefulness of the leased asset meet the definition of assets established in SSAP No. 4. Within that definition, such items also meet the criteria defining nonadmitted assets. Accordingly, such assets shall be reported as nonadmitted assets and charged against surplus. These nonadmitted assets shall be amortized against net income over the shorter of their estimated useful life or the remaining lease term, as defined in SSAP No. 22R. Leasehold improvements that do not meet the definition of assets shall be charged to expense when acquired. [The amortization of leasehold improvements \(including property improvements and integral equipment\) shall cease, with any remaining amount immediately expensed, in any event in which the lease is terminated in advance of the lease term. This includes situations in which leased real estate is acquired by the reporting entity lessee. Such improvements related to the functionality of health care delivery assets shall follow the accounting, reporting and impairment guidance in SSAP No. 73—Health Care Delivery Assets and Leasehold Improvements in Health Care Facilities, and an exception to the application of this guidance to](#)

[leasehold improvements necessary for the functionality of health care delivery assets is included in SSAP No. 73. If leased real estate is acquired, recognition of the real estate shall follow the provisions in SSAP No. 40R—Real Estate Investments.](#)

SSAP No. 73:

9. Furniture, medical equipment and fixtures, and leasehold improvements shall be depreciated over their estimated useful lives but for a period not to exceed three years, except for a leasehold improvement which shall be amortized against net income over the shorter of its estimated useful life or the remaining lease term, using methods detailed in SSAP No. 19. [The amortization of leasehold improvements \(including property improvements and integral equipment\) shall cease, with any remaining amount immediately expensed, in any event in which the lease is terminated in advance of the lease term. This includes situations in which leased real estate is acquired by the reporting entity lessee but excludes situations where the real estate lease agreement has a purchase option that contains language that allows leasehold improvements necessary for the functionality of specific health care delivery assets¹ to be excluded from the purchase cost of the real estate. Upon acquisition, such leasehold improvements necessary for the functionality of healthcare delivery assets shall follow the guidance for health care delivery assets in this statement. If leased real estate is acquired, recognition of the real estate shall follow the provisions in SSAP No. 40R—Real Estate Investments.](#)

On December 13, 2022, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed revisions, as illustrated above, to *SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements* and *SSAP No. 73—Health Care Delivery Assets and Leasehold Improvements in Health Care Facilities*, which clarify that amortization of leasehold improvements shall immediately end when a lease is terminated and requires that any remaining, unamortized leasehold improvement balance be immediately expensed, with a limited, specific exclusion in SSAP No. 73 that allows leasehold improvements necessary for the functionality of specific health care delivery assets to be excluded in some cases from the purchase cost of the real estate. In addition to the exposed language, illustrated above, the Working Group adopted a minor revision to SSAP No. 19, paragraph 9, as illustrated below, to make this paragraph consistent with changes that were made on prior lease agenda items.

SSAP No. 19:

9. The acquisition cost of depreciable assets, net of salvage, shall be depreciated against net income over the estimated useful lives of the assets in a systematic and rational manner. The acquisition cost of a leasehold improvement shall be amortized against net income over the shorter of its estimated useful life or the ~~original~~ lease term ~~as defined in SSAP No. 22R excluding options or renewal periods~~. For leasehold improvements capitalized subsequent to inception of the lease, the cost shall be amortized over the shorter of its estimated useful life or the remaining ~~original~~ lease term ~~excluding options or renewal periods~~. Amounts capitalized for leasehold improvements in periods subsequent to the original lease term (i.e., during renewal periods), are amortized utilizing the shorter of the estimated useful life of the asset or the remaining ~~lease~~ term ~~of the renewal period~~.

<https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/NationalMeetings/A.NationalMeetingMaterials/2022/Fall-December/Adoptions/21-25-LeaseImprovementsTermination.docx>

¹ [The application of this exception is limited to leasehold improvements necessary for the functionality of health care delivery assets that qualified for admittance under SSAP No. 73.](#)

**Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A**

Issue: ASU 2022-01 – Fair Value Hedging – Portfolio Layer Method

Check (applicable entity):

	P/C	Life	Health
Modification of Existing SSAP	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
New Issue or SSAP	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Interpretation	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Description of Issue: In August 2017, the FASB issued *ASU 2017-12, Derivatives and Hedging: Targeted Improvements to Accounting for Hedging Activities*. Under that ASU, the FASB added guidance to incorporate a “last-of-layer” method to make portfolio fair value hedge accounting more accessible for specific assets. Under the last-of-layer approach, for a closed portfolio of prepayable financial assets or one or more beneficial interests secured by a portfolio of prepayable financial instruments, entities were allowed to hedge a stated amount of the asset or assets in the closed portfolio that is anticipated to be outstanding for the designated hedged period. If the requirements for the last-of-layer method were met, prepayment risk is not incorporated into the measurement of the hedged item.

With the issuance of the last-of-layer guidance in ASU 2017-12, a number of questions were received. After considering those questions, *ASU 2022-01, Fair Value Hedging – Portfolio Layer Method* was issued to address. This ASU expanded the original guidance and provided additional specifications and guidance as follows:

- Expands the last-of-layer method that permitted only one hedged layer to allow multiple hedged layers of a single closed portfolio. This resulted in a name change from last-of-layer to “portfolio layer method.”
- Expands the scope to include nonprepayable financial assets.
- Specifies that eligible hedging instruments in a single-layer hedge may include spot-starting or forward-starting constant notional swaps, or spot or forward-starting amortizing-notional swaps and that the number of hedged layers (that is single or multiple) corresponds with the number of hedges designated.
- Provides additional guidance on the accounting for and disclosure of hedge basis adjustments that are applicable to the portfolio layer method whether a single hedged layer or multiple hedged layers are designated.
- Specifies how hedge basis adjustments should be considered when determining credit losses (impairment) for the assets included in the closed portfolio.

The U.S. GAAP concepts for last-of-layer / portfolio layer method hedging within ASU 2017-12 and ASU 2022-01 are new concepts for statutory accounting. Although there is a general assessment that determination of effective hedges shall be consistent between SAP and U.S. GAAP, incorporating guidance to facilitate the portfolio layer method hedge approach for statutory accounting is expected to necessitate new concept revisions to *SSAP No. 86—Derivatives*.

Initial staff assessments on the U.S. GAAP guidance considered potential issues with how hedge basis adjustments are reflected, as U.S. GAAP prevents basis adjustments directly to assets hedged in a portfolio. However, after discussing with industry, and analyzing how the differences in measurement / recognition between U.S. GAAP and SAP impact this assessment, the basis adjustment impact for portfolio layer method hedges will only occur at the time of dedesignation. This is because SAP generally uses an amortized cost approach for effective hedges (if the

hedged item is valued at amortized cost), and the derivative mirrors that measurement method. Under U.S. GAAP, where they both use a fair value method, basis adjustments occur frequently to reflect the change in fair value. With the SAP measurement approach, fair value hedge basis adjustments only occur at hedge termination or at dedesignation. As such, this is not a key SAP impact.

As detailed in the recommended action, industry has proposed to also capture the partial term hedging concepts from U.S. GAAP as part of the revisions proposed from this agenda item. One of the key concerns for partial term hedges was the potential for interim adjustments to hedged items (as the derivative term would no longer commonly match the hedged item term). Industry has proposed to limit the application of the partial term guidance only to the hedge of recognized assets (and not liabilities). This is a different application scope for partial term hedges from U.S. GAAP but mirrors the U.S. GAAP guidance for the portfolio layer method and will limit the potential for hedge basis adjustments to result with a financial statement presentation that a liability has been reduced when the actual liability has not been reduced. Although the existing guidance within SSAP No. 86 can result with this impact, it is limited as most derivatives mirror the term of the hedged item. Although NAIC staff still recommends a review of the existing guidance in SSAP No. 86 on how basis adjustments are reflected, by limiting the partial term approach to hedges of recognized assets, it permits the partial term hedge guidance to be incorporated before the broader discussion. From discussions with industry, the current application of the partial term hedge approach is limited to recognized assets, so this modification satisfies the current need and prevents significant concerns on how the guidance could impact the presentation of liabilities. Discussion of the partial term hedge approach was detailed in agenda item 2021-20, but key aspects are summarized below:

Partial Term Hedging:

This provision allows reporting entities to enter into fair value hedges of interest rate risk for only a portion of the term of the hedged financial instrument. Prior to the ASU, these sorts of arrangements were not successful in being identified as highly effective due to offsetting changes in the fair value as a result of the difference in timing between the hedged item's principal repayment and the maturity date of the hedging derivative. Under ASU 2017-12, an entity may measure the change in the fair value of the hedged item attributable to changes in the benchmark interest rate by "using an assumed term that begins when the first hedged cash flow begins to accrue and ends when the last hedged cash flow is due and payable." Also, the hedged item's assumed maturity will be the date on which the last hedged cash flow is due and payable, therefore a principal payment will be assumed to occur at the end of the specified partial term.

The example provided under U.S. GAAP involves outstanding fixed rate debt. So, if an entity was to issue \$100 million of five-year, noncallable, fixed-rate debt, the entity could designate a two-year, receive-fixed, pay variable, \$100 million notional interest rate swap as a fair value hedge of the interest rate risk for the first two years of the debt's term. When calculating the change in the fair value of the debt attributable to changes in interest rate risk, the entity may assume that 1) the term of the hedged debt is two years, and 2) repayment of the outstanding debt occurs at the end of the second year. The ASU also permits use of the shortcut method to these partial-term fair value hedges of interest rate risk.

Key elements pertaining to portfolio layer method hedging under U.S. GAAP:

- For a closed portfolio of financial assets or one or more beneficial interests secured by a portfolio of financial instruments, an entity may designate as the hedged item or items a hedged layer or layers if the following criteria are met: *(Note – The FASB was asked to consider expanding the scope to include liabilities (specifically, insurance liabilities), and the FASB elected not to expand the portfolio layer method to include hedges of liabilities.)*
 - As part of the initial hedge documentation, an analysis is completed and documented to support the entity's expectation that the hedged item or items (that is, the hedged layer or layers in aggregate) is anticipated to be outstanding for the designated hedge period. That analysis shall incorporate the entity's current expectations of prepayments, defaults, and other factors affecting the timing and amount of cash flows associated with the closed portfolio.

- For purposes of its analysis, the entity assumes that as prepayments, defaults, and other factors affecting the timing and amount of cash flows occur, they first will be applied to the portion of the closed portfolio that is not hedged.
- The entity applies the partial-term hedging guidance to the assets or beneficial interests used to support the entity's expectation. An asset that matures on a hedged layer's assumed maturity date meets this requirement.
- After a closed portfolio is established, an entity may designate new hedging relationships associated with the closed portfolio without dedesignating any existing hedging relationships associated with the closed portfolio if the criteria are met for those newly designated hedging relationships.
- For one or more existing hedged layer or layers that are designated under the portfolio layer method, the gain or loss (that is, the change in fair value) on the hedged item attributable to the hedged risk shall not adjust the carrying value of the individual beneficial interest or individual assets in or removed from the closed portfolio. Instead, that amount shall be maintained on a closed portfolio basis and recognized currently in earnings.
- If the hedged item is a hedged layer designated in a portfolio layer method hedge on a closed portfolio and the closed portfolio includes only available-for-sale debt securities, the entire gain or loss (that is, the change in fair value) on the hedged item attributable to the hedged risk shall be recognized in earnings rather than in other comprehensive income to offset the gain or loss on the hedging instrument. If the closed portfolio includes available-for-sale debt securities and assets that are not available-for-sale debt securities, an entity shall determine the portion of the change in fair value on the hedged item attributable to the hedged risk associated with the available-for-sale debt securities using a systematic and rational method. That amount shall be recognized in earnings rather than in other comprehensive income. An entity shall not adjust the carrying amount of the individual available-for-sale debt securities included in the closed portfolio.
- For each closed portfolio with one or more hedging relationships designated and accounted for under the portfolio layer method, an entity shall perform and document at each effectiveness assessment date an analysis that supports the entity's expectation that the hedged layer or layers in aggregate is still anticipated to be outstanding for the designated hedge period. That analysis shall incorporate the entity's current expectations of prepayments, defaults, and other factors affecting the timing and amount of cash flows associated with the closed portfolio using a method consistent with the method used to perform the analysis at initial hedge documentation.
- An adjustment that is maintained on a closed portfolio basis in a portfolio layer method hedge in accordance shall be amortized to earnings. Amortization shall begin no later than when the hedged item ceases to be adjusted for changes in its fair value attributable to the risk being hedged. The entity shall fully amortize that adjustment by the hedged item's assumed maturity date.
- An asset or liability that has been designated as being hedged remains subject to the applicable requirements for assessing impairment or credit losses for that type of asset or for recognizing an increased obligation for that type of liability. A portfolio layer method basis adjustment that is maintained on a closed portfolio basis for an existing hedge shall not be considered when assessing the individual assets or individual beneficial interest included in the closed portfolio for impairment or credit losses or when assessing a portfolio of assets for impairment or credit losses. An entity may not apply this guidance by analogy to other components of amortized cost basis. Because the hedging instrument is recognized separately as an asset or liability, its fair value or expected cash flows shall not be considered in applying those impairment or credit loss requirements to the hedged asset or liability.
- For a fair value hedge of interest rate risk in which the hedged item is designated for a partial term, an entity may measure the change in the fair value of the hedged item attributable to interest rate risk using an

assumed term that begins when the first hedged cash flow begins to accrue and ends at the end of the designated hedge period. The assumed issuance of the hedged item occurs on the date that the first hedged cash flow begins to accrue. The assumed maturity of the hedged item occurs at the end of the designated hedge period. Additionally, an entity may have one or more separately designated partial-term hedging relationships outstanding at the same time for the same debt instrument (for example, 2 outstanding hedging relationships for consecutive interest cash flows in Years 1–3 and consecutive interest cash flows in Years 5–7 of a 10-year debt instrument).

- An entity may elect to discontinue (or partially discontinue) hedge accounting prospectively for all or a portion of the hedged layer for one or more hedging relationships associated with the closed portfolio at any time if a breach has not occurred and a breach is not anticipated. If multiple hedged layers are associated with the closed portfolio, the entity may voluntarily elect to dedesignate (or partially dedesignate) any hedges associated with that closed portfolio.
- For one or more hedging relationships designated under the portfolio layer method, an entity shall discontinue (or partially discontinue) hedge accounting in the following circumstances:
 - If the entity cannot support on a subsequent testing date that the hedged layer or layers are anticipated to be outstanding for the designated hedge period (that is, a breach is anticipated), it shall discontinue (or partially discontinue) hedge accounting for one or more hedging relationships for the portion of the hedged item that is no longer anticipated to be outstanding for the designated hedge period.
 - If on a subsequent testing date the outstanding amount of the closed portfolio of financial assets or one or more beneficial interests is less than the hedged layer or layers (that is, a breach has occurred), the entity shall discontinue (or partially discontinue) hedge accounting for one or more hedging relationships for the portion of the hedged item that is no longer outstanding.
- In the event of either an anticipated breach or a breach that has occurred, if multiple hedged layers are associated with a closed portfolio, an entity shall determine which hedge or hedges to discontinue (or partially discontinue) in accordance with an accounting policy election. That accounting policy election shall specify a systematic and rational approach to determining which hedge or hedges to discontinue (or partially discontinue). An entity shall establish its accounting policy no later than when it first anticipates a breach or when a breach has occurred (whichever comes first). After an entity establishes its accounting policy, it shall consistently apply its accounting policy to all portfolio layer method breaches (anticipated and occurred).
- If a portfolio layer method hedging relationship is discontinued (or partially discontinued) in a voluntary dedesignation or in anticipation of a breach, the basis adjustment associated with the dedesignated amount as of the discontinuation date shall be allocated to the remaining individual assets in the closed portfolio that supported the dedesignated hedged layer using a systematic and rational method. An entity shall amortize those amounts over a period that is consistent with the amortization of other discounts or premiums associated with the respective assets.
- For a portfolio layer method hedging relationship that is discontinued because a breach has occurred, as of the discontinuation date an entity shall:
 - Determine the portion of the basis adjustment associated with the amount of the hedged layer that exceeds the closed portfolio (that is, the portion of the basis adjustment associated with the breach) using a systematic and rational method and immediately recognize that amount in interest income
 - Disclose the information specified for the breach.

- A closed portfolio may simultaneously have a layer or layers that have been breached and a layer or layers that it anticipates will be breached. In that case, an entity shall apply the guidance in this paragraph for the breach or breaches that have occurred and the guidance for the anticipated breach or breaches.
- New disclosures that include:
 - Amortized cost basis of closed portfolios of financial assets or beneficial interests
 - Amount that represents the hedged layers
 - Basis adjustments associated with the hedged layers
 - Hedge basis adjustment recognized in current-period interest income because of a breach.
 - Circumstances that led to a breach.

Existing Authoritative Literature:

SSAP No. 86—Derivatives

Establishes statutory accounting guidance for derivative instruments and hedging, income generation and replication (synthetic asset) transactions.

Guidance for portfolio hedges is limited to fair value hedges as follows:

26. Fair value hedges qualify for hedge accounting if all of the following criteria are met:
- d. The hedged item is specifically identified as either all or a specific portion of a recognized asset or liability or of an unrecognized firm commitment. The hedged item is a single asset or liability (or a specific portion thereof) or is a portfolio of similar assets or a portfolio of similar liabilities (or a specific portion thereof);
 - e. If similar assets or similar liabilities are aggregated and hedged as a portfolio, the individual assets or individual liabilities must share the risk exposure for which they are designated as being hedged. The change in fair value attributable to the hedged risk for each individual item in a hedged portfolio must be expected to respond in a generally proportionate manner to the overall change in fair value of the aggregate portfolio attributable to the hedged risk; and

Under existing guidance, hedges identified as ‘portfolio’ hedges that did not qualify within the limited parameters in paragraph 26 did not qualify as hedging and were not permitted “hedge accounting” treatment in the statutory financial statements. Without hedge accounting, the hedging instruments are required to be reported at fair value, with fluctuations in fair value gains and losses recognized through surplus.

22. Derivative instruments used in hedging transactions that meet the criteria of a highly effective hedge shall be considered an effective hedge and are permitted to be valued and reported in a manner that is consistent with the hedged asset or liability (referred to as hedge accounting). For instance, assume an entity has a financial instrument on which it is currently receiving income at a variable rate but wishes to receive income at a fixed rate and thus enters into a swap agreement to exchange the cash flows. If the transaction qualifies as an effective hedge and a financial instrument on a statutory basis is valued and reported at amortized cost, then the swap would also be valued and reported at amortized cost. Derivative instruments used in hedging transactions that do not meet or no longer meet the criteria of an effective hedge, or that meet the required criteria but the entity has chosen not to apply hedge accounting, shall be accounted for at fair value and the changes in the fair value shall be recorded as unrealized gains or unrealized losses (referred to as fair value accounting).

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups):

- Agenda item 2018-30: SSAP No. 86 – Hedge Effectiveness Documentation considered the revised hedge effectiveness documentation provisions incorporated within ASU 2017-12, Derivatives and hedging. The

revisions from this agenda item were adopted Nov. 15, 2018, and were effective Jan. 1, 2019, with early adoption permitted. U.S. GAAP filers could only early adopt if they also early-adopted ASU 2017-12.

- Agenda item 2021-20: Effective Derivatives – ASU 2017-12 is considering other aspects pending from ASU 2017-12, primarily hedge effectiveness assessments, inclusion of guidance for excluded components and the measurement of excluded components.

Information or issues (included in *Description of Issue*) not previously contemplated by the Working Group:
None

Convergence with International Financial Reporting Standards (IFRS): NA

Recommendation:

NAIC staff has been working with industry representatives on ASU 2022-01 for portfolio hedges, as well as on the U.S. guidance for partial term derivatives issued in ASU 2017-12. With these efforts, industry has provided NAIC staff suggested edits to incorporate key aspects of the U.S. GAAP guidance for portfolio hedges and partial-term hedges into SSAP No. 86. NAIC staff recommends that the Working Group classify this agenda item as a New SAP Concept and expose the proposed edits for comment. It is also recommended that the Working Group direct NAIC staff to prepare one issue paper with all recent derivative revisions.

Summary of Revisions Proposed in this Agenda Item – Portfolio Layer Method and Partial Term:

- SSAP No. 86: Revisions are proposed to paragraph 26 (fair value hedges) to detail criteria for portfolio and partial-term hedges. A small disclosure edit is proposed to paragraph 62 and guidance for reporting when the hedge is discontinued is proposed for inclusion in Exhibit C.

Revisions have also been proposed to identify the adoption of *ASU 2022-01, Fair Value Hedging – Portfolio Layer Method* and to adopt with modification the guidance for partial-term hedges from ASU 2017-12. For the current proposal, the partial term hedge guidance is limited to hedged assets (not liabilities.) This is different from U.S. GAAP, but further statutory discussion is needed on basis adjustments when hedging liabilities, especially under partial term. It has been suggested that the Working Group move forward with incorporating the guidance for hedged assets at this time, as that addresses the current industry need, and consider guidance for hedged liabilities subsequently. (It was noted that industry is not aware of situations of partial-term liability hedges. Furthermore, the adjustment for hedged liabilities is a broader issue in SSAP No. 86, so the revisions would be more expansive.) Portfolio hedges are limited to recognized assets under U.S. GAAP, so proposed guidance for SAP for those hedges is consistent. (Industry has identified that the FASB may consider expanding the scope of portfolio hedges to liabilities. If this occurs, consideration will then occur for statutory accounting.)

- Exhibit A – Assessment of Hedge Effectiveness: Limited revisions to paragraphs 17-18 to mirror updated U.S. GAAP guidance and a new section (beginning with paragraph 46) for specific hedge assessment guidance on the portfolio layer method.

Staff Review Completed by: Julie Gann - NAIC Staff, April 2022

Proposed Edits to SSAP No. 86:

Fair Value Hedges (Note- subparagraphs 26a-c are not affected and are omitted for brevity)

26. Fair value hedges qualify for hedge accounting if all of the following criteria are met:
- d. The hedged item is specifically identified as either all, ~~or~~ a specific portion, or the partial term of a recognized asset, or all or a specific portion of ~~or~~ a recognized liability or of an unrecognized firm commitment. The hedged item is a single asset or liability (or a specific portion or partial term

- thereof) or is a portfolio of similar assets or a portfolio of similar liabilities (or a specific portion thereof) or a closed portfolio of assets (pursuant to paragraph 26f and Exhibit A, paragraph 46) where assumed layer or layers is anticipated to be outstanding (or a specific portion thereof)¹. For a partial term hedge of one or more consecutive selected contractual cash flows where the hedged item begins when the first hedge cash flow begins to accrue and ends at the end of the designation hedge period, the assumed maturity of the hedged item occurs at the end of the designated hedge period; (ASC 815-25-35-13B Partial Term Hedging.)
- e. If similar assets or similar liabilities are aggregated and hedged as a portfolio, the individual assets or individual liabilities must share the risk exposure for which they are designated as being hedged. The change in fair value attributable to the hedged risk for each individual item in a hedged portfolio must be expected to respond in a generally proportionate manner to the overall change in fair value of the aggregate portfolio attributable to the hedged risk; and
- f. For a closed portfolio of financial assets or one or more beneficial interests secured by a portfolio of financial instruments, an entity may designate as the hedged item or items a hedged layer or layers (this designation is referred to throughout as the “portfolio layer method” (detailed in Exhibit A). (ASC 815-20-25-12A Portfolio Layer Method)
- f.g. If the hedged item is a financial asset or liability, a recognized loan servicing right, or a nonfinancial firm commitment with financial components, the designated risk being hedged is:
- i. The risk of changes in the overall fair value of the entire hedged item;
 - ii. The risk of changes in its fair value attributable to changes in benchmark interest rate;
 - iii. The risk of changes in its fair value attributable to changes in the related foreign currency exchange rates; or
 - iv. The risk of changes in its fair value attributable to both changes in the obligor’s creditworthiness and changes in the spread over the benchmark interest rate with respect to the related financial asset’s or liability’s credit sector at inception of the hedge (referred to as credit risk).

If the risk designated as being hedged is not the risk in paragraph 26.f.i., two or more of the other risks (benchmark interest rate risk, foreign currency exchange risk, and credit risk) may simultaneously be designated as being hedged.

The benchmark interest rate being hedged in a hedge of interest rate risk must be specifically identified as part of the designation and documentation at the inception of the hedging relationship. In calculating the change in the hedged item's fair value attributable to changes in the benchmark interest rate, the estimated coupon cash flows used in calculating fair value shall ~~must~~ be based on either all of the full contractual cash flows of the hedged item or the benchmark rate component of the contractual coupon cash flows of the hedged item determined at hedge inception. An entity may designate a fair value hedge of interest rate risk in which the hedged item is a prepayment instrument. The entity may consider only how changes in the benchmark interest rate affect the decision to settle the hedged item before its scheduled maturity (for example, an entity may consider only how change in the benchmark interest rate affect an obligor’s decision to call a debt instrument when it has the right to do so.) The entity need not consider other factors that would

¹ For clarity, partial-term hedges and portfolio hedges addressed in paragraph 26.f. are limited to the situations in which the hedged item(s) is a recognized asset or a closed portfolio of financial assets. These hedging accounting methods are not permitted to hedge liabilities.

affect this decision (for example, credit risk) when assessing hedge effectiveness. (ASU 815-25-35-13 & 815-20-25-6B) ~~Excluding some of the hedged item's contractual cash flows (for example, the portion of the interest coupon in excess of the benchmark interest rate) from the calculation is not permitted.~~²—An entity may not simply designate prepayment risk as the risk being hedged for a financial asset. However, it can designate the option component of a prepayable instrument as the hedged item in a fair value hedge of the entity's exposure to changes in the fair value of that "prepayment" option, perhaps thereby achieving the objective of its desire to hedge prepayment risk. The effect of an embedded derivative of the same risk class must be considered in designating a hedge of an individual risk. For example, the effect of an embedded prepayment option must be considered in designating a hedge of benchmark interest rate risk.

Disclosure Requirements

62. Reporting entities shall disclose the following for all derivative contracts used:
- a. General disclosures:
 - vii. The net gain or loss recognized in unrealized gains or losses during the period ending period resulting from derivatives that no longer qualify for hedge accounting. For portfolio layer method hedges, disclose circumstances that led to the breach. (ASC 815-10-50-5C.)

Staff Note: The shaded section reflects revised guidance adopted with agenda item 2021-20.

Relevant Literature

64. This statement adopts the framework established by FAS 133, *FASB Statement No. 137, Accounting for Derivative Instruments and Hedging Activities—Deferral of the Effective Date of FASB Statement No. 133, An amendment of FASB Statement No. 133* (FAS 137) and *FASB Statement No. 138, Accounting for Certain Derivative Instruments and Certain Hedging Activities, An amendment of FASB Statement No. 133* (FAS 138), for fair value and cash flow hedges, including its technical guidance to the extent such guidance is consistent with the statutory accounting approach to derivatives utilized in this statement. This statement adopts the provisions of FAS 133 and 138 related to foreign currency hedges. With the exception of guidance specific to foreign currency hedges and amendments specific to refining the hedging of interest rate risk (under FAS 138, the risk of changes in the benchmark interest rate would be a hedged risk), this statement rejects FAS No. 137 and 138 as well as the various related Emerging Issues Task Force interpretations. This statement adopts paragraphs 4 and 25 of *FASB Statement No. 149: Amendment of Statement 133 on Derivative Instruments and Hedging Activities* (FAS 149) regarding the definition of an underlying and guidance for assessing hedge effectiveness. (The adoption from FAS 149 on the assessment of hedge effectiveness is impacted by the adoption with modification of guidance from ASU 2017-12 as detailed in paragraph 65b, with the guidance from ASU 2017-12 superseding the prior adoption to the extent applicable.) All other paragraphs in FAS 149 are rejected as not applicable for statutory accounting. This statement adopts FSP FAS 133-1 and FIN 45-5: *Disclosures about Credit Derivatives and Certain Guarantees, An Amendment of FASB Statement No. 133 and FASB Interpretation No. 45 and Clarification of the Effective Date of FASB Statement No. 161* (FSP FAS 133-1 and FIN 45-4) and requires disclosures by sellers of credit derivatives. This statement rejects *FSP FIN 39-1, Amendments of FASB Interpretation No. 39, and ASU 2014-03, Derivatives and Hedging – Accounting for Certain Receive-Variable, Pay-Fixed Interest Rate Swaps – Simplified Hedge Accounting Approach*.

² ~~The first sentence of paragraph 26.d. that specifically permits the hedged item to be identified as either all or a specific portion of a recognized asset or liability or of an unrecognized firm commitment is not affected by the provisions in this subparagraph.~~

65. This statement adopts, with modification, certain revisions to ASC 815-20 included in ASU 2017-12. Remaining provisions of ASU 2017-12 will be subsequently assessed for statutory accounting and shall not be considered adopted for statutory accounting until that assessment is complete.
- a. Revisions effective January 1, 2019 with early adoption permitted, are limited to specific provisions, and related transition guidance, pertaining to the documentation and assessment of hedge effectiveness and only includes: 1) provisions allowing more time to perform the initial quantitative hedge effectiveness assessment; 2) provisions allowing subsequent assessments of hedge effectiveness to be performed qualitatively if certain conditions are met; and 3) revisions regarding use of the critical terms and short-cut methods for assessing hedge effectiveness.
 - b. Revisions effective January 1, 2023, with early adoption permitted, are limited to the criteria for initial and subsequent hedge effectiveness detailed in the FASB Accounting Standards Codification (ASC) paragraphs 815-20-25-72 through 815-20-35-20, as modified through the issuance of ASU 2017-12. This adoption reflects statutory modifications to specify that the accounting and reporting of hedging instruments, including excluded components of the instruments, shall follow statutory specific guidance detailed in the statement. The intent of this guidance is to clarify that the determination of whether a hedging instrument qualifies as an effective hedge shall converge with U.S. GAAP, but that the measurement method shall continue to follow statutory specific provisions. The adoption of the referenced ASC paragraphs only extends to revisions incorporated through ASU 2017-12; therefore, any subsequent U.S. GAAP edits would require statutory accounting consideration before considered adopted.
 - c. Revisions effective January 1, 2023, with early adoption permitted, are limited to the criteria for the portfolio layer method detailed in ASU 2022-01, criteria to only consider how changes in the benchmark interest rate affect the decision to settle the hedged item before its scheduled maturity date in 815-20-25-6B, adding option in calculating the change in the hedged item's fair value attributed to changes in the benchmark interest rate based on the benchmark rate components of the contractual cash flows detailed in FASB ASC 815-25-35-13, and the partial-term hedging method detailed in FASB ASC 815-25-35-13B. The adoption of the partial term hedging method reflects statutory modifications that limits its use only when the hedged item is a recognized asset. This is different than U.S. GAAP, which permits the partial term method for hedged liabilities. The statutory limitation is established to prevent interim basis adjustments to hedged liabilities that could present a reduction of reported liabilities on the financial statements when the actual liability has not been reduced. Reconsideration of this statutory limitation may occur after a broader project to consider how derivative basis adjustments to hedged liabilities shall be reflected in the financial statements.

Effective Date and Transition

~~74.73~~ This statement is effective for derivative transaction entered into or modified on or after January 1, 2003. A modification is any revision or change in contractual terms of the derivative. SSAP No. 31 applies to derivative transaction prior to January 1, 2003. Alternatively, an insurer may choose to apply this statement to all derivatives to which the insurer is a party as of January 1, 2003. In either case, the insurer is to disclose the transition approach that is being used.

- a. Revisions adopted to paragraph 64 to reject FSP FIN 39-1 is effective January 1, 2013, for companies that have previously reported a position in the balance sheet that was net of counterparty agreements. (Companies that have previously reported derivative instruments and/or related collateral gross shall not be impacted by these revisions.)
- b. Revisions adopted in paragraph 16 clarify the reporting for amounts received/paid to adjust variation margin until the derivative contract has ended and are effective January 1, 2018, on a

- prospective basis, for reporting entities that have previously considered these amounts to reflect settlement or realized gains/losses. (Companies that have previously reported variation margin changes in line with the revisions shall not be impacted by these revisions.)
- c. Revisions to incorporate limited provisions from ASU 2017-12 pertaining to the documentation of hedge effectiveness (detailed in paragraph 65) are effective January 1, 2019, with early adoption permitted for year-end 2018. However, if the reporting entity is a U.S. GAAP filer, the reporting entity may only elect early adoption if the entity has also elected early adoption of ASU 2017-12 for year-end 2018.
 - d. Revisions adopted April 2019 to explicitly include structured notes in scope of this statement are effective December 31, 2019. Revisions adopted July 2020 to define “derivative premium,” require gross reporting of derivatives without the impact of financing premiums and require separate recognition of premiums payable and premiums receivable, are effective January 1, 2021.
 - e. Revisions adopted August 2022 that adopt with modification the criteria for initial and subsequent hedge effectiveness detailed in the FASB ASC paragraphs 815-20-25-72 through 815-20-35-20, as modified through the issuance of ASU 2017-12 and that incorporate statutory accounting revisions for the accounting and reporting of excluded components are effective January 1, 2023, with early adoption permitted. These revisions shall be applied prospectively for all new and existing hedges. Entities shall detail the adoption of this guidance as a change in accounting principle pursuant to *SSAP No. 3—Accounting Changes and Corrections of Errors*.
 - f. [Revisions adopted December 13, 2022 that adopt U.S. GAAP guidance for the portfolio layer method, U.S. GAAP guidance to only consider how changes in the benchmark interest rate affect the decision to settle the hedged item before its scheduled maturity, U.S. GAAP guidance adding option in calculating the change in the hedged item’s fair value attributed to changes in the benchmark interest rate based on the benchmark rate component of the contractual coupon cash flows, that and adopt with modification U.S. GAAP guidance for partial term hedging are effective January 1, 2023, with early adoption permitted. These revisions shall be applied prospectively to qualifying new hedges.](#)

Proposed Edits to Exhibit C – Interest Rate Hedging

- 2d. Gain/Loss on Termination of a swap, collar or forward accounted for under hedge accounting (includes closing, exercise, maturity, and expiry):
 - i. Exercise—The remaining book value of the derivative shall become an adjustment to the cost or proceeds of the hedged item(s) received or disposed of individually or in aggregate;
 - ii. Sale, maturity, expiry, or other closing transaction of a derivative which is an effective hedge—Any gain or loss on the transaction, except for excluded components, will adjust the basis (or proceeds) of the hedged item(s) individually or in aggregate. [If a portfolio layer method hedging relationship is discontinued \(or partially discontinued\) in a voluntary dedesignation or in anticipation of a breach, the basis adjustment associated with the dedesignated amount as of the discontinuation date shall be allocated to the remaining individual assets in the closed portfolio that supported the dedesignated hedged layer using a systematic and rational method.](#) Alternatively, if the item being hedged is subject to IMR, the gain or loss on the terminated hedging derivative may be realized and shall be subject to IMR upon termination. [\(ASU 815-25-40-9\)](#)
 - iii. Gain/loss on termination of derivatives will be recognized currently in net income (realized gain/loss) to the extent they ceased to be effective hedges.

- iv. Upon the redesignation of a derivative from a currently effective hedging relationship-
 - (a) with an item(s) carried at amortized cost to another effective hedging relationship with an item(s) carried at amortized cost, the derivative shall continue to be recorded at amortized cost and no gain or loss on the derivative shall be recognized.
 - (b) with an item(s) carried at amortized cost or fair value to an effective relationship with an item(s) carried at fair value, the accounting for the derivative shall be consistent with (ii) above.
 - (c) with an item(s) carried at fair value to an effective relationship with an item(s) carried at amortized cost, the accounting for the derivative shall be consistent with (ii) above.

Exhibit A – Assessment of Effectiveness

17. All of the following conditions apply to both fair value hedges and cash flow hedges: *(815-20-25-104)*
- e. The interest-bearing asset or liability is not prepayable, that is, able to be settled by either party before its scheduled maturity, or the assumed maturity date if the hedged item is measured as a partial-term hedge of interest rate risk in which the assumed maturity of the hedged items occur on the date in which the last hedged cash flow is due and payable ends at the end of the designated hedge period, in accordance with paragraph 815-25-35-13B, with the following qualifications:
 - i. This criterion does not apply to an interest-bearing asset or liability that is prepayable solely due to an embedded call option (put option) if the hedging instrument is a compound derivative composed of an interest rate swap and a mirror-image call option (put option).
 - ii. The call option embedded in the interest rate swap is considered a mirror image of the call option embedded in the hedged item if all of the following conditions are met:
18. All of the following incremental conditions apply to fair value hedges only: *(815-20-25-105 & 815-25-35-13B)*
- a. The expiration date of the interest rate swap matches the maturity date of the interest-bearing asset or liability or the assumed maturity date if the hedged item is measured as a partial-term hedge of interest rate risk in which the assumed maturity of the hedged items ends at the end of the designated hedge period occur on the date in which the last hedged cash flow is due and payable in accordance with paragraph 815-25-35-13B.

Portfolio Layer Method (Note – New paragraphs at the end of Exhibit A.)

46. For a closed portfolio of financial assets or one or more beneficial interests secured by a portfolio of financial instruments, an entity may designate as the hedged item or items a hedged layer or layers (this designation is referred to throughout as the “portfolio layer method.”) (ASU 815-20-25-12A)

- a. As part of the initial hedge documentation, an analysis is completed and documented to support the entity’s expectation that the hedged item or items (that is, the hedged layer or layers in aggregate) is anticipated to be outstanding for the designated hedge period. That analysis shall incorporate the entity’s current expectations of prepayments, defaults, and other factors affecting the timing and amount of cash flows associated with the closed portfolio.

- b. For purposes of its analysis in paragraph 46.a., the entity assumes that as prepayments, defaults, and other factors affecting the timing and amount of cash flows occur, they first will be applied to the portion of the closed portfolio that is not hedged; and
- c. The entity applies the partial-term hedging guidance to the assets or beneficial interest used to support the entity's expectation in paragraph 46.a. An asset that matures on a hedged layer's assumed maturity date meets this requirement.

47. After a closed portfolio is established in accordance with paragraph 46, and entity may designate new hedging relationships associated with the closed portfolio without dedesignating any existing hedging relationships associated with the closed portfolio if the criteria of paragraph 46 are met for those newly designated hedging relationships. (ASU 815-20-25-12B)

48. For the portfolio layer method if both of the following conditions exist, the quantitative test described for similar assets (shared risk exposure) may be performed qualitatively on a hedge-by-hedge basis and only at hedge inception:

- a. The hedged item is a hedged layer in a portfolio layer hedge and designated in accordance with paragraph 26.f. of SSAP No. 86.
- b. An entity measures the change in fair value of the hedged item based on the benchmark rate component of the contractual coupon cash flows.

Using the benchmark rate component of the contractual coupon cash flows when all assets have the same assumed maturity date and prepayment risk does not affect the measurement of the hedged item results in all hedged items having the same benchmark rate component coupon cash flows. (ASU 815-20-55-14A)

49. For one or more hedging relationships designated under the portfolio layer method, an entity shall discontinue (or partially discontinue) hedge accounting in the following circumstances: (ASU 815-25-40-8)

- a. If the entity cannot support on a subsequent testing date that the hedged layer or layers are anticipated to be outstanding for the designated hedge (that is, a breach is anticipated), it shall discontinue (or partially discontinue) hedge accounting for one or more hedging relationships for the portion of the hedged item that is no longer anticipated to be outstanding for the designated hedge period.
- b. If on a subsequent testing date the outstanding amount of the closed portfolio of financial assets or one or more beneficial interests is less than the hedged layer or layers (that is, a breach has occurred), the entity shall discontinue (or partially discontinue) hedge accounting for one or more hedging relationships for the portion of the hedged item that is no longer outstanding.

50. In the event of either an anticipated breach (as described in paragraph 49.a.) or a breach that has occurred (as described in paragraph 49.b.) for portfolio layer method, if multiple hedged layers are associated with a closed portfolio, an entity shall determine which hedge or hedges to discontinue (or partially discontinue) in accordance with an accounting policy election. That accounting policy election shall specify a systematic and rational approach to determining which hedge or hedges to discontinue (or partially discontinue). An entity shall establish its accounting policy no later than when it first anticipates a breach or when a breach has occurred (whichever comes first). After an entity establishes its accounting policy, it shall consistently apply its accounting policy to all portfolio layer method breaches (anticipated and occurred). (ASU 815-25-40-8A)

In the issue paper, the U.S. GAAP references not pulled into Exhibit will also be updated as follows:

Consideration of Prepayment Risk Using the ~~Last-of-Layer~~ Portfolio Layer Method

815-20-25-118A In a fair value hedge of interest rate risk designated under the portfolio layer ~~last-of-layer~~ method in accordance with paragraph 815-20-25-12A, an entity may exclude prepayment risk when measuring the change in fair value of the hedged item attributable to interest rate risk.

Status:

On December 13, 2022, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed revisions, as illustrated above, to *SSAP No. 86—Derivatives*. The revisions adopt with modification derivative guidance from *ASU 2017-12, Derivatives and Hedging* and *ASU 2022-01, Fair Value Hedging – Portfolio Layer* to include guidance for the portfolio layer method and partial-term hedges. These revisions are effective Jan. 1, 2023, with early adoption permitted.

<https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/NationalMeetings/A.NationalMeetingMaterials/2022/Fall-December/Adoptions/22-09-ASU2022-01-PortfolioHedges.docx>

**Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A**

Issue: ASU 2022-02 – Troubled Debt Restructurings and Vintage Disclosures

Check (applicable entity):

	P/C	Life	Health
Modification of Existing SSAP	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
New Issue or SSAP	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Interpretation	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Description of Issue: In April 2022, the Financial Accounting Standards Board (FASB) issued *Accounting Standards Update (ASU) 2022-02: Troubled Debt Restructurings and Vintage Disclosures* to eliminate prior U.S. GAAP guidance for troubled debt restructurings (TDRs) by creditors and instead require an entity to evaluate whether the modification represents a new loan or a continuation of an existing loan. The elimination of the separate TDR recognition and measurement guidance was supported for U.S. GAAP as losses are captured in the allowance for credit losses, pursuant to *ASU 2016-13: Measurement of Credit Losses on Financial Instruments*. With ASU 2022-02, expanded U.S. GAAP disclosures have been incorporated for modifications provided to debtors experiencing financial difficulty. Also, the ASU revises the ASU 2016-13 vintage gross write-off disclosures for public business entities. The effective date of ASU 2022-02 is Jan. 1, 2023, for entities that have adopted ASU 2016-13. For entities that have yet to adopt ASU 2016-13 (also known as the ‘current expected credit loss’ - CECL standard), the effective date of ASU 2022-02 will occur concurrently when an entity adopts ASU 2016-13.

Previously issued U.S. GAAP guidance involving TDRs by creditors was adopted with modification in *SSAP No. 36—Troubled Debt Restructuring*. This guidance was originally issued in *FAS 15, Accounting for Debtors and Creditors for Troubled Debt Restructurings* and then captured in the *FASB Accounting Standards Codification (ASC) 310-40: Receivables – Troubled Debt Restructuring by Creditors*. This ASC guidance has been predominantly superseded with the issuance of ASU 2022-02. Under the existing statutory accounting guidance, if the fair value of the modified loan is less than the recorded investment in the loan (including accrued interest, net deferred loan fees or costs, and unamortized premium or discount), a new cost basis is established at the fair value, with the difference recorded as a realized loss in the statement of operations.

Under ASU 2016-13 (also known as the ‘current expected credit loss’ - CECL standard) assets are reported at the net amount expected to be collected. For assets held at amortized cost, a valuation allowance reflecting expected credit losses is established and is deducted from the amortized cost basis to present the net carrying amount expected to be collected. For assets held at fair value, there is still an allowance for credit losses, which permits reversals of credit losses previously recorded to be reflected in net income. (For assets held at fair value, the CECL model does not change measurement method, but changes the process for recognizing fluctuations in fair value as a result of credit losses.)

Although consideration of ASU 2016-13 is still pending statutory accounting review, from initial assessments and industry outreach, a full adoption of the CECL standard is not likely to be supported. This is because 1) insurers more commonly hold assets at amortized cost under SAP and at fair value (as available for sale) under U.S. GAAP – so the CECL model would significantly impact the measurement method under SAP, but not under U.S. GAAP, and 2) the asset-valuation reserve (AVR), a statutory accounting guidance applicable to life and fraternal insurers, establishes a reserve to offset potential credit-related investment losses on most investment categories. With ASU 2016-13 applicable to small public and non-public U.S. GAAP filers as of Jan. 1, 2023, NAIC staff are currently soliciting input from industry on key CECL impacts to assess for statutory accounting purposes. Once that information is received, a further review will occur on ASU 2016-13 to determine the extent that CECL concepts should be reflected within statutory accounting principles.

Under new U.S. GAAP guidance in ASU 2022-02, when the terms of the loan have been revised, creditors would determine whether the changes to the loan are more than minor and if the terms are at least as favorable to the lender as the terms for comparable loans to other customers with similar collection risks who are not refinancing / restructuring a loan. If these criteria are met, then the restructured loan would be accounted for as a new loan. If a new loan, any unamortized net fees or costs and any prepayment penalties from the original loan shall be recognized in interest income when the new loan is granted. If the criteria are not met, the unamortized net fees or costs from the original loan and any prepayment penalties shall be carried forward as a part of the net investment in the new loan. With this approach, the investment in the new loan consists of the net remaining investment in the original loan, any additional funds advanced to the borrower, any fees received, and direct loan origination costs associated with the refinancing or restructuring. It's important to highlight that this U.S. GAAP guidance does not address any loss for the restructured loan as recognition of losses would be captured in the allowance for credit losses pursuant to ASU 2016-13.

With ASU 2022-02, expanded disclosures on commitments and modified loans have been incorporated. Although some of the general concepts within the following U.S. GAAP disclosures are captured in SSAP No. 36, paragraph 23, the following U.S. GAAP disclosures are more specific than what was previously incorporated:

1. Disclose if the creditor has a commitment to lend additional funds to debtors experiencing financial difficulty for which the creditor has modified the terms of the receivables in the form of principal forgiveness, an interest rate reduction, and other-than-insignificant payment delay, or a term extension in the current reporting period (ASU 310-10-50-36). (Note – This is similar to a prior GAAP disclosure for TDRs and reflected in concept within SSAP No. 36, paragraph 23.b.)
2. In addition to disclosures about the type and magnitude of certain modifications of receivables made to debtors experiencing financial difficulty (summarized in paragraphs 3-5 below), the financial effect of those modifications and the degree of success of the modification in mitigating potential credit losses, an entity shall consider providing information that helps financial statement users understand significant changes in the type of magnitude of modifications, including those modifications that, for example, were caused by a major credit event, even if the modifications would not require the disclosures detailed below.) (ASU 310-10-50-38)
3. For each period in which a statement of income is presented, an entity shall disclose the following information related to modifications of receivables that are in the form of principal forgiveness, an interest rate reduction, an other-than insignificant payment delay, or a term extension (or a combination thereof) made to debtors experiencing financial difficulty during the reporting period. (ASU 310-10-50-42)
 - a. By class of financing receivable, qualitative and quantitative information about:
 - i. The types of modifications utilized by an entity, including the total period-end amortized cost basis of the modified receivables and the percentage of modifications of receivables made to debtors experiencing financial difficulty relative to the total period-end amortized cost basis of receivables in the class of financing receivable.
 - ii. The financial effect of the modification by type of modification, which shall provide information about the changes to the contractual terms as a result of the modification and shall include the incremental effect of principal forgiveness on the amortized cost basis of the modified receivables, as applicable, or the reduction in weighted-average interest rates (versus a range) for interest rate reductions.
 - iii. Receivable performance in the 12 months after a modification of a receivable made to a debtor experiencing financial difficulty.

- b. By portfolio segment, qualitative information about how those modifications and the debtors' subsequent performance are factored into determining the allowance for credit losses.
4. Receivables made be modified in more than one manner. An entity that modifies the same receivable in more than one manner shall provide disclosures sufficient for users to understand the different types of combinations of modifications provided to borrowers. For example, a receivable may be modified to provide both principal forgiveness and an interest rate reduction. In that case, an entity shall disclose the period-end amortized cost basis of that receivable in a separate category that reflects that a combination of mortification types has been granted. If another receivable was modified to provide both an interest rate reduction and a term extension, the period-end amortized cost basis of that receivable shall be presented in a different category. Multiple separate combinations categories may be necessary if significant. The same receivable's period-end amortized cost basis shall not be presented in multiple categories. (310-10-50-43)
5. For each period in which a statement of income is presented, an entity shall disclose the following information about financing receivables that had a payment default during the period and had been modified in the form of principal forgiveness, an interest rate reduction, an other-than-insignificant payment delay, or a term extension (or a combination thereof) within the previous 12 months preceding the payment default when the debtor was experiencing financial difficulty at the time of the modification. (310-10-50-44)
 - a. By class of financing receivable, qualitative and quantitative information about those defaulted financing receivables, including the following:
 - i. The type of contractual change the modification provided.
 - ii. The amount of financing receivables that defaulted, including the period-end amortized cost basis for financing receivables that defaulted.
 - b. By portfolio segment, qualitative information about how those defaults are factored into determining the allowance for credit losses.

Per the ASU, the disclosures in paragraphs 3, 4 and 5 shall be provided regardless of whether a modification of a receivable to a debtor experiencing financial difficulty results in a new loan. (ASU 310-10-50-41)

In addition to the TDR for creditors guidance, ASU 2022-02 also incorporates and revises "vintage" disclosures for gross write-offs for public business entities involving financing receivables and net investment in leases. These disclosures were originally captured as part of the CECL guidance in ASU 2016-13 for all entities, and the revisions modify and restrict the disclosures to public business entities:

- When disclosing credit quality indicators of financing receivables and net investment in leases, a public business entity shall present the amortized cost basis within each credit quality indicator by year of origination (that is, vintage year). For purchased financing receivables and net investment in leases, an entity shall use the initial date of issuance to determine the year of origination, not the date of acquisition. For origination years before the fifth annual period, a public business entity may present the amortized cost basis of financing receivables and net investments in leases in the aggregate. For interim-period disclosures, the current year-to-date originations in the current reporting period are considered to the current-period originations. (326-20-50-6)
- A public business entity shall present the gross write-offs recorded in the current period, on a current year-to-date basis, for financing receivables and net investments in leases by origination year. For origination years before the fifth annual period, a public business entity may present the gross write-offs in the current period for financing receivables and net investments in leases in aggregate. The requirement to present the amortized cost basis within each credit quality indicator by year of origination is not required for an entity that is not a public business entity. (326-20-50-6A)

Existing Authoritative Literature:

SSAP No. 36—Troubled Debt Restructuring

A troubled debt restructuring is defined as a debt restructuring whereby the creditor, for economic or legal reasons related to the debtor's financial difficulties, grants a concession to the debtor that it would not otherwise grant. Guidance in SSAP No. 36, adopted from U.S. GAAP for creditors, details the following:

- Determining whether a creditor has granted a concession
- Determining whether a debtor is experiencing financial difficulties
- Determining whether a restructuring results in a delay in payment that is insignificant
- Accounting by creditors
- Disclosure for creditors.

Key excerpts from the guidance in SSAP No. 36:

Accounting by Creditors

17. A creditor shall account for a troubled debt restructuring according to the type of the restructuring (receipt of assets in full satisfaction, modification of terms, combination of types). Generally, troubled debt restructuring involving the transfer of assets shall be accounted for at the fair value of the assets received. Troubled debt restructuring involving modification of terms shall be accounted for at fair value (as determined by acceptable appraisal methodologies) in accordance with *SSAP No. 100R—Fair Value*. If the restructured loan is collateral dependent, fair value shall be the fair value of the collateral. If the restructured loan is not collateral dependent, fair value shall be determined in accordance with SSAP No. 100R. If the determined fair value of the loan is less than the recorded investment in the loan (including accrued interest, net deferred loan fees or costs, and unamortized premium or discount), a new cost basis shall be established at the fair value with the difference being recorded as a realized loss in the statement of operations. After the troubled debt restructuring, a creditor shall account for the assets consistent with the statutory guidance for such assets.

18. A creditor shall account for assets, including foreclosed property and equity interests in corporations, joint ventures, or partnerships, received in satisfaction of the loan at their fair value (as determined by acceptable appraisal methodologies) at the time of restructuring or at the book value of the loan if lower. If the fair value is less than the book value, the required writedown shall be recognized as a realized capital loss. The creditor shall reclassify the asset from loans to the appropriate asset account, such as real estate or other invested assets, at the time that the creditor obtains clear title to the asset except for mortgage loans which shall follow the guidance in paragraph 18 of SSAP No. 37. After the troubled debt restructuring, a creditor shall account for the assets received in satisfaction of the loan consistent with the statutory guidance for similar assets.

19. Any fees received in connection with a modification of terms of a troubled debt restructuring shall be applied as a reduction of the recorded investment in the loan. All costs associated with the restructuring, including direct loan origination costs, shall be charged to expense as incurred.

Disclosure by Creditors

23. A creditor shall disclose in the financial statements the information captured in paragraphs 23.a., 23.b. and 23.c. about troubled debt restructuring as of the date of each balance sheet presented. Disclosures captured from paragraphs 23.d. and 23.e. are required in the statutory audited financial statements only:

- a. As of the date of each statement of financial position presented, the recorded investment in the loans for which impairment has been recognized in accordance with this statement and the related realized capital loss. (For mortgage loans, the disclosures in SSAP No. 37 shall also be completed.)

- b. The amount of commitments, if any, to lend additional funds to debtors owing receivables whose terms have been modified in troubled debt restructuring
 - c. The creditor's income recognition policy for interest income on an impaired loan
 - d. For troubled debt restructurings that occurred during the annual reporting period, aggregated by type of instrument, qualitative and quantitative information on (1) how the items were modified and (2) the financial effects of the modifications
 - e. If restructured within the previous 12 months and there has been a payment default during that period, disclose qualitative and quantitative information about the defaulted instruments, aggregated by type of instrument, including: (1) type of instruments that defaulted and (2) the amount of recorded investments for which default occurred
24. Refer to the Preamble for further discussion regarding disclosure requirements.
25. This statement is not intended to modify the requirement for life and health insurers to complete the annual statement exhibit disclosing long-term mortgage loans in good standing with restructured terms.

Relevant Literature

26. This statement adopts with modification *FASB Statement No. 15, Accounting by Debtors and Creditors for Troubled Debt Restructurings* (FAS 15) to specify that creditors shall reclassify assets obtained in a troubled debt restructuring from loans to the appropriate asset account at the time the creditor obtains clear title to the asset, except for mortgage loans which shall be reclassified at the beginning of the redemption period unless it is probable that the mortgage loan will be redeemed and with modification to require that gains and losses from extinguishment of debt be reported as capital gains or losses, and charged to operations. In August 2012, this statement was revised to adopt paragraphs 310-40-15-13 through 310-40-15-18 and 310-40-15-20 of the FASB Codification incorporated through *FASB ASU 2011-02, A Creditors Determination of Whether a Restructuring Is a Troubled Debt Restructuring*. Also in August 2012, this statement adopted with modification the disclosure requirements included in paragraphs 310-10-50-33 through 310-10-50-34 of the FASB Codification originally incorporated from *ASU 2010-20, Receivables (Topic 310), Disclosures About the Credit Quality of Financing Receivables and the Allowance for Credit Losses*, deferred by *ASU 2011-01, Receivables (Topic 310), Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings in Update No. 2010-20* and reinstated through *ASU 2011-02*. These disclosure requirements have been modified to be applicable for all troubled debt restructurings within the scope of SSAP No. 36, rather than limited to troubled debt restructurings of "financing receivables." The revisions adopted in August 2012 from *ASU 2011-02* and *ASU 2010-20* are effective January 1, 2013, with early application permitted.
27. This statement adopts paragraphs 9, 22, and 25 of *FASB Statement No. 114, Accounting by Creditors for Impairment of a Loan* (FAS 114). Paragraphs 6.d., 13 and 21 of FAS 114 are rejected. *FASB Statement No. 118, Accounting by Creditors for Impairment of a Loan—Income Recognition and Disclosures* is adopted as it relates to troubled debt restructuring.
28. This statement adopts *FASB Technical Bulletin 81-6, Applicability of Statement 15 to Debtors in Bankruptcy Situations* and *FASB Technical Bulletin 80-2, Classification of Debt Restructuring by Debtors and Creditors*. It also adopts *FASB Emerging Issue Task Force No. 87-18, Use of Zero Coupon Bonds in a Troubled Debt Restructuring*, *FASB Emerging Issue Task Force No. 87-19, Substituted Debtors in a Troubled Debt Restructuring*, *FASB Emerging Issue Task Force No. 89-15, Accounting for a Modification of Debt Terms When the Debtor is Experiencing Financial Difficulties* consistent with the modifications to FAS 15 discussed in this statement, *FASB Emerging Issues Task Force No. 96-22, Applicability of the Disclosures Required by FASB Statement No. 114 When a Loan Is Restructured in a Troubled Debt Restructuring into Two (or More) Loans* and *FASB EITF 02-4: Determining Whether a Debtor's Modification or Exchange of Debt Instruments is Within the Scope of FASB Statement No. 15*.
29. Although *FASB Statement No. 91, Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases* (FAS 91) was rejected in SSAP No. 26R—*Bonds*, this statement is consistent with paragraph 14 of *FAS No. 91*.

30. This statement rejects *FASB Emerging Issues Task Force No. 94-8, Accounting for Conversion of a Loan into a Security in a Troubled Debt Restructuring* and *FASB Technical Bulletin 94-1, Application of Statement 115 to Debt Securities Restructured in a Troubled Debt Restructuring*.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups):

In 2020, in response to the COVID pandemic, the Statutory Accounting Principles (E) Working Group issued two interpretations providing limited time exceptions for troubled debt restructurings. INT 20-07, believed most widely used, provided limited-time practical expedients in determining whether restructured payments are considered insignificant. Both interpretations automatically expired on Jan. 2, 2022.

- INT 20-03: Troubled Debt Restructurings Due to COVID-19
- INT 20-07: Troubled Debt Restructuring of Certain Debt Investments Due to COVID-19

In 2016, with the issuance of ASU 2016-13, the Working Group began discussions on the CECL standard for statutory accounting. Although a number of preliminary discussions occurred, discussions halted as the effective date of U.S. GAAP standard (as well as other standards) was delayed in response to the COVID-19 pandemic. ASU 2016-13 is now effective January 2023 for smaller reporting public entities and nonpublic companies. When discussions were ongoing, a comment letter received from interested parties dated July 9, 2018, recommended that the NAIC retain the existing credit impairment guidance in statutory accounting principles. The discussion on ASU 2016-13 for statutory accounting is expected to resume in 2022.

Information or issues (included in *Description of Issue*) not previously contemplated by the Working Group:
None

Convergence with International Financial Reporting Standards (IFRS): NA

Recommendation:

NAIC staff recommends that the Working Group move this item to the active listing, categorized as a SAP clarification, and expose the intent to retain existing guidance in *SSAP No. 36—Troubled Debt Restructuring* along with revisions to the relevant literature section to identify the rejection of ASU 2022-02 and detail the GAAP/SAP differences for the accounting of troubled debt restructurings for creditors. Note that paragraph 26 addresses ASU 2022-02 and paragraphs 27-29 detail the historical differences that were previously in paragraphs 26-30 in a more reader friendly format including moving old effective date language from the relevant literature section to the effective date paragraph. With this exposure, comments are requested on whether the expanded U.S. GAAP disclosures for modifications should be considered for statutory accounting.

NAIC staff recommends that the CECL disclosures, including the revisions for “vintage gross write-offs” for public business entities be considered as part of the review of ASU 2016-13 for expected credit losses. However, NAIC staff requests comments on this recommendation and whether the disclosures should be considered for statutory accounting in advance of reviewing ASU 2016-13 for statutory accounting.

Staff Review Completed by: Julie Gann - NAIC Staff, April 2022

[https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/Maintenance/Active Form A's/2022/22-XX - ASU 2022-02 - TDR CECL - With Edits.docx](https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/Maintenance/Active%20Form%20A's/2022/22-XX-ASU%2022-02-TDR%20CECL-With%20Edits.docx)

Proposed Revisions to SSAP No. 36:

Relevant Literature

26. This statement rejects ASU 2022-02, *Troubled Debt Restructurings and Vintage Disclosures* and the U.S. GAAP guidance within the Accounting Standards Codification for troubled debt restructurings for creditors. This ASU is rejected as the U.S. GAAP guidance for troubled debt restructuring by creditors has been significantly modified to eliminate the separate recognition of losses from restructurings as losses are captured within the allowance for credit losses valuation account established pursuant to ASU 2016-13, *Financial Instruments – Credit Losses*. As statutory accounting has not adopted ASU 2016-13, the prior troubled debt restructuring adopted from U.S GAAP in effect prior to ASU 2016-13 and ASU 2022-02 has been retained. With the rejection of ASU 2022-02, reporting entities shall continue to apply the prior concepts within SSAP No. 36 when assessing and classifying modifications as troubled debt restructurings. These retained concepts do not permit entities to consider troubled debt restructurings as new loans and therefore do not permit immediate recognition of unamortized fees, costs, or prepayment penalties as interest income at the time of restructuring. Additionally, fees received by a reporting entity from a restructuring shall continue to reduce the recorded investment and all costs incurred by a reporting entity with the restructuring shall continue to be charged to expense as incurred.

27. Although the statutory accounting guidance for troubled debt restructurings for creditors no longer reflects authoritative guidance from U.S. GAAP, the guidance in SSAP No. 36 reflects the following superseded U.S. GAAP guidance as follows:

- a. Adopted with modification FASB Statement No. 15, *Accounting by Debtors and Creditors for Troubled Debt Restructurings* (FAS 15) to specify that creditors shall reclassify assets obtained in a troubled debt restructuring from loans to the appropriate asset account at the time the creditor obtains clear title to the asset, except for mortgage loans which shall be reclassified at the beginning of the redemption period unless it is probable that the mortgage loan will be redeemed and with modification to require that gains and losses from extinguishment of debt be reported as capital gains or losses, and charged to operations.
- b. Adopted paragraphs 310-40-15-13 through 310-40-15-18 and 310-40-15-20 of the FASB Codification incorporated through FASB ASU 2011-02, *A Creditors Determination of Whether a Restructuring Is a Troubled Debt Restructuring*
- c. Adopted with modification the disclosure requirements included in paragraphs 310-10-50-33 through 310-10-50-34 of the FASB Codification originally incorporated from ASU 2010-20, *Receivables (Topic 310), Disclosures About the Credit Quality of Financing Receivables and the Allowance for Credit Losses*, deferred by ASU 2011-01, *Receivables (Topic 310), Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings in Update No. 2010-20* and reinstated through ASU 2011-02. These disclosure requirements were modified to be applicable for all troubled debt restructurings within the scope of SSAP No. 36, rather than limited to troubled debt restructurings of “financing receivables.”
- d. Adopted paragraphs 9, 22, and 25 of FASB Statement No. 114, *Accounting by Creditors for Impairment of a Loan* (FAS 114). Adopted FASB Statement No. 118, *Accounting by Creditors for Impairment of a Loan—Income Recognition and Disclosures* as it relates to troubled debt restructuring.
- e. Adopts FASB Technical Bulletin 81-6, *Applicability of Statement 15 to Debtors in Bankruptcy Situations* and FASB Technical Bulletin 80-2, *Classification of Debt Restructuring by Debtors and Creditors*, FASB Emerging Issue Task Force No. 87-18, *Use of Zero Coupon Bonds in a Troubled Debt Restructuring*, FASB Emerging Issue Task Force No. 87-19, *Substituted Debtors in a Troubled Debt Restructuring*, FASB Emerging Issue Task Force No. 89-15, *Accounting for a Modification of Debt Terms When the Debtor is Experiencing Financial Difficulties* consistent with the modifications to FAS 15, FASB Emerging Issues Task Force No. 96-22, *Applicability of the Disclosures Required by FASB Statement No. 114 When a Loan Is Restructured in a Troubled Debt Restructuring into*

Two (or More) Loans and FASB EITF 02-4: Determining Whether a Debtor's Modification or Exchange of Debt Instruments is Within the Scope of FASB Statement No. 15.

- f. *This statement is consistent with paragraph 14 of FASB Statement No. 91, Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases (FAS 91), but FAS 91 was rejected in SSAP No. 26R*

28. *For historical reference purposes, the following superseded U.S. GAAP guidance was previously rejected within this statement:*

- a. *Paragraph 6.d, 13 and 21 of FAS 114.*
- b. *FASB Emerging Issues Task Force No. 94-8, Accounting for Conversion of a Loan into a Security in a Troubled Debt Restructuring and FASB Technical Bulletin 94-1, Application of Statement 115 to Debt Securities Restructured in a Troubled Debt Restructuring.*

~~26. This statement adopts with modification FASB Statement No. 15, Accounting by Debtors and Creditors for Troubled Debt Restructurings (FAS 15) to specify that creditors shall reclassify assets obtained in a troubled debt restructuring from loans to the appropriate asset account at the time the creditor obtains clear title to the asset, except for mortgage loans which shall be reclassified at the beginning of the redemption period unless it is probable that the mortgage loan will be redeemed and with modification to require that gains and losses from extinguishment of debt be reported as capital gains or losses, and charged to operations. In August 2012, this statement was revised to adopt paragraphs 310-40-15-13 through 310-40-15-18 and 310-40-15-20 of the FASB Codification incorporated through FASB ASU 2011-02, A Creditors Determination of Whether a Restructuring Is a Troubled Debt Restructuring. Also in August 2012, this statement adopted with modification the disclosure requirements included in paragraphs 310-10-50-33 through 310-10-50-34 of the FASB Codification originally incorporated from ASU 2010-20, Receivables (Topic 310), Disclosures About the Credit Quality of Financing Receivables and the Allowance for Credit Losses, deferred by ASU 2011-01, Receivables (Topic 310), Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings in Update No. 2010-20 and reinstated through ASU 2011-02. These disclosure requirements have been modified to be applicable for all troubled debt restructurings within the scope of SSAP No. 36, rather than limited to troubled debt restructurings of "financing receivables." The revisions adopted in August 2012 from ASU 2011-02 and ASU 2010-20 are effective January 1, 2013, with early application permitted.~~

~~27. This statement adopts paragraphs 9, 22, and 25 of FASB Statement No. 114, Accounting by Creditors for Impairment of a Loan (FAS 114). Paragraphs 6.d., 13 and 21 of FAS 114 are rejected. FASB Statement No. 118, Accounting by Creditors for Impairment of a Loan—Income Recognition and Disclosures is adopted as it relates to troubled debt restructuring.~~

~~28. This statement adopts FASB Technical Bulletin 81-6, Applicability of Statement 15 to Debtors in Bankruptcy Situations and FASB Technical Bulletin 80-2, Classification of Debt Restructuring by Debtors and Creditors. It also adopts FASB Emerging Issue Task Force No. 87-18, Use of Zero Coupon Bonds in a Troubled Debt Restructuring, FASB Emerging Issue Task Force No. 87-19, Substituted Debtors in a Troubled Debt Restructuring, FASB Emerging Issue Task Force No. 89-15, Accounting for a Modification of Debt Terms When the Debtor is Experiencing Financial Difficulties consistent with the modifications to FAS 15 discussed in this statement, FASB Emerging Issues Task Force No. 96-22, Applicability of the Disclosures Required by FASB Statement No. 114 When a Loan Is Restructured in a Troubled Debt Restructuring into Two (or More) Loans and FASB EITF 02-4: Determining Whether a Debtor's Modification or Exchange of Debt Instruments is Within the Scope of FASB Statement No. 15.~~

~~29. Although FASB Statement No. 91, Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases (FAS 91) was rejected in SSAP No. 26R—Bonds, this statement is consistent with paragraph 14 of FAS No. 91.~~

~~30. This statement rejects FASB Emerging Issues Task Force No. 94-8, Accounting for Conversion of a Loan into a Security in a Troubled Debt Restructuring and FASB Technical Bulletin 94-1, Application of Statement 115 to Debt Securities Restructured in a Troubled Debt Restructuring.~~

Effective Date and Transition

~~31-29.~~ 31. This statement is effective for years beginning January 1, 2001. The provisions of this statement shall be applied to all troubled debt restructurings entered into on or after January 1, 2001. The adoption of FASB EITF 02-4: Determining Whether a Debtor’s Modification or Exchange of Debt Instruments is within the Scope of FASB Statement No. 15 was incorporated from INT 03-12 and effective December 7, 2003. [The revisions adopted in August 2012 from ASU 2011-02 and ASU 2010-20 are effective January 1, 2013, with early application permitted.](#)

Comments Requested – Is additional disclosure information desired on troubled debt restructurings?

As detailed in the summary of new GAAP guidance, disclosures are expanded to allocate TDRs by type of modification – such as principal forgiveness, interest rate reduction, other-than-insignificant payment delay or term extension. Also under the new U.S. GAAP guidance, TDR disclosures are aggregated based on type of modification, and if more than one modification occurs, then a new category is reported to aggregate info for all contracts that have similar modifications. (So, modifications that encompass both principal forgiveness and interest rate reductions would be aggregated in a separate category, and modifications that include interest rate reductions and term extensions would be aggregated in a separate category.)

Below are the current disclosures and data-template for statutory financials. As shown, the data captured is limited.

Disclosure by Creditors

23. A creditor shall disclose in the financial statements the information captured in paragraphs 23.a., 23.b. and 23.c. about troubled debt restructuring as of the date of each balance sheet presented. Disclosures captured from paragraphs 23.d. and 23.e. are required in the statutory audited financial statements only:

- a. As of the date of each statement of financial position presented, the recorded investment in the loans for which impairment has been recognized in accordance with this statement and the related realized capital loss. (For mortgage loans, the disclosures in SSAP No. 37 shall also be completed.)
- b. The amount of commitments, if any, to lend additional funds to debtors owing receivables whose terms have been modified in troubled debt restructuring
- c. The creditor's income recognition policy for interest income on an impaired loan
- d. For troubled debt restructurings that occurred during the annual reporting period, aggregated by type of instrument, qualitative and quantitative information on (1) how the items were modified and (2) the financial effects of the modifications
- e. If restructured within the previous 12 months and there has been a payment default during that period, disclose qualitative and quantitative information about the defaulted instruments, aggregated by type of instrument, including: (1) type of instruments that defaulted and (2) the amount of recorded investments for which default occurred

Note 5B. Debt Restructuring

	Current Year	Prior Year
(1) The total recorded investment in restructured loans, as of year-end	\$ _____	_____
(2) The realized capital losses related to these loans	\$ _____	_____
(3) Total contractual commitments to extend credit to debtors owing receivables whose terms have been		

modified in troubled debt restructurings \$ _____

Status:

On December 13, 2022, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed revisions, as illustrated above, to *SSAP No. 36—Troubled Debt Restructuring*. The revisions reject *ASU 2022-02, Troubled Debt Restructurings and Vintage Disclosures* and identifies that retained guidance reflects superseded U.S. GAAP.

<https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/NationalMeetings/A.NationalMeetingMaterials/2022/Fall-December/Adoptions/22-10-ASU2022-02-TDRCECL.docx>

**Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A**

Issue: Related Parties – Footnote Updates

Check (applicable entity):

	P/C	Life	Health
Modification of Existing SSAP	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
New Issue or SSAP	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Interpretation	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Description of Issue: At its May 24, 2022, meeting, the Statutory Accounting Principles (E) Working Group adopted agenda item 2021-21 – Related Party Reporting. That agenda item encompassed two main goals:

1. Clarified the reporting of affiliate transactions within existing reporting lines in the investment schedules, while remaining consistent with the definition of an “affiliate” pursuant to the *Insurance Holding Company System Regulatory Act* (Model #440), *SSAP No. 25—Affiliates and Other Related Parties* and *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*.
2. Incorporated new reporting requirements for investment transactions with related parties. This agenda item added a new column to annual statement reporting schedules: B – Mortgage Loans, D – Long-Term Bonds, DB – Derivatives, BA – Other Long-Term Invested Assets, DA – Short-Term Investments, E2 – Cash Equivalents, and DL – Securities Lending Collateral Assets where the reporting entity must select a code that best describes the related party relationship within the investment.

When agenda item 2021-21 was exposed for the final time on April 4, 2022, a footnote was added to *SSAP No. 25*, paragraph 9 that states “Consistent with *SSAP No. 97*, footnote 1, investments in an exchange traded fund (ETF) or a mutual fund (as defined by the SEC) does not reflect ownership in an underlying entity, regardless of the ownership percentage the reporting entity (or the holding company group) has of the ETF or mutual fund unless ownership of the ETF actually results in “control” with the power to direct or cause the direction of management of an underlying company. ETFs and mutual funds are comprised of portfolios of securities subject to the regulatory requirements of the federal securities laws.” Among the comments received from interested parties after the April 4 exposure was a suggestion to extend the exemption to foreign open-end investment funds governed and authorized in accordance with regulations established by the applicable foreign jurisdiction, which are within the scope of *SSAP No. 30R—Unaffiliated Common Stock*.

As part of the adoption of agenda item 2021-21 at the May 24 meeting, NAIC staff were directed by the Working Group to make revisions to include foreign open-end funds *SSAP No. 25* and *SSAP No. 97* in the footnotes.

Existing Authoritative Literature:

SSAP No. 25—Affiliates and Other Related Parties (paragraph and footnote originally adopted on the May 24, 2022, Working Group call.)

9. For entities not controlled by voting interests, such as limited partnerships, trusts and other special purpose entities, control may be held by a general partner, servicer, or by other arrangements. The ability of the reporting entity or its affiliates to direct the management and policies of an entity through such arrangements shall constitute control as defined in paragraph 6. Additionally, a reporting entity or its affiliates may have indirect control of other entities through such arrangements. For example, if a limited partnership were to be controlled by an affiliated general partner, and that limited partnership held greater than 10% of the voting interests of another company^{FN}, indirect control shall be presumed to exist unless the presumption of control can be overcome as detailed in paragraph 7. If direct or indirect control exists, whether through voting securities, contracts, common management or otherwise, the arrangement is

considered affiliated under paragraph 5. Consistent with paragraph 8, a disclaimer of affiliation does not eliminate a “related party” distinction or disclosure requirements for material transactions pursuant to SSAP No. 25.

FN—Consistent with SSAP No. 97, footnote 1, investments in an exchange traded fund (ETF) or a mutual fund (as defined by the SEC) does not reflect ownership in an underlying entity, regardless of the ownership percentage the reporting entity (or the holding company group) has of the ETF or mutual fund unless ownership of the ETF actually results in “control” with the power to direct or cause the direction of management of an underlying company. ETFs and mutual funds are comprised of portfolios of securities subject to the regulatory requirements of the federal securities laws.

SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities

5. Control is defined as the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of the investee, whether through the (a) ownership of voting securities, (b) by contract other than a commercial contract for goods or nonmanagement services, (c) by common management, or (d) otherwise. Control shall be presumed to exist if a reporting entity and its affiliates directly or indirectly, own, control, hold with the power to vote, or hold proxies representing 10% or more of the voting interests of the entity^{FN}.

FN—Investments in an exchange traded fund (ETF) or a mutual fund (as defined by the SEC) does not reflect ownership in an underlying entity, regardless of the ownership percentage the reporting entity (or the holding company group) has of the ETF or mutual fund unless ownership of the ETF actually results in “control” with the power to direct or cause the direction of management of an underlying company. ETFs and mutual funds are comprised of portfolios of securities subject to the regulatory requirements of the federal securities laws. ETFs and mutual funds held by a reporting entity shall be reported as common stock, unless the ETF qualifies for bond or preferred stock treatment per the *Purposes and Procedures Manual of the NAIC Investment Analysis Office*. Reporting entities are not required to verify that SCAs (subject to SSAP No. 97) are represented in the portfolio of securities held in ETFs or mutual funds or to adjust the value of SCAs as a result of investments in ETFs or mutual funds.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): In March 2021, the Statutory Accounting Principles (E) Working Group adopted revisions to SSAP No. 25 pursuant to agenda item 2019-34: Related Parties, Disclaimers of Affiliation and Variable Interest Entities. Additionally, a new reporting Schedule Y, Part 3 was adopted by the Blanks (E) Working Group in proposal 2020-37BWG, with an initial effective date of Dec. 31, 2021, to capture information on all entities with ownership greater than 10%, the ultimate controlling parties of those owners and other entities that the ultimate controlling party controls.

The adopted revisions to SSAP No. 25 from agenda item 2019-34 are summarized as follows:

- Clarify the identification of related parties and ensure that any related party identified under U.S. GAAP or SEC reporting requirements would be considered a related party under statutory accounting principles.
- Clarify that non-controlling ownership over 10% results in a related party classification regardless of any disclaimer of control or disclaimer of affiliation.
- Clarify the impact of a disclaimer of control or disclaimer of affiliate under SAP. As detailed, such disclaimers impact holding company group allocation and reporting as an SCA under SSAP No. 97, but do not eliminate the classification as a “related party” and the disclosure of material transactions as required under SSAP No. 25.
- Rejected several U.S. GAAP standards addressing variable interest entities.

On May 24, 2022, the Working Group adopted agenda item 2021-21 – Related Party Reporting, which encompassed two main goals:

- Clarified the reporting of affiliate transactions within existing reporting lines in the investment schedules, while remaining consistent with the definition of an “affiliate” pursuant to Model #440, SSAP No. 25 and SSAP No. 97.
- Incorporated new reporting requirements for investment transactions with related parties. This agenda item added a new column to annual statement reporting schedules: B – Mortgage Loans, D – Long-Term Bonds, DB – Derivatives, BA – Other Long-Term Invested Assets, DA – Short-Term Investments, E2 – Cash Equivalents, and DL – Securities Lending Collateral Assets where the reporting entity must select a code that best describes the related party relationship within the investment.

Information or issues (included in *Description of Issue*) not previously contemplated by the Working Group:
None

Convergence with International Financial Reporting Standards (IFRS): None

Staff Recommendation: NAIC staff recommends that the Working Group move this item to the active listing, categorized as a SAP clarification, and expose revisions to SSAP No. 25 and SSAP No. 97 to incorporate language to exempt foreign open-end investment funds governed and authorized in accordance with regulations established by the applicable foreign jurisdiction from the look-through provisions included in SSAP No. 25.

Proposed edits to SSAP No. 25:

9. For entities not controlled by voting interests, such as limited partnerships, trusts and other special purpose entities, control may be held by a general partner, servicer, or by other arrangements. The ability of the reporting entity or its affiliates to direct the management and policies of an entity through such arrangements shall constitute control as defined in paragraph 6. Additionally, a reporting entity or its affiliates may have indirect control of other entities through such arrangements. For example, if a limited partnership were to be controlled by an affiliated general partner, and that limited partnership held greater than 10% of the voting interests of another company^{FN}, indirect control shall be presumed to exist unless the presumption of control can be overcome as detailed in paragraph 7. If direct or indirect control exists, whether through voting securities, contracts, common management or otherwise, the arrangement is considered affiliated under paragraph 5. Consistent with paragraph 8, a disclaimer of affiliation does not eliminate a “related party” distinction or disclosure requirements for material transactions pursuant to SSAP No. 25.

FN—Consistent with SSAP No. 97, footnote 1, investments in an exchange traded fund (ETF), ~~or~~ a mutual fund (as defined by the SEC) or a foreign open-end investment funds governed and authorized in accordance with regulations established by the applicable foreign jurisdiction does not reflect ownership in an underlying entity, regardless of the ownership percentage the reporting entity (or the holding company group) has of the ETF, ~~or~~ mutual fund or foreign open-end investment fund unless ownership of the ~~ETF fund~~ actually results in “control” with the power to direct or cause the direction of management of an underlying company. ETFs, ~~and~~ mutual funds and foreign open-end investment funds are comprised of portfolios of securities subject to the regulatory requirements of the federal securities laws or the applicable foreign jurisdictions laws.

Proposed edits to SSAP No. 97:

5. Control is defined as the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of the investee, whether through the (a) ownership of voting securities, (b) by contract other than a commercial contract for goods or nonmanagement services, (c) by common management, or (d) otherwise. Control shall be presumed to exist if a reporting entity and its

affiliates directly or indirectly, own, control, hold with the power to vote, or hold proxies representing 10% or more of the voting interests of the entity^{FN}.

FN—Investments in an exchange traded fund (ETF), ~~or~~ a mutual fund (as defined by the SEC) or a foreign open-end investment fund governed and authorized in accordance with regulations established by the applicable foreign jurisdiction does not reflect ownership in an underlying entity, regardless of the ownership percentage the reporting entity (or the holding company group) has of the ETF, ~~or~~ mutual fund or foreign open-end investment fund unless ownership of the ~~fund~~ETF actually results in “control” with the power to direct or cause the direction of management of an underlying company. ETFs, ~~and~~ mutual funds and foreign open-end investment funds are comprised of portfolios of securities subject to the regulatory requirements of the federal securities laws or the applicable foreign jurisdictions laws. ETFs, ~~and~~ mutual funds and foreign open-end investment funds held by a reporting entity shall be reported as common stock, unless the ~~fund~~ETF qualifies for bond or preferred stock treatment per the *Purposes and Procedures Manual of the NAIC Investment Analysis Office*. Reporting entities are not required to verify that SCAs (subject to SSAP No. 97) are represented in the portfolio of securities held in ETFs, ~~or~~ mutual funds or foreign open-end investment funds or to adjust the value of SCAs as a result of investments in ETFs, ~~or~~ mutual funds or foreign open-end investment funds.

Staff Review Completed by: Jake Stultz – NAIC Staff, July 2022

Status:

On August 10, 2022, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a SAP clarification, and exposed revisions to SSAP No. 25 and SSAP No. 97 to incorporate language to exempt foreign open-end investment funds governed and authorized in accordance with regulations established by the applicable foreign jurisdiction from the look-through provisions included in SSAP No. 25 and SSAP No. 97.

On December 13, 2022, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed revisions, as illustrated above, to SSAP No. 25 and SSAP No. 97. The revisions identify foreign open-end investment funds as a fund in which ownership percentage is not deemed to reflect control unless the entity actually controls with the power to direct management of the underlying company.

<https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/NationalMeetings/A.NationalMeetingMaterials/2022/Fall-December/Adoptions/22-13-RelatedPartyFootnoteRev.docx>

**Revisions to the
As of March 2023, Accounting Practices and Procedures Manual**

On **March 22, 2023**, the Statutory Accounting Principles (E) Working Group adopted the following revisions to the *As of March 2023 Accounting Practices and Procedures Manual*. Documents associated with these revisions are linked to the reference items in bold text.

Ref #	SSAP/ Appendix	Title	Summary
Issue Paper No. 167	SSAP No. 86	<i>Issue Paper No. 167, Derivatives and Hedging</i> <i>New SAP Concept</i> Effective Immediately	Adoption of <i>Issue Paper No. 167—Derivatives and Hedging</i> to detail the historical actions of the authoritative guidance resulting in new SAP concepts within <i>SSAP No. 86—Derivatives</i> . As the statutory accounting guidance has already been adopted, the issue paper adoption is for historical documentation and does not change authoritative guidance.
2022-15	SSAP No. 25	SSAP No. 25 – Affiliate Reporting Clarification <i>SAP Clarification</i> Effective Immediately (March 22, 2023)	Revisions clarify that any invested asset held by a reporting entity which is issued by an affiliated entity, or which includes the obligations of an affiliated entity, is an affiliated investment.
2022-16	SSAP No. 100R	<i>ASU 2022-03, Fair Value Measurement of Restricted Securities</i> <i>SAP Clarification</i> Effective Immediately (March 22, 2023)	Revisions adopt with modification the fair value measurement guidance from <i>ASU 2022-03, Fair Value Measurement of Restricted Securities</i> to incorporate updated guidance for restricted securities for statutory accounting. The disclosures from ASU 2022-03 were not adopted.
2022-17	SSAP No. 34	Interest Income Disclosure Update <i>SAP Clarification</i> Effective December 31, 2023	Revisions adopt additional disclosures in SSAP No. 34 to data capture the gross, nonadmitted and admitted amounts of interest income due and accrued, and to reflect the cumulative amount of paid-in-kind interest income included in the current principal balance.

Ref #	SSAP/ Appendix	Title	Summary
2022-18	SSAP No. 105R	<p><i>ASU 2022-04, Disclosure of Supplier Finance Program Obligations</i></p> <p><i>SAP Clarification</i></p> <p>Effective Immediately (March 22, 2023)</p>	Revisions reject <i>ASU 2022-04, Disclosure of Supplier Finance Program Obligations</i> for statutory accounting.
AG 49-A	Appendix C	<p><i>Actuarial Guideline XLIX-A—The Application of the Life Illustrations Model Regulation to Policies with Index-Based Interest Sold (On or After December 14, 2020)</i></p>	Revisions to AG 49-A were adopted by the Life Actuarial (A) Task Force on December 11, 2022; adopted by the Life Insurance and Annuities (A) Committee on February 24, 2023; adopted by the Executive (EX) Committee and Plenary on March 25, 2023.
AG 54	Appendix C	<p><i>Actuarial Guideline LIV—Nonforfeiture Requirements for Index-Linked Variable Annuity Products</i></p>	New AG 49-A was adopted by the Life Actuarial (A) Task Force on December 11, 2022; adopted by the Life Insurance and Annuities (A) Committee on February 24, 2023; adopted by the Executive (EX) Committee and Plenary on March 25, 2023.

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Statutory Issue Paper No. 167

Derivatives and Hedging

STATUS

Finalized March 22, 2023

Original SSAP and Current Authoritative Guidance: SSAP No. 86

Type of Issue:

Common Area

SUMMARY OF ISSUE

1. Statutory accounting guidance for derivatives is in *SSAP No. 86—Derivatives*. Although SSAP No. 86 indicates “adoption of the framework” of specific U.S. GAAP guidance, the accounting and reporting guidance for derivatives, particularly with regards to the four U.S. GAAP derivative cornerstones, is distinctly different between SSAP No. 86 and FAS 133/ASC 815. For example, under U.S. GAAP, assessment effectiveness under U.S. GAAP is largely an income statement management tool (to offset variations consistently through net income or other comprehensive income – OCI), but as SAP uses an amortized cost measurement method for a number of hedged items, the criteria for hedge effectiveness and the measurement approach for derivatives must be adjusted accordingly.

2. In August 2017, the FASB issued *ASU 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities* to improve the financial reporting of hedging relationships to better portray the economic results of an entity’s risk management activities in its financial statements. In addition, the amendments incorporated certain targeted improvements to simplify the application of the hedge accounting guidance in current U.S. GAAP. ASU 2017-12 included a new concept for a ‘last of layer’ approach to make portfolio fair value hedge accounting more accessible for specific assets. With the issuance of the last-of-layer guidance, a number of questions were received. After considering those questions, *ASU 2022-01 Fair Value Hedging – Portfolio Layer Method* was issued. This ASU expanded the original guidance and provided additional specifications and guidance.

3. The Statutory Accounting Principles (E) Working Group has considered several revisions to SSAP No. 86 in response to the review of ASU 2017-12 and ASU 2022-01. This issue paper has been drafted to detail the revisions incorporated into statutory accounting. These revisions, except for those initially adopted in 2018, are considered new SAP concepts.

DISCUSSION

Topic 1: Hedge Documentation and Initial Assessment Efficiencies (Agenda Item 2018-30)

4. The overall intent of ASU 2017-12 was to reduce cost and complexity of applying hedge accounting by simplifying the way assessments of hedge effectiveness may be performed. It was noted that the efficiencies gained from the revisions in the ASU for U.S. GAAP filers would be lost if corresponding provisions were not considered for statutory accounting. Pursuant to a July 9, 2018, interested parties’ comment letter, three elements were requested to be considered by the Statutory Accounting Principles (E) Working Group in a nonsubstantive (SAP clarification) proposal. Interested parties noted that these elements will reduce the costs associated with hedge accounting, while neither changing the underlying accounting, nor creating any additional regulatory risks or concerns:

- a. Allow companies to perform subsequent assessments of hedge effectiveness qualitatively if certain conditions are met.

- b. Allow companies more time to perform the quantitative hedge effectiveness assessment.
- c. Clarify that companies may apply the “critical terms match” method for a group of forecaster transactions if the transactions occur and the derivatives mature within the same 31-day period or fiscal month, and the other requirements for applying the critical match method are satisfied.

5. On August 4, 2018, the Working Group exposed revisions to incorporate hedge documentation and assessment efficiencies from ASU 2017-12. This item was exposed with a shortened comment period to allow for potential revisions and re-exposure if needed, to permit adoption and application prior to year-end 2018. On November 15, 2018, the Working Group adopted the exposed revisions as final. The revisions were adopted with an effective date of January 1, 2019, with early adoption permitted for year-end 2018. U.S. GAAP filers could only early adopt if they had also early adopted ASU 2017-12.

6. Additionally, in ASU 2017-12, in response to comments requesting a more flexible approach to hedging interest rate risk, the FASB decided to amend the guidance for hedging interest rate risk of financial instruments for both fair value and cash flow hedges. With the revisions, the FASB decided to redefine the term interest rate risk and eliminate the benchmark interest rate concept for variable-rate financial instruments. With the changes, the FASB incorporated the SIFMA rate in the list of eligible rates for fixed income instruments and noted that the FASB will add to the list of eligible benchmark rates as necessary. The revisions adopted to SSAP No. 86 are detailed in Exhibit A.

7. With the inclusion of revisions, certain elements from the U.S. GAAP guidance were not duplicated within statutory accounting. The elements were considered part of the prior adoption of the “FAS 133 / technical guidance” originally reflected in SSAP No. 86:

- a. Exceptions from the initial prospective quantitative assessment were not captured in the statutory guidance as they were not necessarily new under ASU 2017-12. The following overview details when an initial prospective quantitative assessment would not be required:
 - i. In a cash flow or fair value hedge, the entity applies the short-cut method.
 - ii. In a cash flow or fair value hedge, the entity determines that the critical terms of the hedging instrument and the hedged item match.
 - iii. In a cash flow hedge, the hedging instrument is an option and it meets specific criteria detailed in the U.S. GAAP guidance
 - iv. In a cash flow hedge, a private company that is not a financial institution applies the simplified hedge accounting approach.
 - v. In a cash flow hedge, the entity assesses hedge effectiveness under the change in variable cash flows method permitted under U.S. GAAP, with all noted conditions being met.
 - vi. In a cash flow hedge, the entity assesses hedge effectiveness under the hypothetical derivative method permitted under U.S. GAAP and all the critical terms of the hypothetical derivative and the hedging instrument are the same.
 - vii. In a net investment hedge, the entity assesses hedge effectiveness using a method based on changes in spot exchange rates, and the conditions noted under U.S. GAAP are met.

- viii. In a net investment hedge, the entity assesses hedge effectiveness using a method based on changes in forward exchange rates and the noted condition under U.S. GAAP are met.
- b. The short-cut method and critical terms match method are current method permitted under U.S. GAAP retained under ASU 2017-12. Under these methods, an entity may qualitatively assume, in very limited circumstances, that

8. Ultimately, the revisions incorporated in 2018, effective January 1, 2019, with early application permitted, from ASU 2017-12 were limited to specific provisions, and related transition guidance, pertaining to the documentation and assessment of hedge effectiveness: 1) provisions allowing more time to perform the initial qualitative hedge effectiveness assessment; 2) provisions allowing subsequent assessments of hedge effectiveness to be performed qualitatively if certain conditions are met; and 3) revisions regarding use of the critical terms and short-cut method for assessing hedge effectiveness. With the adoption of the limited provisions, it was identified that the remaining provisions of ASU 2017-12 would be subsequently assessed for statutory accounting and shall not be considered adopted for statutory accounting until that assessment is completed, with a conclusion to adopt the U.S. GAAP guidance.

9. The revisions adopted in November 2018 included revisions to both SSAP No. 86 as well as Exhibit B – Assessment of Hedging Effectiveness. The subsequent revisions adopted in 2022 eliminated Exhibit B as well as incorporated new guidance through the SSAP. Ultimately, the final adopted guidance, as reflected in the AP&P Manual, is the authoritative guidance.

Topic 2: Hedge Effectiveness and Measurement Methods for Excluded Components (Ref #2021-20)

10. In December 2011, consideration began on revisions to facilitate effective hedge assessments consistently between statutory accounting and U.S. GAAP. The Working Group exposed a concept agenda item to solicit comments and directed NAIC staff to work with regulators and industry in developing revisions for consistent hedge effectiveness assessments and with the treatment of excluded components.

11. After working with industry, on April 4, 2022, the Working Group exposed two documents for public comment. The first document proposed revisions in the form of a new exhibit A to SSAP No. 86, which would replace both Exhibit A and Exhibit B. This new exhibit A would adopt with modification U.S. Guidance in determining hedge effectiveness. The second document proposed revised guidance to SSAP No. 86 to update the permitted excluded components to mirror U.S. GAAP but establish statutory-specific measurement methods for the excluded components.

12. The new Exhibit A intends to reflect the position that the assessment of hedge effectiveness for derivatives should be consistent between U.S. GAAP and SAP. In other words, transactions identified to be highly effective hedges under U.S. would be identified as highly effective hedged under statutory accounting. If a hedging instrument results with offsetting changes (or other permitted aspects) to a hedged item pursuant to the guidelines under U.S. GAAP to qualify as a highly effective hedge, the same assessment as a highly effective hedge should occur under SAP.

13. The Exhibit A would adopt, with modification U.S. GAAP guidance pertaining to the criteria for initial and subsequent hedge effectiveness detailed in the FASB Accounting Standards Codification (ASC) paragraphs 815-20-25-72 through 815-20-35-20, as modified through the issuance of ASU 2017-12. Although the U.S. GAAP guidance for the assessment and determination of hedge effectiveness is proposed to be adopted, statutory modifications are captured to specify that the accounting and reporting of hedging instruments, including excluded components of the instruments, shall follow statutory specific guidance detailed in SSAP No. 86. The intent of this guidance is to clarify that the determination of whether a hedging instrument qualifies as an effective hedge shall converge with U.S. GAAP, but that the measurement method shall continue to follow statutory specific provisions. The adopt from U.S. GAAP only extends to

revisions incorporated through ASU 2017-12, as such, any subsequent U.S. GAAP edits would require statutory accounting consideration before they were considered adopted.

14. In addition to new Exhibit A to SSAP No. 86, the Working Group also exposed proposed revisions to SSAP No. 86, paragraphs 23, 40-41 and Exhibit C, to expand the list of permitted excluded components in assessing derivative effectiveness to match U.S. GAAP and to establish statutory specific measurement requirements for each type of excluded component.

15. The prior SSAP No. 86 guidance reflected the list of permitted excluded components originally adopted from U.S. GAAP. Since the original inclusion in SSAP No. 86, and within ASU 2017-12, U.S. GAAP had expanded the list, and it was noted that the statutory accounting treatment of excluded components related to foreign currency transactions were hindering the ability to engage in those transactions. It was also identified that current measurement guidance within the SSAP was conflicting between the guidance and specific hedge procedures detailed in Exhibit C. Through the discussions with industry, it was identified that different measurement or recognition provisions should be considered to properly reflect the type of excluded component with the financial statements, with specific guidance included in SSAP No. 86 accordingly:

- a. If the excluded component pertains to the difference between a foreign currency spot price and the forward or future price (e.g., a forward spot rate), then this premium/discount shall be amortized into income over the life of the contract or hedged program. (This guidance addresses the excluded component in Exhibit A, paragraph 8.d.)
- b. If the excluded component pertains to a foreign currency swap cross-currency basis spread, the impact of fair value changes shall be reflected as a component of the foreign currency swap's periodic interest accrual. (This guidance addresses the excluded component in Exhibit A, paragraph 8.e.)
- c. For all other excluded components, the excluded component shall be measured and reported at fair value, with changes in fair value recognized as unrealized gains or losses. (This guidance shall be applied to excluded components detailed in Exhibit A, paragraphs 8.a. through 8.c.)

16. On August 10, 2022, after the exposure timeframe, in which interested party comments were received supporting the proposed revisions, the Working Group adopted the exposed revisions. This adoption resulted with both the new Exhibit A that adopts with modification U.S. GAAP guidance in determining hedge effectiveness and the revisions to SSAP No. 86 to incorporate measurement method guidance for excluded components. These revisions were adopted with a January 1, 2023, effective date, with early adoption permitted. With the action to adopt, the Working Group directed a blanks proposal to incorporate Schedule DB reporting fields and templates to capture the new disclosures for excluded components. These disclosure and investment schedule changes will be in effect for year-end 2023. Companies that early adopt the revisions are directly to complete the required disclosures in a narrative format for year-end 2022.

Topic 3: Portfolio Layer Method and Partial Term Hedging (Ref #2022-09)

17. In August 2022, considerations began to expand statutory accounting guidance to incorporate the portfolio layer method detailed in *ASU 2022-01, Fair Value Hedging – Portfolio Layer Method*. The guidance in ASU 2022-01 reflects an expansion of the last-of-layer method detailed in ASU 2017-12.

18. Under the last-of-layer approach captured in ASU 2017-12, for a closed portfolio of prepayable financial assets or one or more beneficial interests secured by a portfolio of prepayable financial instruments, entities were allowed to hedge a stated amount of the asset or assets in the closed portfolio that

is anticipated to be outstanding for the designated hedged period. If the requirements for the last-of-layer method were met, prepayment risk is not incorporated into the measurement of the hedged item. With the application of this guidance, a number of questions were received. After considering those questions, FASB issued *ASU 2022-01, Fair Value Hedging – Portfolio Layer Method*, which expanded the guidance and provided additional specifications for application. Ultimately, for a closed portfolio of financial assets or one of more beneficial interests secured by a portfolio of financial instruments, an entity may designate as the hedged item or items a hedged layer or layers if the following criteria is met:

- a. As part of the initial hedge documentation, an analysis is completed and documented to support the entity's expectation that the hedged item or items (that is, the hedged layer or layers in aggregate) is anticipated to be outstanding for the designated hedge period. That analysis shall incorporate the entity's current expectations of prepayments, defaults, and other factors affecting the timing and amount of cash flows associated with the closed portfolio.
- b. For purposes of its analysis, the entity assumes that as prepayments, defaults, and other factors affecting the timing and amount of cash flows occur, they first will be applied to the portion of the closed portfolio that is not hedged.
- c. The entity applies the partial-term hedging guidance to the assets or beneficial interests used to support the entity's expectation. An asset that matures on a hedged layer's assumed maturity date meets this requirement.

19. Similar to concepts supporting the adoption of prior U.S. GAAP revisions, there is a general assessment that determination of effective hedges shall be consistent between statutory accounting and U.S. GAAP. As such, new SAP concepts revisions to reflect the portfolio layer method in establishing effective hedge dynamics was proposed to be consistent with U.S. GAAP. With the U.S. GAAP guidance limiting the application of this guidance to hedges of recognized financial assets, a consistent scope threshold was established for statutory accounting.

20. The review of the portfolio layer method identified that U.S. GAAP prevents basis adjustments directly to assets hedged in a portfolio and it was considered on whether statutory revisions would be necessary to address similar basis adjustment revisions under statutory accounting. However, after further assessments, it was identified that the fair value measurement method under U.S. GAAP, which results in ongoing basis adjustments from changes in fair value over the derivative term, would not be a prominent issue under statutory accounting, which predominantly uses an amortized cost approach for effective hedges. With the use of amortized cost, basis adjustments do not occur until hedge termination or at designation of the hedge, therefore this was identified as not a key statutory accounting impact.

21. In addition to considering guidance for the portfolio layer method, representatives from interested parties proposed to also capture concepts for partial term hedges from ASU 2017-12. (As detailed in the FASB criteria above in paragraph 18 for portfolio layer method hedges, application of a the partial-term hedging guidance is used to support the entity's expectation.) Prior review of partial term hedge concepts noted concern as how interim adjustments to hedged items, particularly for hedged liabilities, would be reflected in the financial statements. With the statutory accounting guidance to reflect derivative gains or losses as basis adjustments on the hedge item, if a hedge to a recognized liability resulted in a reduction to the presentation of the liability, this could misrepresent the financial statements as the liability itself had not been reduced. In considering these concerns and recognizing that a broader project would likely be needed to address these basis adjustments, representatives from industry recommended incorporated the U.S. GAAP guidance for partial term hedges, with a statutory modification to limit the application to hedges of recognized assets.

22. Although the proposal to limit partial term hedges to recognized assets is a modification from the overarching concept to mirror hedge effectiveness assessments between U.S. GAAP and SAP, it was identified as an approach that would be consistent with the U.S. GAAP scope application for the portfolio layer method and would reflect how industry currently uses partial term hedge transactions. As such, although the modification created a U.S. GAAP and SAP difference, the modification satisfies the current need for statutory guidance and prevents significant concerns on how the guidance could impact the presentation of liabilities. With this discussion, it was identified that subsequent consideration of the limitation to recognized assets could occur, with potential expansion to hedges of recognized liabilities as part of a broader discussion on how derivative gains and losses are recognized as basis adjustments.

23. The proposed revisions exposed to incorporate the portfolio layer method and the partial-term hedging method are summarized as follows:

- a. Revisions to SSAP No. 86, predominantly in paragraph 26.d., 26.f., and 26.g., to detail the ability to hedge recognized assets under the portfolio layer method and partial-term hedge. Also, revisions to paragraph 62 for a new disclosure for portfolio layer derivatives that no longer qualify for hedge accounting and the circumstances that led to the breach, as well as guidance in paragraphs 65.c. and 74.f. to detail relevant U.S. GAAP literature and the effective date.
- b. Revisions to SSAP No. 86 – Exhibit, Exhibit A – Assessment of Hedge Effectiveness, to add a new section on the assessment of portfolio layer method for hedge effectiveness. (Note – This exhibit was the new exhibit adopted in agenda item 2021-20 which replaced the prior Exhibit A and Exhibit B within SSAP No. 86.)
- c. Revisions to SSAP No. 86 – Exhibit C, paragraph 2.d., for which a portfolio layer method is discontinued to detail how the basis adjustment shall be allocated to the remaining individual assets in the closed portfolio. (Note – With the adoption of agenda item 2021-20, this Exhibit was renamed as Exhibit B.)

24. The proposed revisions reflect adoption of U.S. GAAP for the criteria for the portfolio layer method detailed in ASU 2022-01, criteria to only consider how changes in the benchmark interest rate affect the decision to settle the hedged item before its scheduled maturity date in ASC 815-20-25-6B, adding option in calculating the change in the hedged item's fair value attributed to changes in the benchmark interest rate based on the benchmark rate components of the contractual cash flows detailed in FASB ASC 815-25-35-13, and the partial-term hedging method detailed in FASB ASC 815-25-35-13B. The adoption of the partial term hedging method reflects statutory modifications that limits its use only when the hedged item is a recognized asset. This is different than U.S. GAAP, which permits the partial term method for hedged liabilities. The statutory limitation is established to prevent interim basis adjustments to hedged liabilities that could present a reduction of reported liabilities on the financial statements when the actual liability has not been reduced. Reconsideration of this statutory limitation may occur after a broader project to consider how derivative basis adjustments to hedged liabilities shall be reflected in the financial statements.

25. On December 13, 2022, the Working Group adopted the exposed revisions. This adoption resulted with the revisions identified in paragraph 23 above. These revisions were adopted with a January 1, 2023 effective date, with early adoption permitted. The revisions shall be applied prospectively to qualifying new hedges.

~~25-26.~~ An updated version of this Issue Paper was exposed on December 12, 2022, and adopted on March 22, 2023. The purpose of this Issue Paper is to document the historical actions resulting in new SAP concepts within SSAP No. 86—Derivatives. As issue papers are not represented in the statutory hierarchy, the adoption of this Issue Paper does not change the effective date of the previously adopted authoritative literature.

Exhibit 1 – Revisions adopted to SSAP No. 86 on November 15, 2018 (Agenda Item 2018-30)

38. At inception of the hedge, documentation must include:
- a. A formal documentation of the hedging relationship and the entity's risk management objective and strategy for undertaking the hedge, including identification of the hedging instrument, the hedged item, the nature of the risk being hedged, and how the hedging instrument's effectiveness in offsetting the exposure to changes in the hedged item's fair value or variability in cash flows attributable to the hedged risk will be assessed, including whether an entity will perform subsequent effectiveness assessments on a qualitative basis (per paragraph 42) and how it intends to carry out that qualitative assessment. There must be a reasonable basis for how the entity plans to assess the hedging instrument's effectiveness;
 - b. An entity's defined risk management strategy for a particular hedging relationship may exclude certain components of a specific hedging derivative's change in fair value, such as time value, from the assessment of hedge effectiveness, as discussed in paragraph 37 and Exhibit B;
 - c. Signature of approval, for each instrument, by person(s) authorized, either by the entity's board of directors or a committee authorized by the board, to approve such transactions; and
 - d. A description of the reporting entity's methodology used to verify that opening transactions do not exceed limitations promulgated by the state of domicile.

39. At inception, if an entity is required to perform an initial prospective assessment of hedge effectiveness on a quantitative basis (using information applicable as of the date of hedge inception^{FN}), the assessment is considered to be performed concurrently at hedge inception if it completed by the earliest of the following: (815-20-25-3)

- a. The first quarterly hedge effectiveness assessment date.
- b. The date that financial statements that include the hedged transaction are available to be issued.
- c. The date that the hedging instrument and hedged item no longer qualify for hedge accounting.
- d. The date of expiration, sale, termination or exercise of the hedging instrument.
- e. The date of dedesignation of the hedging relationship.
- f. For a cash flow hedge of a forecasted transaction, the date that the forecasted transaction occurs.

New Footnote – Entities are required to perform an initial prospective assessment unless qualifying for an exception in accordance with ASU 2017-12, paragraph 815-20-25-3.

40. For all derivatives terminated, expired, or exercised during the year:
- a. Signature of approval, for each instrument, by person(s) authorized, either by the entity's board of directors or a committee authorized by the board, to approve such transactions;

- b. A description, for each instrument, of the nature of the transaction, including:
 - i. The date of the transaction;
 - ii. A complete and accurate description of the specific derivative, including description of the underlying securities, currencies, rates, indices, commodities, derivatives, or other financial market instruments;
 - iii. Number of contracts or notional amount;
 - iv. Date of maturity, expiry or settlement;
 - v. Strike price, rate or index (termination price for futures contracts);
 - vi. Counterparty, or exchange on which the transaction was traded; and
 - vii. Consideration paid or received, if any, on termination.
 - c. Description of the reporting entity's methodology to verify that derivatives were effective hedges; and
 - d. Identification of any derivatives that ceased to be effective as hedges.
41. For derivatives open at quarter-end:
- a. A description of the methodology used to verify the continued effectiveness of hedges, [and whether the entity is using qualitative assessments pursuant to paragraph 42^{FN}](#);
 - b. An identification of any derivatives that have ceased to be effective as hedges;
 - c. A description of the reporting entity's methodology to determine fair values of derivatives;
 - d. Copy of Master Agreements, if any, where indicated on Schedule DB Part D.

[New Footnote: For purposes of this requirement, this statement adopts the guidance for effectiveness assessment after initial designation reflected in ASU 2017-12, including the concepts and restrictions for use of the short-cut method and the critical terms match method.](#)

42. [An entity may subsequently qualitatively assess hedge effectiveness, on a hedge-by-hedge basis, if both the conditions in paragraphs 42.a. and 42.b. were initially met. When an entity performs subsequent qualitative assessments of hedge effectiveness, it shall verify and document whenever financial statements or earnings are reported and at least every three months that the facts and circumstances related to the hedging relationship have not changed such that it can assert qualitatively that the hedging relationship was and continues to be highly effective. An entity may perform a quantitative assessment in any reporting period to validate whether qualitative assessments remain appropriate. When facts and circumstances change such that an entity no longer can assert qualitatively that the hedging relationship continue to be highly effective, then the entity shall begin performing quantitative assessments. \(815-20-35-2A, 2C and 2D abbreviated\)](#)

- a. [An entity performs an initial quantitative test of hedge effectiveness on a prospective basis \(that is, it is not assuming that the hedging relationship is perfectly effective at hedge inception\) and the results of that quantitative test demonstrate highly effective offset.](#)

- b. [At hedge inception, an entity can reasonably support an expectation of high effectiveness on a qualitative basis in subsequent periods.](#)

RELEVANT LITERATURE

~~60~~⁵⁹. This statement adopts the framework established by FAS 133, FASB Statement No. 137, Accounting for Derivative Instruments and Hedging Activities—Deferral of the Effective Date of FASB Statement No. 133, An amendment of FASB Statement No. 133 (FAS 137) and FASB Statement No. 138, Accounting for Certain Derivative Instruments and Certain Hedging Activities, An amendment of FASB Statement No. 133 (FAS 138), for fair value and cash flow hedges, including its technical guidance to the extent such guidance is consistent with the statutory accounting approach to derivatives utilized in this statement. This statement adopts the provisions of FAS 133 and 138 related to foreign currency hedges. With the exception of guidance specific to foreign currency hedges and amendments specific to refining the hedging of interest rate risk (under FAS 138, the risk of changes in the benchmark interest rate would be a hedged risk), this statement rejects FAS No. 137 and 138 as well as the various related Emerging Issues Task Force interpretations. This statement adopts paragraphs 4 and 25 of FASB Statement No. 149: Amendment of Statement 133 on Derivative Instruments and Hedging Activities (FAS 149) regarding the definition of an underlying and guidance for assessing hedge effectiveness. All other paragraphs in FAS 149 are rejected as not applicable for statutory accounting. This statement adopts FSP FAS 133-1 and FIN 45-5: Disclosures about Credit Derivatives and Certain Guarantees, An Amendment of FASB Statement No. 133 and FASB Interpretation No.45 and Clarification of the Effective Date of FASB Statement No. 161 (FSP FAS 133-1 and FIN 45-4) and requires disclosures by sellers of credit derivatives. This statement rejects FSP FIN 39-1, Amendments of FASB Interpretation No. 39, and ASU 2014-03, Derivatives and Hedging – Accounting for Certain Receive-Variable, Pay-Fixed Interest Rate Swaps – Simplified Hedge Accounting Approach.

[61 This statement adopts certain revisions to ASC 815-20 included in ASU 2017-12. This adoption is limited to specific provisions, and related transition guidance, pertaining to the documentation and assessment of hedge effectiveness and only includes: 1\) provisions allowing more time to perform the initial quantitative hedge effectiveness assessment; 2\) provisions allowing subsequent assessments of hedge effectiveness to be performed qualitatively if certain conditions are met; and 3\) revisions regarding use of the critical terms and short-cut methods for assessing hedge effectiveness. The remaining provisions of ASU 2017-12 will be subsequently assessed for statutory accounting and shall not be considered adopted for statutory accounting until that assessment is complete.](#)

~~62~~⁶⁰. This statement adopts with modification revisions to ASC 815 as reflected within ASU 2016-05, Effect of Derivative Contract Novations on Existing Hedge Accounting Relationships. This guidance is modified to require prospective application, as such it is only applicable to future counterparty changes in derivative instruments, and this guidance cannot be used to adjust derivative transactions previously terminated. This statement adopts revisions to ASC 815-20-25-15 as reflected within ASU 2010-08, Technical Corrections to Various Topics. This statement adopts revisions to ASC 815-10-50-4K as reflected within ASU 2010-11, Derivatives and Hedging (Topic 815), Scope Exception Related to Embedded Credit Derivatives, but rejects all other GAAP revisions from ASU 2010-11 and ASU 2014-16, Derivatives and Hedging, Determining Whether the Host Contract in a Hybrid Financial Instrument Issued in the Form of a Share is More Akin to Debt or to Equity and ASU 2016-06, Derivatives and Hedging, Contingent Put and Call Options in Debt Instruments. These GAAP revisions are rejected as embedded derivatives are not separated from the host contract and recognized as derivatives under SSAP No. 86. Revisions are also incorporated to SSAP No. 86 to require disclosures on embedded credit derivatives that expose the holder of a financial instrument to the possibility of being required to make future payments. This disclosure is a modification to the GAAP disclosures specific to statutory accounting as embedded credit derivatives are not separately recognized under statutory accounting. It should be noted that the conclusions reached in this statement are not intended to usurp the rules and regulations put forth by states in their respective investment laws. The contents of this statement are intended to provide accounting

guidance on the use of derivatives as allowed by an insurer's state of domicile. It is not intended to imply that insurers may use derivatives or cash instruments that the insurer's state of domicile does not allow under the state's insurance regulatory requirements, e.g., in replication transactions.

~~6364~~. This statement adopts revisions to ASC 815-20 as reflected within ASU 2013-10, Derivatives and Hedging, Inclusion of the Fed Funds Effective Swap Rate (or Overnight Index Swap Rate) as a benchmark interest rate for Hedge Accounting Purposes. These revisions define a benchmark interest rate, clarify what can be used in the U.S. for a benchmark interest rate, and eliminate the prior restriction on using different benchmark rates for similar hedges.

Effective Date and Transition

~~6765~~. This statement is effective for derivative transaction entered into or modified on or after January 1, 2003. A modification is any revision or change in contractual terms of the derivative. SSAP No. 31 applies to derivative transaction prior to January 1, 2003. Alternatively, an insurer may choose to apply this statement to all derivatives to which the insurer is a party as of January 1, 2003. In either case, the insurer is to disclose the transition approach that is being used. Revisions adopted to paragraph 59 to reject FSP FIN 39-1 is effective January 1, 2013, for companies that have previously reported a position in the balance sheet that was net of counterparty agreements. (Companies that have previously reported derivative instruments and/or related collateral gross shall not be impacted by these revisions.) Revisions adopted in paragraph 15 clarify the reporting for amounts received/paid to adjust variation margin until the derivative contract has ended and are effective January 1, 2018, on a prospective basis, for reporting entities that have previously considered these amounts to reflect settlement or realized gains/losses. (Companies that have previously reported variation margin changes in line with the revisions shall not be impacted by these revisions.) [Revisions to incorporate limited provisions from ASU 2017-12 pertaining to the documentation of hedge effectiveness \(detailed in paragraph 61\) are effective January 1, 2019, with early adoption permitted for year-end 2018. However, if the reporting entity is a U.S. GAAP filer, the reporting entity may only elect early adoption if the entity has also elected early adoption of ASU 2017-12 for year-end 2018.](#)

SSAP NO. 86 - EXHIBIT B – ASSESSMENT OF HEDGING EFFECTIVENESS

The following is based on paragraphs 62-70 of FAS 133 to offer additional guidance on assessing hedging effectiveness. The intent of such is to remain consistent with ~~FAS 133~~[U.S. GAAP](#) with respect to assessing hedge effectiveness, [including guidance in ASU 2017-12 that outlines when an entity may perform subsequent assessments of hedge effectiveness qualitatively.](#)

1. This statement requires that an entity define at the time it designates a hedging relationship the method it will use to assess the hedge's effectiveness in achieving offsetting changes in fair value or offsetting cash flows attributable to the risk being hedged. It also requires that an entity use that defined method consistently throughout the hedge period to assess at inception of the hedge and on an ongoing basis whether it expects the hedging relationship to be highly effective in achieving offset. If the entity identifies an improved method and wants to apply that method prospectively, it must discontinue the existing hedging relationship and designate the relationship anew using the improved method. Although this statement suggests a method for assessing whether a hedge is expected to be highly effective or measuring hedge ineffectiveness, the appropriateness of a given method of assessing hedge effectiveness can depend on the nature of the risk being hedged and the type of hedging instrument used. Ordinarily, however, an entity should assess effectiveness for similar hedges in a similar manner; use of different methods for similar hedges should be justified.

2. In defining how hedge effectiveness will be assessed, an entity must specify whether it will include in that assessment all of the gain or loss on a hedging instrument. As discussed in paragraph 33, this statement permits (but does not require) an entity to exclude all or a part of the hedging instrument's time value from the assessment of hedge effectiveness, as follows:

- a. If the effectiveness of a hedge with an option contract is assessed based on changes in the option's intrinsic value, the change in the time value of the contract would be excluded from the assessment of hedge effectiveness.
- b. If the effectiveness of a hedge with an option contract is assessed based on changes in the option's minimum value, that is, its intrinsic value plus the effect of discounting, the change in the volatility value of the contract would be excluded from the assessment of hedge effectiveness.
- c. If the effectiveness of a hedge with a forward or futures contract is assessed based on changes in fair value attributable to changes in spot prices, the change in the fair value of the contract related to the changes in the difference between the spot price and the forward or futures price would be excluded from the assessment of hedge effectiveness.

In each circumstance above, changes in the excluded component would be included in unrealized gains or losses. As noted in paragraph 1 of this Exhibit, the effectiveness of similar hedges generally should be assessed similarly; that includes whether a component of the gain or loss on a derivative is excluded in assessing effectiveness. No other components of a gain or loss on the designated hedging instrument may be excluded from the assessment of hedge effectiveness.

3. In assessing the effectiveness of a cash flow hedge, an entity generally will need to consider the time value of money if significant in the circumstances. Considering the effect of the time value of money is especially important if the hedging instrument involves periodic cash settlements. An example of a situation in which an entity likely would reflect the time value of money is a tailing strategy with futures contracts. When using a tailing strategy, an entity adjusts the size or contract amount of futures contracts used in a hedge so that earnings (or expense) from reinvestment (or funding) of daily settlement gains (or losses) on the futures do not distort the results of the hedge. To assess offset of expected cash flows when a tailing strategy has been used, an entity could reflect the time value of money, perhaps by comparing the present value of the hedged forecasted cash flow with the results of the hedging instrument.

4. ~~Whether a hedging relationship qualifies as highly effective sometimes will be easy to assess.~~ If the critical terms of the hedging instrument and of the ~~entire~~ hedged ~~item~~ asset or liability (as opposed to selected cash flows) or hedged forecasted transaction are the same, the entity could conclude that changes in fair value or cash flows attributable to the risk being hedged are expected to completely offset at inception and on an ongoing basis. For example, an entity may assume that a hedge of a forecasted purchase of a commodity with a forward contract will be ~~highly~~ perfectly effective if:

- a. The forward contract is for purchase of the same quantity of the same commodity at the same time and location as the hedged forecasted purchase.
- b. The fair value of the forward contract at inception is zero.
- c. Either the change in the discount or premium on the forward contract is excluded from the assessment of effectiveness and included directly in unrealized gains and losses pursuant to paragraph 22.B. or the change in expected cash flows on the forecasted transaction is based on the forward price for the commodity.

5. In a cash flow hedge of a group of forecasted transactions, an entity may assume that the timing in which the hedged transactions are expected to occur and the maturity date of the hedging instrument match in accordance with paragraph if those forecasted transactions occur and the derivative matures within the same 31-day period or fiscal month. (815-20-25-844)

~~56.~~ However, assessing hedge effectiveness can be more complex. For example, hedge effectiveness would be reduced by the following circumstances, among others:

- a. A difference between the basis of the hedging instrument and the hedged item or hedged transaction (such as a Deutsche mark-based hedging instrument and Dutch guilder-based hedged item), to the extent that those bases do not move in tandem
- b. Differences in critical terms of the hedging instrument and hedged item or hedged transaction, such as differences in notional amounts, maturities, quantity, location, or delivery dates.

Hedge effectiveness also would be reduced if part of the change in the fair value of a derivative is attributable to a change in the counterparty's creditworthiness.

[67](#). A hedge that meets the effectiveness test specified in paragraphs 19.b. and 20.b. (that is, both at inception and on an ongoing basis, the entity expects the hedge to be highly effective at achieving offsetting changes in fair values or cash flows) also must meet the other hedge accounting criteria to qualify for hedge accounting. If the hedge initially qualifies for hedge accounting, the entity would continue to assess whether the hedge meets the effectiveness test. If the hedge fails the effectiveness test at any time (that is, if the entity does not expect the hedge to be highly effective at achieving offsetting changes in fair values or cash flows), the hedge ceases to qualify for hedge accounting. The discussions of measuring hedge effectiveness in the examples in the remainder of this Exhibit assume that the hedge satisfied all of the criteria for hedge accounting at inception.

Exhibit 2 – Revisions adopted to SSAP No. 86 on August 10, 2021 (Agenda Item 2021-20)**Derivatives Used in Hedging Transactions**

22. Derivative instruments used in hedging transactions that meet the criteria of a highly effective hedge shall be considered an effective hedge and are permitted to be valued and reported in a manner that is consistent with the hedged asset or liability (referred to as hedge accounting). For instance, assume an entity has a financial instrument on which it is currently receiving income at a variable rate but wishes to receive income at a fixed rate and thus enters into a swap agreement to exchange the cash flows. If the transaction qualifies as an effective hedge and a financial instrument on a statutory basis is valued and reported at amortized cost, then the swap would also be valued and reported at amortized cost. Derivative instruments used in hedging transactions that do not meet or no longer meet the criteria of an effective hedge, or that meet the required criteria but the entity has chosen not to apply hedge accounting, shall be accounted for at fair value and the changes in the fair value shall be recorded as unrealized gains or unrealized losses (referred to as fair value accounting)¹.

23. Entities shall not bifurcate the effectiveness of derivatives. A derivative instrument is either classified as an effective hedge or an ineffective hedge. Entities must account for the derivative using fair value accounting if it is deemed to be ineffective or becomes ineffective. [Derivative instruments classified as effective with excluded components in determining hedge effectiveness pursuant to Exhibit A, paragraph 8, shall account for the derivative and excluded components pursuant to the guidance in paragraph 40.](#) Entities may redesignate a derivative in a hedging relationship even though the derivative was used in a previous hedging relationship that proved to be ineffective. A change in the counterparty to a derivative instrument that has been designated as the hedging instrument in an existing hedging relationship would not, in and of itself, be considered a termination of the derivative instrument. An entity shall prospectively discontinue hedge accounting for an existing hedge if any one of the following occurs:

- a. Any criterion in paragraphs 26-38 is no longer met;
- b. The derivative expires or is sold, terminated, or exercised (the effect is recorded as realized gains or losses or, for effective hedges of firm commitments or forecasted transactions, in a manner that is consistent with the hedged transaction – see paragraph 24);
- c. The entity removes the designation of the hedge; or
- d. The derivative is deemed to be impaired in accordance with paragraph 18. A permanent decline in a counterparty's credit quality/rating is one example of impairment required by paragraph 18, for derivatives used in hedging transactions.

Hedge Effectiveness

39. The measurement of hedge effectiveness for a particular hedging relationship shall be consistent with the entity's risk management strategy and the method of assessing hedge effectiveness that was documented at the inception of the hedging relationship, as discussed in paragraph 41.

40. The gain or loss on a derivative designated as a hedge and assessed to be effective is reported consistently with the hedged item. (Therefore, if the hedged item is reported at amortized cost, and the hedging instrument is consistent with that measurement method, fluctuations in fair value would not be recognized as unrealized gains or losses for either the hedging item or hedging instrument.) If an entity's defined risk management strategy for a particular hedging relationship excludes a specific component of the gain or loss, or related cash flows, on the hedging derivative from the assessment of hedge effectiveness

¹ Pursuant to paragraph 19, the gross reported value of a derivative and the determination of unrealized gains or losses shall exclude the impact of financing premiums. Premiums payable or receivable from the acquisition or writing of a derivative shall not be reflected in the gross reporting of derivatives or in determining the fair value change in a derivative.

(as discussed in Exhibit ~~BA~~, paragraph 8), specific accounting treatment shall be followed for the ~~that~~ excluded component: ~~of the gain or loss shall be recognized as an unrealized gain or loss. For example, if the effectiveness of a hedge with an option contract is assessed based on changes in the option's intrinsic value, the changes in the option's time value would be recognized in unrealized gains or losses. Time value is equal to the fair value of the option less its intrinsic value.~~

- a. If the excluded component pertains to the difference between a foreign currency spot price and the forward or future price (e.g., a forward spot rate), then this premium/discount shall be amortized into income over the life of the contract or hedged program. (This guidance addresses the excluded component in Exhibit A, paragraph 8.d.)
- b. If the excluded component pertains to a foreign currency swap cross-currency basis spread, the impact of fair value changes shall be reflected as a component of the foreign currency swap's periodic interest accrual. (This guidance addresses the excluded component in Exhibit A, paragraph 8.e.)
- c. For all other excluded components, the excluded component shall be measured and reported at fair value, with changes in fair value recognized as unrealized gains or losses. (This guidance shall be applied to excluded components detailed in Exhibit A, paragraphs 8.a.-8.c.)

41. Hedging instruments with excluded components shall be identified in the financial statement investment schedule (Schedule DB) and shall be disclosed pursuant to ~~paragraph 41.g.~~

Proposed New Disclosure Paragraph (This is proposed as a new paragraph 41.g. with reordering of subsequent paragraphs.)

- g. For hedging instruments with excluded components for determining hedge effectiveness:
 - i. In the investment schedule, identify hedging instruments with excluded components, and report the current fair value of the excluded component, the fair value of the excluded component that is reflected in the reported BACV for the hedging instrument (this item would not be applicable for foreign-currency forwards and currency swaps where the forward points or cross-currency basis, respectively, are the excluded component), and the change in fair value reported as an unrealized gains/loss. (Note – These items will be proposed in electronic columns to Schedule DB.)
 - ii. In the notes to the financial statements, provide information on the aggregate excluded components by category: Time Value, Intrinsic Value, Forward Points and Cross Currency Basis Spread. The aggregate amounts reported should include the following (as applicable): current fair value, recognized unrealized gain/loss, the fair value reflected in BACV, and for the excluded forward points (e.g., forward spot rates), the aggregate amount owed at maturity, along with current year and remaining amortization. (Note – These items will be captured in a blanks proposal/template.)

Relevant Literature

64. This statement adopts the framework established by FAS 133, *FASB Statement No. 137, Accounting for Derivative Instruments and Hedging Activities—Deferral of the Effective Date of FASB Statement No. 133, An amendment of FASB Statement No. 133* (FAS 137) and *FASB Statement No. 138, Accounting for Certain Derivative Instruments and Certain Hedging Activities, An amendment of FASB Statement No. 133* (FAS 138), for fair value and cash flow hedges, including its technical guidance to the

extent such guidance is consistent with the statutory accounting approach to derivatives utilized in this statement. This statement adopts the provisions of FAS 133 and 138 related to foreign currency hedges. With the exception of guidance specific to foreign currency hedges and amendments specific to refining the hedging of interest rate risk (under FAS 138, the risk of changes in the benchmark interest rate would be a hedged risk), this statement rejects FAS No. 137 and 138 as well as the various related Emerging Issues Task Force interpretations. This statement adopts paragraphs 4 and 25 of *FASB Statement No. 149: Amendment of Statement 133 on Derivative Instruments and Hedging Activities* (FAS 149) regarding the definition of an underlying and guidance for assessing hedge effectiveness. [\(The adoption from FAS 149 on the assessment of hedge effectiveness is impacted by the adoption with modification of guidance from ASU 2017-12 as detailed in paragraph 65.b., with the guidance from ASU 2017-12 superseding the prior adoption to the extent applicable.\)](#) All other paragraphs in FAS 149 are rejected as not applicable for statutory accounting. This statement adopts FSP FAS 133-1 and FIN 45-5: *Disclosures about Credit Derivatives and Certain Guarantees, An Amendment of FASB Statement No. 133 and FASB Interpretation No.45 and Clarification of the Effective Date of FASB Statement No. 161* (FSP FAS 133-1 and FIN 45-4) and requires disclosures by sellers of credit derivatives. This statement rejects *FSP FIN 39-1, Amendments of FASB Interpretation No. 39, and ASU 2014-03, Derivatives and Hedging – Accounting for Certain Receive-Variable, Pay-Fixed Interest Rate Swaps – Simplified Hedge Accounting Approach*.

65. This statement adopts, [with modification](#), certain revisions to ASC 815-20 included in ASU 2017-12. [Remaining provisions of ASU 2017-12 will be subsequently assessed for statutory accounting and shall not be considered adopted for statutory accounting until that assessment is complete.](#)

a. [Revisions effective January 1, 2019, with early adoption permitted, ~~This adoption is~~are limited to specific provisions, and related transition guidance, pertaining to the documentation and assessment of hedge effectiveness and only includes: 1\) provisions allowing more time to perform the initial quantitative hedge effectiveness assessment; 2\) provisions allowing subsequent assessments of hedge effectiveness to be performed qualitatively if certain conditions are met; and 3\) revisions regarding use of the critical terms and short-cut methods for assessing hedge effectiveness.](#)

b. [Revisions effective January 1, 2023, with early adoption permitted, are limited to the criteria for initial and subsequent hedge effectiveness detailed in the FASB Accounting Standards Codification \(ASC\) paragraphs 815-20-25-72 through 815-20-35-20, as modified through the issuance of ASU 2017-12. This adoption reflects statutory modifications to specify that the accounting and reporting of hedging instruments, including excluded components of the instruments, shall follow statutory specific guidance detailed in the statement. The intent of this guidance is to clarify that the determination of whether a hedging instrument qualifies as an effective hedge shall converge with U.S. GAAP, but that the measurement method shall continue to follow statutory specific provisions. The adoption of the referenced ASC paragraphs only extends to revisions incorporated through ASU 2017-12; therefore, any subsequent U.S. GAAP edits would require statutory accounting consideration before considered adopted.](#)

~~The remaining provisions of ASU 2017-12 will be subsequently assessed for statutory accounting and shall not be considered adopted for statutory accounting until that assessment is complete.~~

Effective Date and Transition

~~74.73~~ This statement is effective for derivative transaction entered into or modified on or after January 1, 2003. A modification is any revision or change in contractual terms of the derivative. SSAP No. 31 applies to derivative transaction prior to January 1, 2003. Alternatively, an insurer may choose to apply this statement to all derivatives to which the insurer is a party as of January 1, 2003. In either case, the insurer is to disclose the transition approach that is being used.

- a. Revisions adopted to paragraph 64 to reject FSP FIN 39-1 is effective January 1, 2013, for companies that have previously reported a position in the balance sheet that was net of counterparty agreements. (Companies that have previously reported derivative instruments and/or related collateral gross shall not be impacted by these revisions.)
- b. Revisions adopted in paragraph 16 clarify the reporting for amounts received/paid to adjust variation margin until the derivative contract has ended and are effective January 1, 2018, on a prospective basis, for reporting entities that have previously considered these amounts to reflect settlement or realized gains/losses. (Companies that have previously reported variation margin changes in line with the revisions shall not be impacted by these revisions.)
- c. Revisions to incorporate limited provisions from ASU 2017-12 pertaining to the documentation of hedge effectiveness (detailed in paragraph 65) are effective January 1, 2019, with early adoption permitted for year-end 2018. However, if the reporting entity is a U.S. GAAP filer, the reporting entity may only elect early adoption if the entity has also elected early adoption of ASU 2017-12 for year-end 2018.
- d. Revisions adopted April 2019 to explicitly include structured notes in scope of this statement are effective December 31, 2019. Revisions adopted July 2020 to define “derivative premium,” require gross reporting of derivatives without the impact of financing premiums and require separate recognition of premiums payable and premiums receivable, are effective January 1, 2021.
- e. Revisions adopted August 2022 that adopt with modification the criteria for initial and subsequent hedge effectiveness detailed in the FASB ASC paragraphs 815-20-25-72 through 815-20-35-20, as modified through the issuance of ASU 2017-12 and that incorporate statutory accounting revisions for the accounting and reporting of excluded components are effective January 1, 2023, with early adoption permitted. These revisions shall be applied prospectively for all new and existing hedges. Entities shall detail the adoption of this guidance as a change in accounting principle pursuant to SSAP No. 3—Accounting Changes and Corrections of Errors

With the adoption of the new Exhibit A as detailed in the subsequent section, Exhibit C will be renamed Exhibit B. Due to the details of Exhibit A (including the FASB ASC paragraphs not duplicated in the SSAP), the following Exhibit B section is included before the new Exhibit A in this issue paper for ease of readability.

EXHIBIT ~~C~~B— SPECIFIC HEDGE ACCOUNTING PROCEDURES FOR DERIVATIVES

Specific hedge accounting procedures for derivative instruments are outlined below.

1. Call and Put Options, Warrants, Caps, and Floors:
 - a. Accounting at Date of Acquisition (purchase) or Issuance (written): The premium paid or received for purchasing or writing a call option, put option, warrant, cap or floor shall either be (i) recorded as an asset (purchase) or liability (written) on the Derivative line on the Assets (or) Liabilities pages or (ii) combined with the hedged item(s) individually or in the aggregate;
 - b. Statement Value:
 - i. Open derivatives hedging items recorded at amortized cost:

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- (a) Options, warrants, caps, and floors purchased or written shall be valued at amortized cost in a manner consistent with the hedged item. (Components of a hedging instrument excluded from the determination of hedge effectiveness shall be recognized at fair value, with changes in fair value recognized as unrealized gains/losses throughout the duration of the hedging instrument. These components are not captured within the guidance for effective hedges detailed within this section.);
 - (b) The amortization period and methods used shall result in a constant effective yield over the life of the hedged item or program. (For floating rate hedged items, the estimated effective yield shall be based on the current rate so the changes in yields attributable to changes in interest rates will be recognized in the period of change). Specific treatment includes:
 - (1) Holdings in derivatives purchased or written within a year of maturity or expiry need not be amortized;
 - (2) For hedges of forecasted transactions or firm commitments, the derivative may be recorded at cost until the hedged transaction occurs or it is determined that the hedge was not effective (see (d) in this section 1.b.i.);
 - (3) For other derivatives, the amortization period is usually from date of acquisition (issuance) of the derivative to maturity of the hedged item or program.
 - (c) For hedges where the cost of the derivative is combined with the hedged item, the statement value is zero. The fair value of the derivative and hedged item shall be determined and reported separately, either individually or in the aggregate;
 - (d) For hedges of forecasted transactions or firm commitments, the derivative shall be recorded at cost until (1) the hedged transaction occurs or (2) it is determined that the hedge was not effective (when the derivative is valued in accordance with (e) in this section);
 - (e) If during the life of the derivative it or a designated portion of the derivative is no longer effective as a hedge, valuation at amortized cost ceases and the derivative or the designated portion of the derivative shall be valued at its current fair value with gains and losses recognized in unrealized gains or unrealized losses to the extent it ceased to be an effective hedge.
- d. Gain/Loss on Termination of an option, warrant, cap or floor accounted for under hedge accounting (includes closing, exercise, maturity, and expiry):
- i. Exercise of an Option: The remaining book value of the derivative shall become an adjustment to the cost or proceeds of the hedged item(s) received or disposed of individually or in aggregate;
 - ii. Sale, maturity, expiry, or other closing transaction of a derivative which is an effective hedge—Any gain or loss on the transaction, except for excluded components, will adjust the basis (or proceeds) of the hedged item(s) individually or in aggregate. Alternatively, if the item being hedged is subject to IMR, the gain

or loss on the terminated hedging derivative may be realized and shall be subject to IMR upon termination. For hedging instruments with excluded components in determining hedge effectiveness, the unrealized gain/loss from the change in fair value of the excluded component shall be realized upon the closing transaction. This gain/loss shall not be used to adjust the basis or proceeds of the hedged item.;

- iii. Gain/loss on termination of derivatives will be recognized currently in net income (realized gain/loss) to the extent they ceased to be effective hedges.
- iv. Upon the redesignation of a derivative from a currently effective hedging relationship:
 - (a) with an item(s) carried at amortized cost to another effective hedging relationship with an item(s) carried at amortized cost, the derivative shall continue to be recorded at amortized cost and no gain or loss on the derivative shall be recognized.
 - (b) with an item(s) carried at amortized cost or fair value to an effective relationship with an item(s) carried at fair value, the accounting for the derivative shall be consistent with (ii) above.
 - (c) with an item(s) carried at fair value to an effective relationship with an item(s) carried at amortized cost, the accounting for the derivative shall be consistent with (ii) above.

2. Swaps, Collars, and Forwards (see also discussion in Introduction above):

a. Accounting at Date of Opening Position:

- i. Any premium paid or received at date of opening shall either be (a) recorded on the Derivative line on the Assets (or) Liabilities pages or (b) combined with the hedged item(s), individually or in the aggregate;

b. Statement Value:

- i. Open derivatives hedging items recorded at amortized cost:
 - (a) Swaps, collars, and forwards shall be valued at amortized cost in a manner consistent with hedged item. (Components of a hedging instrument excluded from the determination of hedge effectiveness not addressed in 2.b.iii. shall be recognized at fair value, with changes in fair value of the excluded component recognized as unrealized gains/losses throughout the duration of the hedging instrument. These components are not captured within the guidance for effective hedges detailed within this section.);
 - (b) The amortization period and methods used shall result in a constant effective yield over the life of the hedged item or program. (For floating rate hedged items the estimated effective yield shall be based on the current rate so the changes in yields attributable to changes in interest rates will be recognized in the period of change.) Specific treatment includes:
 - (1) Holdings in derivatives purchased or written within a year of maturity or expiry need not be amortized;

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- (2) For hedges of forecasted transactions or firm commitments, the derivative shall be recorded at cost until (a) the hedged transaction occurs or (b) it is determined that the hedge was not effective (see (5) in this section 2.b.i.);
 - (3) For other derivatives the amortization period is usually from date of acquisition (issuance) of the derivative to maturity of the hedged item or program;
 - (4) For hedges where the cost of the derivative is combined with the hedged item, the statement value is zero. The fair value of the derivative and hedged item shall be determined and reported separately, either individually or in the aggregate;
 - (5) If during the life of the derivative it or a designated portion of the derivative is no longer effective as a hedge, valuation at amortized cost ceases and the derivative or a designated portion of the derivative shall be valued at its current fair value with gains and losses recorded in unrealized gains or unrealized losses to the extent that it ceased to be an effective hedge. Upon redesignation into an effective hedging relationship, the derivative's mark to fair value through unrealized gain or loss shall be reversed.
- ii. Open derivatives hedging items recorded at fair value (where gains and losses on the hedged item are recognized as adjustments to unassigned funds (surplus):
- (a) Swaps, collars, or forwards shall be valued at current fair value with changes in fair value recognized currently consistent with the hedged item; this will result in unrealized gain/loss treatment with adjustment to unassigned funds (surplus);
 - (b) For hedges where the derivative is combined with the hedged item, the fair value of the derivative and hedge item shall be determined and reported separately, either individually or in the aggregate. The cost (book value) basis used to figure gain/loss on the derivative is zero.
- iii. Open foreign currency swap and forward contracts hedging foreign currency exposure on items denominated in a foreign currency and translated into U.S. dollars where fair value accounting is not being used:
- (a) ~~The foreign exchange premium (discount) on the currency contract shall be amortized into income over the life of the contract or hedge program.~~ The foreign exchange premium (discount) is defined as the foreign currency (notional) amount to be received (paid) times the net of the forward rate minus the spot rate at the time the contract was opened. For forward contracts, an excluded component representing a foreign exchange premium (discount) (forward points) on the currency contract shall be amortized into income over the life of the contract or hedge program. Amortization is not required if the contract was entered into within a year of maturity. For foreign currency swaps, an excluded component representing a cross-currency basis spread, is recognized into income through the foreign currency swap's periodic interest accruals.

~~Amortization is not required if the contract was entered into within a year of maturity;~~

- (b) A foreign currency translation adjustment shall be reflected as an unrealized gain/loss (unassigned funds (surplus) adjustment) using the same procedures as done to translate the hedged item;
- (c) The unrealized gain/loss for the period equals the foreign currency (notional) amount to be received (paid) times the net of the current spot rate minus the prior period end spot rate;
- (d) The statement value of the derivative equals the amortized cost plus:
 - 1. For forward contracts, the amortized (premium) discount plus the cumulative unrealized gain/(loss) on the contract.
 - 2. For foreign currency swaps, ~~T~~the cumulative unrealized gain/(loss) on the contract. The cross-currency basis spread is recorded through the Investment Income Due and Accrued or Other Liabilities, as a component of the foreign currency swap's periodic interest accrual.

The cumulative unrealized gain/loss equals the foreign currency (notional) amount to be received (paid) times the net of the current spot rate minus the spot rate at the time the contract was opened;

- (e) Recognition of unrealized gains/losses and amortization of foreign exchange premium/discount on derivatives hedging forecasted transactions or firm commitments shall be deferred until the hedged transaction occurs. These deferred gains/losses will adjust the basis or proceeds of the hedged transaction when it occurs;
- (f) For hedges where the cost of the foreign currency contract is combined with the hedged item, the statement value on Schedule DB is zero. The fair value of the derivative and hedged item shall be determined and reported separately, either individually or in the aggregate;
- (g) ~~If during the life of the currency contract it or a designated portion of the currency contract is not effective as a hedge,~~ The derivative shall be recorded at fair value and valuation at amortized cost shall cease. To the extent it ceased to be an effective hedge, a cumulative unrealized gain/loss (surplus adjustment) ~~will~~ shall be recognized equal to the difference between the carrying value of the derivative on the balance sheet and the fair value of the derivative if either of the following occur:
 - 1. During the life of the currency contract it or a designated portion of the currency contract is not effective as a hedge.
 - 2. The entity decides to terminate the derivative in advance of scheduled maturity.

~~notional amount or designated notional amount times the difference between the forward rate available for the remaining maturity of the~~

~~contract (i.e., the forward rate as of the balance sheet date) and the forward rate at the time it ceased to be an effective hedge.~~

- iv. Open derivatives hedging items recorded at fair value, where gains and losses on the hedged item are recognized currently in earnings: swaps, collars and forwards shall be valued at current fair value with changes in fair value recognized currently in earnings together with the gains and losses on the hedged item.
 - (a) If during the life of the derivative it or a designated portion of the derivative is no longer effective as a hedge, recognition of changes in fair value through earnings ceases. The derivative shall continue to be valued at its current fair value, but thereafter gains or losses shall be recognized in unrealized gains or unrealized losses to the extent it ceased to be an effective hedge.
- c. Cash Flows and Income:
 - i. Where the cost of the derivative is not combined with the hedged item:
 - (a) Amortization of premium paid or received on derivatives is an adjustment to net investment income or another appropriate caption within operating income consistent with the reporting of the hedged item;
 - (b) Periodic cash flows and accruals of income/expense are to be reported in a manner consistent with the hedged item, usually as net investment income or another appropriate caption within operating income.
 - ii. Where the cost of the derivative is combined with the hedged item, the cash flows and income of the derivative on Schedule DB is zero. All related amortization and cash flow accounting shall be reported with the hedged item instead of with the derivative.
- d. Gain/Loss on Termination of a swap, collar or forward accounted for under hedge accounting (includes closing, exercise, maturity, and expiry):
 - i. Exercise—The remaining book value of the derivative shall become an adjustment to the cost or proceeds of the hedged item(s) received or disposed of individually or in aggregate;
 - ii. Sale, maturity, expiry, or other closing transaction of a derivative which is an effective hedge—Any gain or loss on the transaction, except for excluded components, will adjust the basis (or proceeds) of the hedged item(s) individually or in aggregate. Alternatively, if the item being hedged is subject to IMR, the gain or loss on the terminated hedging derivative may be realized and shall be subject to IMR upon termination.‡
 - iii. Gain/loss on termination of derivatives will be recognized currently in net income (realized gain/loss) to the extent they ceased to be effective hedges.
 - iv. Upon the redesignation of a derivative from a currently effective hedging relationship-
 - (a) with an item(s) carried at amortized cost to another effective hedging relationship with an item(s) carried at amortized cost, the derivative shall

continue to be recorded at amortized cost and no gain or loss on the derivative shall be recognized.

- (b) with an item(s) carried at amortized cost or fair value to an effective relationship with an item(s) carried at fair value, the accounting for the derivative shall be consistent with (ii) above.
- (c) with an item(s) carried at fair value to an effective relationship with an item(s) carried at amortized cost, the accounting for the derivative shall be consistent with (ii) above.

The following new Exhibit A replaces both Exhibit A and Exhibit B within the existing SSAP No. 86. This is new guidance within SSAP No. 86, and the tracked changes shown in the section below reflect the modifications from U.S. GAAP. References to the FASB ASC are included in this issue paper for historical reference and will not be duplicated within the SSAP.

EXHIBIT A – DISCUSSION OF HEDGE EFFECTIVENESS

The guidance within this exhibit reflects the adoption, with modification, of *FASB Accounting Standards Codification (ASC) 815-20-25-72 through 815-20-35-20*, as revised through the issuance of *ASU 2017-12: Derivatives and Hedging: Targeted Improvements to Accounting for Hedging Activities* (ASU 2017-12) (issued on August 28, 2017). This adoption captures the U.S. GAAP guidance for the assessment and determination of hedge effectiveness, with modification to require the accounting and reporting of hedging instruments, including excluded components of hedging instruments to follow specific statutory accounting guidance in SSAP No. 86. The intent of this guidance is to clarify that the determination of whether a hedging instrument and derivative transaction qualifies as an effective hedge shall converge with U.S. GAAP, but that the measurement and reporting of effective hedge transactions shall follow statutory specific provisions. The adoption only extends to revisions incorporated to the FASB ASC through ASU 2017-12, therefore any subsequent U.S. GAAP edits to the ASC would require statutory accounting adoption before application. The guidance within this Exhibit reflects excerpts from the U.S. GAAP ASC, but do not reflect the full U.S. GAAP guidance referenced in the adopted language. The exclusion of cited guidance is to manage the extent of detail included within SSAP No. 86. Excerpts not duplicated within from the cited U.S. GAAP guidance are considered adopted unless subject to the specific accounting and reporting statutory exclusion. This Exhibit intends to supplement the guidance in SSAP No. 86 on hedge effectiveness. In any event in which this Exhibit could be interpreted as conflicting with the SSAP No. 86 guidance, the guidance in the body of SSAP No. 86 shall be followed.

Hedge Effectiveness Criteria Applicable to Both Fair Value Hedges and Cash Flow Hedges

1. This guidance addresses hedge effectiveness criteria applicable to both fair value hedges and cash flow hedges. (815-20-25-74)
2. To qualify for hedge accounting, the hedging relationship, both at inception of the hedge and on an ongoing basis, shall be expected to be highly effective in achieving either of the following: (815-20-25-75)
 - a. Offsetting changes in fair value attributable to the hedged risk during the period that the hedge is designated (if a fair value hedge)
 - b. Offsetting cash flows attributable to the hedged risk during the term of the hedge (if a cash flow hedge), unless the hedging instrument is used to modify the contractually specified interest receipts or payments associated with a recognized financial asset liability from one variable rate to another variable rate. ~~except as indicated in paragraph 815-20-25-50~~

3. If the hedging instrument (such as an at-the-money option contract) provides only one-sided offset of the hedged risk, either of the following conditions shall be met: (815-20-25-76)
- a. The increases (or decreases) in the fair value of the hedging instrument are expected to be highly effective in offsetting the decreases (or increases) in the fair value of the hedged item (if a fair value hedge).
 - b. The cash inflows (outflows) from the hedging instrument are expected to be highly effective in offsetting the corresponding change in the cash outflows or inflows of the hedged transaction (if a cash flow hedge).
4. There would be a mismatch between the change in fair value or cash flows of the hedging instrument and the change in fair value or cash flows of the hedged item or hedged transaction in any of the following circumstances, among others: (815-20-25-77)
- a. A difference between the basis of the hedging instrument and the hedged item or hedged transaction, to the extent that those bases do not move in tandem
 - b. Differences in critical terms of the hedging instrument and hedged item or hedged transaction, such as differences in any of the following:
 - i. Notional amounts
 - ii. Maturities
 - iii. Quantity
 - iv. Location (not applicable for hedging relationships in which the variability in cash flows attributable to changes in a contractually specified component is designated as the hedged risk)
 - v. Delivery Dates
5. An entity shall consider hedge effectiveness in two different ways—in prospective considerations and in retrospective evaluations: (815-20-25-79)
- a. Prospective considerations. The entity's expectation that the relationship will be highly effective over future periods in achieving offsetting changes in fair value or cash flows, which is forward looking, must be assessed on a quantitative basis at hedge inception unless one of the exceptions [detailed in ASU 2017-12](#), paragraph 815-20-25-3(b)(2)(iv)(01)² is met. Prospective assessments shall be subsequently performed whenever financial statements or earnings are reported and at least every three months. The entity shall elect at hedge inception ~~in accordance with paragraph 815-20-25-3(b)(2)(iv)(03)~~ whether to perform subsequent [retrospective and prospective hedge effectiveness](#) assessments on a quantitative or qualitative basis. ~~See paragraphs 815-20-35-2A through 35-2F for additional guidance on qualitative assessments of hedge effectiveness.~~ A quantitative assessment can be based on regression or other statistical analysis of past changes in fair values or cash flows as well as on other relevant information. The quantitative prospective assessment of hedge effectiveness shall consider all reasonably possible changes in fair value (if a fair value hedge) or in fair value or cash flows (if a cash flow hedge) of the derivative instrument and the hedged items for the period used to assess whether the

² Reference to this ASU 2017-12 guidance is consistent with the guidance in SSAP No. 86, paragraph 42, footnote 5.

requirement for expectation of highly effective offset is satisfied. The quantitative prospective assessment may not be limited only to the likely or expected changes in fair value (if a fair value hedge) or in fair value or cash flows (if a cash flow hedge) of the derivative instrument or the hedged items. Generally, the process of formulating an expectation regarding the effectiveness of a proposed hedging relationship involves a probability-weighted analysis of the possible changes in fair value (if a fair value hedge) or in fair value or cash flows (if a cash flow hedge) of the derivative instrument and the hedged items for the hedge period. Therefore, a probable future change in fair value will be more heavily weighted than a reasonably possible future change. ~~That calculation technique is consistent with the definition of the term expected cash flow in FASB Concepts Statement No. 7, Using Cash Flow Information and Present Value in Accounting Measurements.~~

- b. Retrospective evaluations. An assessment of effectiveness may be performed on a quantitative or qualitative basis on the basis of the entity's election at hedge inception ~~in accordance with paragraph 815-20-25-3(b)(2)(iv)(03).~~ That assessment shall be performed whenever financial statements or earnings are reported, and at least every three months. ~~See paragraphs 815-20-35-2 through 35-4 for further guidance.~~ At inception of the hedge, an entity electing a dollar-offset approach to perform retrospective evaluations on a quantitative basis may choose either a period-by-period approach or a cumulative approach in designating how effectiveness of a fair value hedge or of a cash flow hedge will be assessed retrospectively under that approach, depending on the nature of the hedge initially documented in accordance with paragraph 815-20-25-3. ~~For example, an entity may decide that the cumulative approach is generally preferred, yet may wish to use the period-by-period approach in certain circumstances. See paragraphs 815-20-35-5 through 35-6 for further guidance.~~

(ASC paragraph 815-20-25-79A not included in Exhibit A.)

6. All assessments of effectiveness shall be consistent with the originally documented risk management strategy for that particular hedging relationship. An entity shall use the quantitative effectiveness assessment method defined at hedge inception consistently for the periods that the entity either elects or is required to assess hedge effectiveness on a quantitative basis. *(815-20-25-80)*

7. This Subtopic guidance does not specify a single method for assessing whether a hedge is expected to be highly effective. The method of assessing effectiveness shall be reasonable. The appropriateness of a given method of assessing hedge effectiveness depends on the nature of the risk being hedged and the type of hedging instrument used. Ordinarily, an entity shall assess effectiveness for similar hedges in a similar manner, including whether a component of the gain or loss on a derivative instrument is excluded in assessing effectiveness for similar hedges. Use of different methods for similar hedges shall be justified. The mechanics of isolating the change in time value of an option discussed beginning in paragraph 13 815-20-25-98 also shall be applied consistently. *(815-20-25-81)*

8. In defining how hedge effectiveness will be assessed, an entity shall specify whether it will include in that assessment all of the gain or loss on a hedging instrument. An entity may exclude all or a part of the hedging instrument's time value from the assessment of hedge effectiveness, as follows: *(815-20-25-82)*

- a. If the effectiveness of a hedge with an option is assessed based on changes in the option's intrinsic value, the change in the time value of the option would be excluded from the assessment of hedge effectiveness.

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- b. If the effectiveness of a hedge with an option is assessed based on changes in the option's minimum value, that is, its intrinsic value plus the effect of discounting, the change in the volatility value of the contract shall be excluded from the assessment of hedge effectiveness.
- c. An entity may exclude any of the following components of the change in an option's time value from the assessment of hedge effectiveness:
 - i. The portion of the change in time value attributable to the passage of time (theta)
 - ii. The portion of the change in time value attributable to changes due to volatility (vega)
 - iii. The portion of the change in time value attributable to changes due to interest rates (rho).
- d. If the effectiveness of a hedge with a forward contract or futures contract is assessed based on changes in fair value attributable to changes in spot prices, the change in the fair value of the contract related to the changes in the difference between the spot price and the forward or futures price shall be excluded from the assessment of hedge effectiveness.
- e. An entity may exclude the portion of the change in fair value of a currency swap attributable to a cross-currency basis spread.

9. No other components of a gain or loss on the designated hedging instrument shall be excluded from the assessment of hedge effectiveness nor shall an entity exclude any aspect of a change in an option's value from the assessment of hedge effectiveness that is not one of the permissible components of the change in an option's time value. For example, an entity shall not exclude from the assessment of hedge effectiveness the portion of the change in time value attributable to changes in other market variables (that is, other than rho and vega). (815-20-25-83)

Note – The following ASC Paragraphs 815-20-25-83A and 83B are not adopted within SSAP No. 86 as they address measurement and recognition. Measurement and recognition guidance shall follow the provisions detailed in SSAP No. 86.

For fair value and cash flow hedges, the initial value of the component excluded from the assessment of effectiveness shall be recognized in earnings using a systematic and rational method over the life of the hedging instrument. Any difference between the change in fair value of the excluded component and amounts recognized in earnings under that systematic and rational method shall be recognized in other comprehensive income. Example 31 beginning in paragraph 815-20-55-235 illustrates this approach for a cash flow hedge in which the hedging instrument is an option and the entire time value is excluded from the assessment of effectiveness. (815-20-25-83A)

For fair value and cash flow hedges, an entity alternatively may elect to record changes in the fair value of the excluded component currently in earnings. This election shall be applied consistently to similar hedges in accordance with paragraph 815-20-25-81 and shall be disclosed in accordance with paragraph 815-10-50-4EEEE. (815-20-25-83B)

10. If the critical terms of the hedging instrument and of the hedged item or hedged forecasted transaction are the same, the entity could conclude that changes in fair value or cash flows attributable to the risk being hedged are expected to completely offset at inception and on an ongoing basis. For example, an entity may assume that a hedge of a forecasted purchase of a commodity with a forward contract will be perfectly effective if all of the following criteria are met:

- a. The forward contract is for purchase of the same quantity of the same commodity at the same time and location as the hedged forecasted purchase. Location differences do not need to be considered if an entity designates the variability in cash flows attributable to changes in a contractually specified component as the hedged risk and the requirements in paragraphs 815-20-25-22A through 25-22B of the FASB Codification are met. (815-20-25-84)
- b. The fair value of the forward contract at inception is zero.
- c. Either of the following criteria is met:
 - i. The change in the discount or premium on the forward contract is excluded from the assessment of effectiveness pursuant to paragraphs 7-9~~815-20-25-81 through 25-83~~.
 - ii. The change in expected cash flows on the forecasted transaction is based on the forward price for the commodity.

11. In a cash flow hedge of a group of forecasted transactions in accordance with paragraph 28.a. of the SSAP guidance~~815-20-25-15(a)(2)~~, an entity may assume that the timing in which the hedged transactions are expected to occur and the maturity date of the hedging instrument match in accordance with paragraph 10.a. ~~815-20-25-84(a)~~ if those forecasted transactions occur and the derivative matures within the same 31-day period or fiscal month. (815-20-25-84A)

12. If all of the criteria in paragraphs 10-11 ~~815-20-25-84 through 25-84A~~ are met, an entity shall still perform and document an assessment of hedge effectiveness at the inception of the hedging relationship and, ~~as discussed beginning in paragraph 815-20-35-9~~, on an ongoing basis throughout the hedge period. No quantitative effectiveness assessment is required at hedge inception if the criteria in paragraphs 10-11 ~~815-20-25-84 through 25-84A~~ are met ~~(see paragraph 815-20-25-3(b)(2)(iv)(01))~~. (815-20-25-85)

(ASC paragraphs 815-20-25-86 to 815-20-25-97 not included in Exhibit A.)

Computing Changes in an Option's Time Value

13. In computing the changes in an option's time value that would be excluded from the assessment of hedge effectiveness, an entity shall use a technique that appropriately isolates those aspects of the change in time value. Generally, to allocate the total change in an option's time value to its different aspects—the passage of time and the market variables—the change in time value attributable to the first aspect to be isolated is determined by holding all other aspects constant as of the beginning of the period. Each remaining aspect of the change in time value is then determined in turn in a specified order based on the ending values of the previously isolated aspects. (815-20-25-98)

14. Based on that general methodology, if only one aspect of the change in time value is excluded from the assessment of hedge effectiveness (for example, theta), that aspect shall be the first aspect for which the change in time value is computed and would be determined by holding all other parameters constant for the period used for assessing hedge effectiveness. However, if more than one aspect of the change in time value is excluded from the assessment of hedge effectiveness (for example, theta and vega), an entity shall determine the amount of that change in time value by isolating each of those two aspects in turn in a prespecified order (one first, the other second). The second aspect to be isolated would be based on the ending value of the first isolated aspect and the beginning values of the remaining aspects. The portion of the change in time value that is included in the assessment of effectiveness shall be determined

by deducting from the total change in time value the portion of the change in time value attributable to excluded components. (815-20-25-99)

(ASC paragraphs 815-20-25-100 and 815-20-25-101 not included in Exhibit A.)

Assuming Perfect Hedge Effectiveness in a Hedge with an Interest Rate Swap

15. The conditions for the shortcut method do not determine which hedging relationships qualify for hedge accounting; rather, those conditions determine which hedging relationships qualify for a shortcut version of hedge accounting that assumes perfect hedge effectiveness. If all of the applicable conditions in the list in paragraph ~~17.815-20-25-104~~ are met, an entity may assume perfect effectiveness in a hedging relationship of interest rate risk involving a recognized interest-bearing asset or liability (or a firm commitment arising on the trade [pricing] date to purchase or issue an interest-bearing asset or liability) and an interest rate swap (or a compound hedging instrument composed of an interest rate swap and a mirror-image call or put option as discussed in paragraph ~~17.c.815-20-25-104(e)~~) provided that, in the case of a firm commitment, the trade date of the asset or liability differs from its settlement date due to generally established conventions in the marketplace in which the transaction is executed. The shortcut method's application shall be limited to hedging relationships that meet each and every applicable condition. That is, all the conditions applicable to fair value hedges shall be met to apply the shortcut method to a fair value hedge, and all the conditions applicable to cash flow hedges shall be met to apply the shortcut method to a cash flow hedge. A hedging relationship cannot qualify for application of the shortcut method based on an assumption of perfect effectiveness justified by applying other criteria. The verb *match* is used in the specified conditions in the list to mean *exactly the same* or *correspond exactly*. (815-20-25-102)

16. Implicit in the conditions for the shortcut method is the requirement that a basis exist for concluding on an ongoing basis that the hedging relationship is expected to be highly effective in achieving offsetting changes in fair values or cash flows. In applying the shortcut method, an entity shall consider the likelihood of the counterparty's compliance with the contractual terms of the hedging derivative that require the counterparty to make payments to the entity. (815-20-25-103)

17. All of the following conditions apply to both fair value hedges and cash flow hedges: (815-20-25-104)

- a. The notional amount of the interest rate swap matches the principal amount of the interest-bearing asset or liability being hedged.
- b. If the hedging instrument is solely an interest rate swap, the fair value of that interest rate swap at the inception of the hedging relationship must be zero, with one exception. The fair value of the swap may be other than zero at the inception of the hedging relationship only if the swap was entered into at the relationship's inception, the transaction price of the swap was zero in the entity's principal market (or most advantageous market), and the difference between transaction price and fair value is attributable solely to differing prices within the bid-ask spread between the entry transaction and a hypothetical exit transaction. The guidance in the preceding sentence is applicable only to transactions considered *at market* (that is, transaction price is zero exclusive of commissions and other transaction costs, ~~as discussed in paragraph 820-10-35-9B~~). If the hedging instrument is solely an interest rate swap that at the inception of the hedging relationship has a positive or negative fair value, but does not meet the one exception specified in this paragraph, the shortcut method shall not be used even if all the other conditions are met.
- c. If the hedging instrument is a compound derivative composed of an interest rate swap and mirror-image call or put option as discussed in (e), the premium for the mirror-image call

or put option shall be paid or received in the same manner as the premium on the call or put option embedded in the hedged item based on the following:

- i. If the implicit premium for the call or put option embedded in the hedged item is being paid principally over the life of the hedged item (through an adjustment of the interest rate), the fair value of the hedging instrument at the inception of the hedging relationship shall be zero (except as discussed previously in (b) regarding differing prices due to the existence of a bid-ask spread).
 - ii. If the implicit premium for the call or put option embedded in the hedged item was principally paid at inception-acquisition (through an original issue discount or premium), the fair value of the hedging instrument at the inception of the hedging relationship shall be equal to the fair value of the mirror-image call or put option.
- d. The formula for computing net settlements under the interest rate swap is the same for each net settlement. That is, both of the following conditions are met:
- i. The fixed rate is the same throughout the term.
 - ii. The variable rate is based on the same index and includes the same constant adjustment or no adjustment. The existence of a stub period and stub rate is not a violation of the criterion in (d) that would preclude application of the shortcut method if the stub rate is the variable rate that corresponds to the length of the stub period.
- e. The interest-bearing asset or liability is not prepayable, that is, able to be settled by either party before its scheduled maturity, or the assumed maturity date if the hedged item is measured [as a partial-term hedge of interest rate risk in which the assumed maturity of the hedged items occur on the date in which the last hedged cash flow is due and payable](#), ~~in accordance with paragraph 815-25-35-13B~~, with the following qualifications:
- i. This criterion does not apply to an interest-bearing asset or liability that is prepayable solely due to an embedded call option (put option) if the hedging instrument is a compound derivative composed of an interest rate swap and a mirror-image call option (put option).
 - ii. The call option embedded in the interest rate swap is considered a mirror image of the call option embedded in the hedged item if all of the following conditions are met:
 - (a) The terms of the two call options match exactly, including all of the following:
 - (1) Maturities
 - (2) Strike price (that is, the actual amount for which the debt instrument could be called) and there is no termination payment equal to the deferred debt issuance costs that remain unamortized on the date the debt is called
 - (3) Related notional amounts

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- (4) Timing and frequency of payments
 - (5) Dates on which the instruments may be called.
- (b) The entity is the writer of one call option and the holder (purchaser) of the other call option.
- f. Any other terms in the interest-bearing financial instruments or interest rate swaps meet both of the following conditions:
- i. The terms are typical of those instruments.
 - ii. The terms do not invalidate the assumption of perfect effectiveness.
18. All of the following incremental conditions apply to fair value hedges only: (815-20-25-105)
- a. The expiration date of the interest rate swap matches the maturity date of the interest-bearing asset or liability or the assumed maturity date if the hedged item is measured [as a partial-term hedge of interest rate risk in which the assumed maturity of the hedged items occur on the date in which the last hedged cash flow is due and payable](#)~~in accordance with paragraph 815-25-35-13B.~~
 - b. There is no floor or cap on the variable interest rate of the interest rate swap.
 - c. The interval between repricings of the variable interest rate in the interest rate swap is frequent enough to justify an assumption that the variable payment or receipt is at a market rate (generally three to six months or less).
 - d. For fair value hedges of a proportion of the principal amount of the interest-bearing asset or liability, the notional amount of the interest rate swap designated as the hedging instrument ~~(see (a) in paragraph 815-20-25-104)~~ matches the portion of the asset or liability being hedged.
 - e. For fair value hedges of portfolios (or proportions thereof) of similar interest-bearing assets or liabilities, both of the following criteria are met:
 - i. The notional amount of the interest rate swap designated as the hedging instrument matches the aggregate notional amount of the hedged item (whether it is all or a proportion of the total portfolio).
 - ii. The remaining criteria for the shortcut method are met with respect to the interest rate swap and the individual assets or liabilities in the portfolio.
 - f. The index on which the variable leg of the interest rate swap is based matches the benchmark interest rate designated as the interest rate risk being hedged for that hedging relationship.
19. All of the following incremental conditions apply to cash flow hedges only: (815-20-25-106)
- a. All interest receipts or payments on the variable-rate asset or liability during the term of the interest rate swap are designated as hedged.

- b. No interest payments beyond the term of the interest rate swap are designated as hedged.
 - c. Either of the following conditions is met:
 - i. There is no floor or cap on the variable interest rate of the interest rate swap.
 - ii. The variable-rate asset or liability has a floor or cap and the interest rate swap has a floor or cap on the variable interest rate that is comparable to the floor or cap on the variable-rate asset or liability. For purposes of this paragraph, comparable does not necessarily mean equal. For example, if an interest rate swap's variable rate is based on LIBOR and an asset's variable rate is LIBOR plus 2 percent, a 10 percent cap on the interest rate swap would be comparable to a 12 percent cap on the asset.
 - d. The repricing dates of the variable-rate asset or liability and the hedging instrument must occur on the same dates and be calculated the same way (that is, both shall be either prospective or retrospective). If the repricing dates of the hedged item occur on the same dates as the repricing dates of the hedging instrument but the repricing calculation for the hedged item is prospective whereas the repricing calculation for the hedging instrument is retrospective, those repricing dates do not match.
 - e. For cash flow hedges of the interest payments on only a portion of the principal amount of the interest-bearing asset or liability, the notional amount of the interest rate swap designated as the hedging instrument (~~see paragraph 815-20-25-104(a)~~) matches the principal amount of the portion of the asset or liability on which the hedged interest payments are based.
 - f. For a cash flow hedge in which the hedged forecasted transaction is a group of individual transactions (as permitted by [paragraph 28.a. of the SSAP guidance](#) ~~paragraph 815-20-25-15(a)~~), if both of the following criteria are met:
 - i. The notional amount of the interest rate swap designated as the hedging instrument (~~see paragraph (a)~~) matches the notional amount of the aggregate group of hedged transactions.
 - ii. The remaining criteria for the shortcut method are met with respect to the interest rate swap and the individual transactions that make up the group. For example, the interest rate repricing dates for the variable-rate assets or liabilities whose interest payments are included in the group of forecasted transactions shall match (that is, be exactly the same as) the reset dates for the interest rate swap.
 - g. The index on which the variable leg of the interest rate swap is based matches the contractually specified interest rate designated as the interest rate being hedged for that hedging relationship.
20. The shortcut method may be applied to a hedging relationship that involves the use of an interest rate swap-in-arrears provided all of the applicable conditions are met. (815-20-25-107)
21. Any discount or premium in the hedged debt's carrying amount (including any related deferred issuance costs) is irrelevant to and has no direct impact on the determination of whether an interest rate swap contains a mirror-image call option under [paragraph 17.e.i.\(e\)](#). Typically, the call price is greater than the par or face amount of the debt instrument. The carrying amount of the debt is economically unrelated

to the amount the issuer would be required to pay to exercise the call embedded in the debt. (815-20-25-108)

22. The fixed interest rate on a hedged item need not exactly match the fixed interest rate on an interest rate swap designated as a fair value hedge. Nor does the variable interest rate on an interest-bearing asset or liability need to be the same as the variable interest rate on an interest rate swap designated as a cash flow hedge. An interest rate swap's fair value comes from its net settlements. The fixed and variable interest rates on an interest rate swap can be changed without affecting the net settlement if both are changed by the same amount. That is, an interest rate swap with a payment based on LIBOR and a receipt based on a fixed rate of 5 percent has the same net settlements and fair value as an interest rate swap with a payment based on LIBOR plus 1 percent and a receipt based on a fixed rate of 6 percent. (815-20-25-109)

23. Comparable credit risk at inception is not a condition for assuming perfect effectiveness even though actually achieving perfect offset would require that the same discount rate be used to determine the fair value of the swap and of the hedged item or hedged transaction. To justify using the same discount rate, the credit risk related to both parties to the swap as well as to the debtor on the hedged interest-bearing asset (in a fair value hedge) or the variable-rate asset on which the interest payments are hedged (in a cash flow hedge) would have to be the same. However, because that complication is caused by the interaction of interest rate risk and credit risk, which are not easily separable, comparable creditworthiness is not considered a necessary condition for assuming perfect effectiveness in a hedge of interest rate risk. (815-20-25-111)

(ASC paragraphs 815-20-25-112 through 815-20-25-143 not included in Exhibit A.)

Hedge Effectiveness – After Designation

24. If a fair value hedge or cash flow hedge initially qualifies for hedge accounting, the entity would continue to assess whether the hedge meets the effectiveness test on either a quantitative basis (using either a dollar-offset test or a statistical method such as regression analysis) or a qualitative basis. ~~See paragraphs 815-20-35-2A through 35-2F for additional guidance on qualitative assessments of effectiveness.~~ If the hedge fails the effectiveness test at any time (that is, if the entity does not expect the hedge to be highly effective at achieving offsetting changes in fair values or cash flows), the hedge ceases to qualify for hedge accounting. At least quarterly, the hedging entity shall determine whether the hedging relationship has been highly effective in having achieved offsetting changes in fair value or cash flows through the date of the periodic assessment.) (815-20-35-2)

Effectiveness Assessment on a Qualitative Basis

25. An entity may qualitatively assess hedge effectiveness if both of the following criteria are met: (815-20-35-2A)

- a. An entity performs an initial quantitative test of hedge effectiveness on a prospective basis (that is, it is not assuming that the hedging relationship is perfectly effective at hedge inception ~~as described in paragraph 815-20-25-3(b)(2)(iv)(01)(A) through (H)~~), and the results of that quantitative test demonstrate highly effective offset.
- b. At hedge inception, an entity can reasonably support an expectation of high effectiveness on a qualitative basis in subsequent periods.

26. An entity may elect to qualitatively assess hedge effectiveness in accordance with [paragraph 25 815-20-35-2A](#) on a hedge-by-hedge basis. If an entity makes this qualitative assessment election, only the

quantitative method specified in an entity's initial hedge documentation must comply with ~~paragraph 7815-20-25-81~~. (815-20-35-2B)

27. When an entity performs qualitative assessments of hedge effectiveness, it shall verify and document whenever financial statements or earnings are reported and at least every three months that the facts and circumstances related to the hedging relationship have not changed such that it can assert qualitatively that the hedging relationship was and continues to be highly effective. While not all-inclusive, the following is a list of indicators that may, individually or in the aggregate, allow an entity to continue to assert qualitatively that the hedging relationship is highly effective: (815-20-35-2C)

- a. An assessment of the factors that enabled the entity to reasonably support an expectation of high effectiveness on a qualitative basis has not changed such that the entity can continue to assert qualitatively that the hedging relationship was and continues to be highly effective. ~~This shall include an assessment of the guidance in paragraph 815-20-25-100 when applicable.~~
- b. There have been no adverse developments regarding the risk of counterparty default.

28. If an entity elects to assess hedge effectiveness on a qualitative basis and then facts and circumstances change such that the entity no longer can assert qualitatively that the hedging relationship was and continues to be highly effective in achieving offsetting changes in fair values or cash flows, the entity shall assess effectiveness of that hedging relationship on a quantitative basis in subsequent periods. In addition, an entity may perform a quantitative assessment of hedge effectiveness in any reporting period to validate whether qualitative assessments of hedge effectiveness remain appropriate. In both cases, the entity shall apply the quantitative method that it identified in its initial hedge documentation ~~in accordance with paragraph (b)(2)(iv)(03)~~. (815-20-35-2D)

29. When an entity determines that facts and circumstances have changed and it no longer can assert qualitatively that the hedging relationship was and continues to be highly effective, the entity shall begin performing subsequent quantitative assessments of hedge effectiveness as of the period that the facts and circumstances changed. If there is no identifiable event that led to the change in the facts and circumstances of the hedging relationship, the entity may begin performing quantitative assessments of effectiveness in the current period. (815-20-35-2E)

30. After performing a quantitative assessment of hedge effectiveness for one or more reporting periods as discussed in ~~paragraphs 28-29 815-20-35-2D through 35-2E~~, an entity may revert to qualitative assessments of hedge effectiveness if it can reasonably support an expectation of high effectiveness on a qualitative basis for subsequent periods. ~~See paragraphs 815-20-55-79G through 55-79N for implementation guidance on factors to consider when determining whether qualitative assessments of effectiveness can be performed after hedge inception.~~ (815-20-35-2F)

Quantitative Hedge Effectiveness Assessments After Hedge Designation

31. Quantitative assessments can be based on regression or other statistical analysis of past changes in fair values or cash flows as well as on other relevant information. (815-20-35-2G)

32. If an entity elects at the inception of a hedging relationship to use the same regression analysis approach for both prospective considerations and retrospective evaluations of assessing effectiveness, then during the term of that hedging relationship both of the following conditions shall be met: (815-20-35-3)

- a. Those regression analysis calculations shall generally incorporate the same number of data points.

- b. That entity must periodically update its regression analysis (or other statistical analysis).
33. Electing to use a regression or other statistical analysis approach instead of a dollar-offset approach to perform retrospective evaluations of assessing hedge effectiveness may affect whether an entity can apply hedge accounting for the current assessment period. (815-20-35-4)
34. In periodically (that is, at least quarterly) assessing retrospectively the effectiveness of a fair value hedge (or a cash flow hedge) in having achieved offsetting changes in fair values (or cash flows) under a dollar-offset approach, an entity shall use either a period-by-period approach or a cumulative approach on individual fair value hedges (or cash flow hedges): (815-20-35-5)
- a. Period-by-period approach. The period-by-period approach involves comparing the changes in the hedging instrument's fair values (or cash flows) that have occurred during the period being assessed to the changes in the hedged item's fair value (or hedged transaction's cash flows) attributable to the risk hedged that have occurred during the same period. If an entity elects to base its comparison of changes in fair value (or cash flows) on a period-by-period approach, the period cannot exceed three months. Fair value (or cash flow) patterns of the hedging instrument or the hedged item (or hedged transaction) in periods before the period being assessed are not relevant.
- b. Cumulative approach. The cumulative approach involves comparing the cumulative changes (to date from inception of the hedge) in the hedging instrument's fair values (or cash flows) to the cumulative changes in the hedged item's fair value (or hedged transaction's cash flows) attributable to the risk hedged.
35. If an entity elects at inception of a hedging relationship to base its comparison of changes in fair value (or cash flows) on a cumulative approach, then that entity must abide by the results of that methodology as long as that hedging relationship remains designated. Electing to utilize a period-by-period approach instead of a cumulative approach (or vice versa) to perform retrospective evaluations of assessing hedge effectiveness under the dollar-offset method may affect whether an entity can apply hedge accounting for the current assessment period. (815-20-35-6)

Assessing Effectiveness Based on Whether the Critical Terms of the Hedging Instrument and the Hedged Items Match

36. If, at inception, the critical terms of the hedging instrument and the hedged forecasted transaction are the same (see paragraphs ~~10-11815-20-25-84 through 25-84A~~), the entity can conclude that changes in cash flows attributable to the risk being hedged are expected to be completely offset by the hedging derivative. Therefore, subsequent assessments can be performed by verifying and documenting whether the critical terms of the hedging instrument and the forecasted transaction have changed during the period in review. (815-20-35-9)
37. Because the assessment of hedge effectiveness in a cash flow hedge involves assessing the likelihood of the counterparty's compliance with the contractual terms of the derivative instrument designated as the hedging instrument, the entity must also assess whether there have been adverse developments regarding the risk of counterparty default, particularly if the entity planned to obtain its cash flows by liquidating the derivative instrument at its fair value. (815-20-35-10)
38. If there are no such changes in the critical terms or adverse developments regarding counterparty default, the entity may conclude that the hedging relationship is perfectly effective. In that case, the change

in fair value of the derivative instrument can be viewed as a proxy for the present value of the change in cash flows attributable to the risk being hedged. (815-20-35-11)

39. However, the entity must assess whether the hedging relationship is expected to continue to be highly effective using a quantitative assessment method (either a dollar-offset test or a statistical method such as regression analysis) if any of the following conditions exist: (815-20-35-12)

- a. The critical terms of the hedging instrument or the hedged forecasted transaction have changed.
- b. There have been adverse developments regarding the risk of counterparty default.

Possibility of Default by the Counterparty to Hedging Derivative

40. For an entity to conclude on an ongoing basis that the hedging relationship is expected to be highly effective in achieving offsetting changes in cash flows, the entity shall not ignore whether it will collect the payments it would be owed under the contractual provisions of the derivative instrument. In complying with the requirements of paragraph [2.b.815-20-25-75\(b\)](#), the entity shall assess the possibility of whether the counterparty to the derivative instrument will default by failing to make any contractually required payments to the entity as scheduled in the derivative instrument. In making that assessment, the entity shall also consider the effect of any related collateralization or financial guarantees. The entity shall be aware of the counterparty's creditworthiness (and changes therein) in determining the fair value of the derivative instrument. Although a change in the counterparty's creditworthiness would not necessarily indicate that the counterparty would default on its obligations, such a change shall warrant further evaluation. (815-20-35-14)

41. If the likelihood that the counterparty will not default ceases to be probable, an entity would be unable to conclude that the hedging relationship in a cash flow hedge is expected to be highly effective in achieving offsetting cash flows. (815-20-35-15)

42. In contrast, a change in the creditworthiness of the derivative instrument's counterparty in a fair value hedge would have an immediate effect because that change in creditworthiness would affect the change in the derivative instrument's fair value, which would immediately affect both of the following: (815-20-35-16)

- a. The assessment of whether the relationship qualifies for hedge accounting
- b. The amount of mismatch between the change in the fair value of the hedging instrument and the hedged item attributable to the hedged risk recognized in earnings under fair value hedge accounting.

43. Paragraph [16815-20-25-103](#) states that, in applying the shortcut method, an entity shall consider the likelihood of the counterparty's compliance with the contractual terms of the hedging derivative that require the counterparty to make payments to the entity. That paragraph explains that implicit in the criteria for the shortcut method is the requirement that a basis exist for concluding on an ongoing basis that the hedging relationship is expected to be highly effective in achieving offsetting changes in fair values or cash flows. (815-20-35-18)

Change in Hedge Effectiveness Method When Hedge Effectiveness is Assessed on a Quantitative Basis

44. If the entity identifies an improved method of assessing hedge effectiveness in accordance with the guidance in paragraph ~~6815-20-25-80~~ and wants to apply that method prospectively, it shall do both of the following: (815-20-35-19)

- a. Discontinue the existing hedging relationship
- b. Designate the relationship anew using the improved method.

45. The new method of assessing hedge effectiveness shall be applied prospectively and shall also be applied to similar hedges unless the use of a different method for similar hedges is justified. A change in the method of assessing hedge effectiveness by an entity shall not be considered a change in accounting principle as defined in ~~Topic 250~~ [SSAP No. 3—Accounting Changes and Corrections of Errors](#). (815-20-35-20)

U.S. GAAP ASC Excerpts Excluded from Exhibit A

This information is included to illustrate the guidance within the adopted ASC references that are not captured in Exhibit A. The guidance within these paragraphs is considered part of the statutory adoption unless they include specific accounting and reporting guidance.

815-20-25-79A See paragraphs 815-20-25-139 through 25-142 about the timing of hedge effectiveness assessments required by paragraph 815-20-25-79 for a private company that is not a financial institution or a not-for-profit entity (except for a not-for-profit entity that has issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market).

815-20-25-86 The remainder of this guidance on hedge effectiveness criteria applicable to both fair value hedges and cash flow hedges is organized as follows:

- a. Hedge effectiveness when the hedging instrument is an option or combination of options
- b. Hedge effectiveness when hedged exposure is more limited than hedging instrument
- c. Hedge effectiveness during designated hedge period
- d. Assuming perfect effectiveness in a hedge with an interest rate swap (the shortcut method).

Hedge Effectiveness When the Hedging Instrument Is an Option or Combination of Options

815-20-25-87 The hedge effectiveness criteria applicable to options and combinations of options are organized as follows:

- a. Determining whether a combination of options is net written
- b. Hedge effectiveness of written options
- c. Hedge effectiveness of options in general.

Determining Whether a Combination of Options Is Net Written

815-20-25-88 This guidance addresses how an entity shall determine whether a combination of options is considered a net written option subject to the requirements of paragraph 815-20-25-94. A combination of options (for example, an interest rate collar) entered into contemporaneously shall be considered a written option if either at inception or over the life of the contracts a net premium is received in cash or as a favorable rate or other term. Furthermore, a derivative instrument that results from combining a written option and any other non-option derivative instrument shall be considered a written option. The determination of whether a combination of options is considered a net written option depends in part on whether strike prices and notional amounts of the options remain constant.

Strike Prices and Notional Amounts Remain Constant

815-20-25-89 For a combination of options in which the strike price and the notional amount in both the written option component and the purchased option component remain constant over the life of the respective component, that combination of options would be considered a net purchased option or a zero cost collar (that is, the combination shall not be considered a net written option subject to the requirements of paragraph 815-20-25-94) provided all of the following conditions are met:

- a. No net premium is received.

- b. The components of the combination of options are based on the same underlying.
- c. The components of the combination of options have the same maturity date.
- d. The notional amount of the written option component is not greater than the notional amount of the purchased option component.

815-20-25-90 If the combination of options does not meet all of those conditions, it shall be subject to the test in paragraph 815-20-25-94. For example, a combination of options having different underlying indexes, such as a collar containing a written floor based on three-month U.S. Treasury rates and a purchased cap based on three-month London Interbank Offered Rate (LIBOR), shall not be considered a net purchased option or a zero cost collar even though those rates may be highly correlated.

Strike Prices and Notional Amounts Do Not Remain Constant

815-20-25-91 If either the written option component or the purchased option component for a combination of options has either strike prices or notional amounts that do not remain constant over the life of the respective component, the assessment to determine whether that combination of options can be considered not to be a written option under paragraph 815-20-25-88 shall be evaluated with respect to each date that either the strike prices or the notional amounts change within the contractual term from inception to maturity.

815-20-25-92 Even though that assessment is made on the date that a combination of options is designated as a hedging instrument (to determine the applicability of paragraph 815-20-25-94), it shall consider the receipt of a net premium (in cash or as a favorable rate or other term) from that combination of options at each point in time that either the strike prices or the notional amounts change, such as either of the following circumstances:

- a. If strike prices fluctuate over the life of a combination of options and no net premium is received at inception, a net premium will typically be received as a favorable term in one or more reporting periods within the contractual term from inception to maturity.
- b. If notional amounts fluctuate over the life of a combination of options and no net premium is received at inception, a net premium or a favorable term will typically be received in one or more periods within the contractual term from inception to maturity.

815-20-25-93 In addition, a combination of options in which either the written option component or the purchased option component has either strike prices or notional amounts that do not remain constant over the life of the respective component shall satisfy all of the conditions in paragraph 815-20-25-89 to be considered not to be a written option (that is, to be considered to be a net purchased option or zero cost collar) under paragraph 815-20-25-88. For example, if the notional amount of the written option component is greater than the notional amount of the purchased option component at any date that the notional amount changes within the contractual term from inception to maturity, the combination of options shall be considered to be a written option under paragraph 815-20-25-88 and, thus, subject to the criteria in the following paragraph.

Hedge Effectiveness of Written Options

815-20-25-94 If a written option is designated as hedging a recognized asset or liability or an unrecognized firm commitment (if a fair value hedge) or the variability in cash flows for a recognized asset or liability or an unrecognized firm commitment (if a cash flow hedge), the combination of the hedged item and the written option provides either of the following:

- a. At least as much potential for gains as a result of a favorable change in the fair value of the combined instruments (that is, the written option and the hedged item, such as an embedded purchased option) as exposure to losses from an unfavorable change in their combined fair value (if a fair value hedge)
- b. At least as much potential for favorable cash flows as exposure to unfavorable cash flows (if a cash flow hedge).

815-20-25-95 The written-option test in the preceding paragraph shall be applied only at inception of the hedging relationship and is met if all possible percentage favorable changes in the underlying (from zero percent to 100 percent) would provide either of the following:

- a. At least as much gain as the loss that would be incurred from an unfavorable change in the underlying of the same percentage (if a fair value hedge)
- b. At least as much favorable cash flows as the unfavorable cash flows that would be incurred from an unfavorable change in the underlying of the same percentage (if a cash flow hedge).

815-20-25-96 The time value of a written option (or net written option) may be excluded from the written-option test if, in defining how hedge effectiveness will be assessed, the entity specifies that it will base that assessment on only changes in the option's intrinsic value. In that circumstance, the change in the time value of the options would be excluded from the assessment of hedge effectiveness in accordance with paragraph 815-20-25-82(a).

815-20-25-97 When applying the written-option test to determine whether there is symmetry of the gain and loss potential of the combined hedged position for all possible percentage changes in the underlying, an entity is permitted to measure the change in the intrinsic value of the written option (or net written option) combined with the change in fair value of the hedged item.

Hedge Effectiveness When Hedged Exposure Is More Limited Than Hedging Instrument

815-20-25-100 An entity may designate as the hedging instrument in a fair value hedge or cash flow hedge a derivative instrument that does not have a limited exposure comparable to the limited exposure of the hedged item to the risk being hedged. However, to make that designation, in accordance with paragraph 815-20-25-75, the entity shall establish that the hedging relationship is expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk during the period that the hedge is designated. See paragraph 815-20-25-79(a) for additional guidance on prospective considerations of hedge effectiveness in this circumstance.

Hedge Effectiveness during Designated Hedge Period

815-20-25-101 It is inappropriate under this Subtopic for an entity to designate a derivative instrument as the hedging instrument if the entity expects that the derivative instrument will not be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk during the period that the hedge is designated, unless the entity has documented undertaking a dynamic hedging strategy in which it has committed itself to an ongoing repositioning strategy for its hedging relationship.

>>>> Application of Prepayable Criterion

815-20-25-112 An interest-bearing asset or liability shall be considered prepayable under the provisions of paragraph 815-20-25-104(e) if one party to the contract has the right to cause the payment of principal before the scheduled payment dates unless either of the following conditions is met:

- a. The debtor has the right to cause settlement of the entire contract before its stated maturity at an amount that is always greater than the then fair value of the contract absent that right.
- b. The creditor has the right to cause settlement of the entire contract before its stated maturity at an amount that is always less than the then fair value of the contract absent that right.

815-20-25-113 However, none of the following shall be considered a prepayment provision:

- a. Any term, clause, or other provision in a debt instrument that gives the debtor or creditor the right to cause prepayment of the debt contingent upon the occurrence of a specific event related to the debtor's credit deterioration or other change in the debtor's credit risk, such as any of the following:
 - 1. The debtor's failure to make timely payment, thus making it delinquent
 - 2. The debtor's failure to meet specific covenant ratios
 - 3. The debtor's disposition of specific significant assets (such as a factory)
 - 4. A declaration of cross-default
 - 5. A restructuring by the debtor.
- b. Any term, clause, or other provision in a debt instrument that gives the debtor or creditor the right to cause prepayment of the debt contingent upon the occurrence of a specific event that meets all of the following conditions:
 - 1. It is not probable at the time of debt issuance.
 - 2. It is unrelated to changes in benchmark interest rates, contractually specified interest rates, or any other market variable.
 - 3. It is related either to the debtor's or creditor's death or to regulatory actions, legislative actions, or other similar events that are beyond the control of the debtor or creditor.
- c. Contingent acceleration clauses that permit the debtor to accelerate the maturity of an outstanding note only upon the occurrence of a specified event that meets all of the following conditions:
 - 1. It is not probable at the time of debt issuance.
 - 2. It is unrelated to changes in benchmark interest rates, contractually specified interest rates, or any other market variable.
 - 3. It is related to regulatory actions, legislative actions, or other similar events that are beyond the control of the debtor or creditor.

815-20-25-114 Furthermore, a right to cause a contract to be prepaid at its then fair value would not cause the interest-bearing asset or liability to be considered prepayable because that right would have a fair value of zero at all times and essentially would provide only liquidity to the holder.

815-20-25-115 Application of this guidance to specific debt instruments is illustrated in paragraph 815-20-55-75.

Application of the Shortcut Method to a Portfolio of Hedged Items

815-20-25-116 Portfolio hedging cannot be used to circumvent the application of the shortcut method criteria beginning in paragraph 815-20-25-102 to a fair value hedge of an individual interest-bearing asset or liability. A portfolio of interest-bearing assets or interest-bearing liabilities cannot qualify for the shortcut method if it contains an interest-bearing asset or liability that individually cannot qualify for the shortcut method.

815-20-25-117 The fair value hedge requirements of paragraph 815-20-25-12(b)(1) ensure that the individual items in a portfolio share the same risk exposure and have fair value changes attributable to the hedged risk that are expected to respond in a generally proportionate manner to the overall fair value changes of the entire portfolio. That requirement restricts the types of portfolios that can qualify for portfolio hedging; however, it also permits the existence of a mismatch between the change in the fair value of the individual hedged items and the change in the fair value of the hedged portfolio attributable to the hedged risk in portfolios that do qualify. As a result, the assumption of perfect effectiveness required for the shortcut method generally is inappropriate for portfolio hedges of similar assets or liabilities that are not also nearly identical (except for their notional amounts). Application of the shortcut method to portfolios that meet the requirements of paragraph 815-20-25-12(b)(1) is appropriate only if the assets or liabilities in the portfolio meet the same stringent criteria in paragraphs 815-20-25-104(e), 815-20-25-104(g), and 815-20-25-105(a) as required for hedges of individual assets and liabilities.

Application of Whether the Shortcut Method Was Not or No Longer Is Appropriate

815-20-25-117A In the period in which an entity determines that use of the shortcut method was not or no longer is appropriate, the entity may use a quantitative method to assess hedge effectiveness and measure hedge results without dedesignating the hedging relationship if both of the following criteria are met:

- a. The entity documented at hedge inception in accordance with paragraph 815-20-25-3(b)(2)(iv)(04) which quantitative method it would use to assess hedge effectiveness and measure hedge results if the shortcut method was not or no longer is appropriate during the life of the hedging relationship.
- b. The hedging relationship was highly effective on a prospective and retrospective basis in achieving offsetting changes in fair value or cash flows attributable to the hedged risk for the periods in which the shortcut method criteria were not met.

815-20-25-117B If the criterion in paragraph 815-20-25-117A(a) is not met, the hedging relationship shall be considered invalid in the period in which the criteria for the shortcut method were not met and in all subsequent periods. If the criterion in paragraph 815-20-25-117A(a) is met, the hedging relationship shall be considered invalid in all periods in which the criterion in paragraph 815-20-25-117A(b) is not met.

815-20-25-117C If an entity cannot identify the date on which the shortcut criteria ceased to be met, the entity shall perform the quantitative assessment of effectiveness documented at hedge inception for all periods since hedge inception.

815-20-25-117D The terms of the hedged item and hedging instrument used to assess effectiveness, in accordance with paragraph 815-20-25-117A(b), shall be those existing as of the date that the shortcut criteria ceased to be met. For cash flow hedges, if the hypothetical derivative method is used as a proxy for the hedged item, the value of the hypothetical derivative shall be set to zero as of hedge inception.

Hedge Effectiveness Criterion Applicable to Fair Value Hedges Only—Effectiveness Horizon

815-20-25-118 In documenting its risk management strategy for a fair value hedge, an entity may specify an intent to consider the possible changes (that is, not limited to the likely or expected changes) in value of the hedging derivative instrument and the hedged item only over a shorter period than the derivative instrument's remaining life in formulating its expectation that the hedging relationship will be highly effective in achieving offsetting changes in fair value for the risk being hedged. The entity does not need to contemplate the offsetting effect for the entire term of the hedging instrument.

Consideration of Prepayment Risk Using the Last-of-Layer Method

815-20-25-118A In a fair value hedge of interest rate risk designated under the last-of-layer method in accordance with paragraph 815-20-25-12A, an entity may exclude prepayment risk when measuring the change in fair value of the hedged item attributable to interest rate risk.

Hedge Effectiveness Criteria Applicable to Cash Flow Hedges Only

815-20-25-119 The hedge effectiveness criteria applicable to cash flow hedges only are organized as follows:

- a. Consideration of the time value of money
- b. Consideration of counterparty credit risk
- c. Additional considerations for options in cash flow hedges
- d. Assuming perfect hedge effectiveness in a cash flow hedge of a variable-rate borrowing with a receive-variable, pay-fixed interest rate swap recorded under the simplified hedge accounting approach.

Consideration of the Time Value of Money

815-20-25-120 In assessing the effectiveness of a cash flow hedge, an entity generally shall consider the time value of money, especially if the hedging instrument involves periodic cash settlements.

815-20-25-121 An example of a situation in which an entity likely would reflect the time value of money is a tailing strategy with futures contracts. When using a tailing strategy, an entity adjusts the size or contract amount of futures contracts used in a hedge so that earnings (or expense) from reinvestment (or funding) of daily settlement gains (or losses) on the futures do not distort the results of the hedge. To assess offset of expected cash flows when a tailing strategy has been used, an entity could reflect the time value of money, perhaps by comparing the present value of the hedged forecasted cash flow with the results of the hedging instrument.

Consideration of Counterparty Credit Risk

815-20-25-122 For a cash flow hedge, an entity shall consider the likelihood of the counterparty's compliance with the contractual terms of the hedging derivative instrument that require the counterparty to make payments to the entity. Paragraph 815-20-35-14 states that, for an entity to conclude on an ongoing basis that a cash flow hedging relationship is expected to be highly effective in achieving offsetting changes in cash flows, the entity shall not ignore whether it will collect the payments it would be owed under the contractual provisions of the derivative instrument. See paragraphs 815-20-35-14 through 35-18 for further guidance.

Additional Considerations for Options in Cash Flow Hedges

815-20-25-123 When an entity has documented that the effectiveness of a cash flow hedge will be assessed based on changes in the hedging option's intrinsic value pursuant to paragraph 815-20-25-82(a), that assessment (and the related cash flow hedge accounting) shall be performed for all changes in intrinsic value—that is, for all periods of time when the option has an intrinsic value, such as when the underlying is above the strike price of the call option.

815-20-25-124 When a purchased option is designated as a hedging instrument in a cash flow hedge, an entity shall not define only limited parameters for the risk exposure designated as being hedged that would include the time value component of that option. An entity cannot arbitrarily exclude some portion of an option's intrinsic value from the hedge effectiveness assessment simply through an articulation of the risk exposure definition. It is inappropriate to assert that only limited risk exposures are being hedged (for example, exposures related only to currency-exchange-rate changes above \$1.65 per pound sterling as illustrated in Example 26 [see paragraph 815-20-55-205]).

815-20-25-125 If an option is designated as the hedging instrument in a cash flow hedge, an entity may assess hedge effectiveness based on a measure of the difference, as of the end of the period used for assessing hedge effectiveness, between the strike price and forward price of the underlying, undiscounted. Although assessment of cash flow hedge effectiveness with respect to an option designated as the hedging instrument in a cash flow hedge shall be performed by comparing the changes in present value of the expected future cash flows of the forecasted transaction to the change in fair value of the derivative instrument (aside from any excluded component under paragraph 815-20-25-82), that measure of changes in the expected future cash flows of the forecasted transaction based on forward rates, undiscounted, is not prohibited. With respect to an option designated as the hedging instrument in a cash flow hedge, assessing hedge effectiveness based on a similar measure with respect to the hedging instrument eliminates any difference that the effect of discounting may have on the hedging instrument and the hedged transaction. Pursuant to paragraph 815-20-25-3(b)(2)(iv), entities shall document the measure of intrinsic value that will be used in the assessment of hedge effectiveness. As discussed in paragraph 815-20-25-80, that measure must be used consistently for each period following designation of the hedging relationship.

Assessing Hedge Effectiveness Based on an Option's Terminal Value

815-20-25-126 The guidance in paragraph 815-20-25-129 addresses a cash flow hedge that meets all of the following conditions:

- a. The hedging instrument is a purchased option or a combination of only options that comprise either a net purchased option or a zero-cost collar.
- b. The exposure being hedged is the variability in expected future cash flows attributed to a particular rate or price beyond (or within) a specified level (or levels).
- c. The assessment of effectiveness is documented as being based on total changes in the option's cash flows (that is, the assessment will include the hedging instrument's entire change in fair value, not just changes in intrinsic value).

815-20-25-127 This guidance has no effect on the accounting for fair value hedging relationships. In addition, in determining the accounting for seemingly similar cash flow hedging relationships, it would be inappropriate to analogize to this guidance.

815-20-25-128 For a hedging relationship that meets all of the conditions in paragraph 815-20-25-126, an entity may focus on the hedging instrument's terminal value (that is, its expected future pay-off amount at

its maturity date) in determining whether the hedging relationship is expected to be highly effective in achieving offsetting cash flows attributable to the hedged risk during the term of the hedge. An entity's focus on the hedging instrument's terminal value is not an impediment to the entity's subsequently deciding to dedesignate that cash flow hedge before the occurrence of the hedged transaction. If the hedging instrument is a purchased cap consisting of a series of purchased caplets that are each hedging an individual hedged transaction in a series of hedged transactions (such as caplets hedging a series of hedged interest payments at different monthly or quarterly dates), the entity may focus on the terminal value of each caplet (that is, the expected future pay-off amount at the maturity date of each caplet) in determining whether each of those hedging relationships is expected to be highly effective in achieving offsetting cash flows. The guidance in this paragraph applies to a purchased option regardless of whether at the inception of the cash flow hedging relationship it is at the money, in the money, or out of the money.

815-20-25-129 A hedging relationship that meets all of the conditions in paragraph 815-20-25-126 may be considered to be perfectly effective if all of the following conditions are met:

- a. The critical terms of the hedging instrument (such as its notional amount, underlying, maturity date, and so forth) completely match the related terms of the hedged forecasted transaction (such as the notional amount, the variable that determines the variability in cash flows, the expected date of the hedged transaction, and so forth).
- b. The strike price (or prices) of the hedging option (or combination of options) matches the specified level (or levels) beyond (or within) which the entity's exposure is being hedged.
- c. The hedging instrument's inflows (outflows) at its maturity date completely offset the change in the hedged transaction's cash flows for the risk being hedged.
- d. The hedging instrument can be exercised only on a single date—its contractual maturity date.

The condition in (d) is consistent with the entity's focus on the hedging instrument's terminal value. If the holder of the option chooses to pay for the ability to exercise the option at dates before the maturity date (for example, by acquiring an American-style option), the hedging relationship would not be perfectly effective.

815-20-25-129A In a hedge of a group of forecasted transactions in accordance with paragraph 815-20-25-15(a)(2), an entity may assume that the timing in which the hedged transactions are expected to occur and the maturity date of the hedging instrument match in accordance with paragraph 815-20-25-129(a) if those forecasted transactions occur and the derivative matures within the same 31-day period or fiscal month.

Hedge Effectiveness of a Net-Purchased Combination of Options

815-20-25-130 The guidance in the following paragraph addresses a cash flow hedging relationship that meets both of the following conditions:

- a. A combination of options (deemed to be a net purchased option) is designated as the hedging instrument.
- b. The effectiveness of the hedge is assessed based only on changes in intrinsic value of the hedging instrument (the combination of options).

815-20-25-131 The assessment of effectiveness of a cash flow hedging relationship meeting the conditions in the preceding paragraph may be based only on changes in the underlying that cause a change in the

intrinsic value of the hedging instrument (the combination of options). Thus, the assessment can exclude ranges of changes in the underlying for which there is no change in the hedging instrument's intrinsic value.

Hedge Accounting Provisions Applicable to Certain Private Companies

Assuming Perfect Hedge Effectiveness in a Cash Flow Hedge of a Variable-Rate Borrowing with a Receive-Variable, Pay-Fixed Interest Rate Swap Recorded under the Simplified Hedge Accounting Approach

815-20-25-133 Paragraphs 815-10-35-1A through 35-1C, 815-10-50-3, 815-20-25-3A, 815-20-25-119, 815-20-25-134 through 25-138, 815-20-55-79A through 55-79B, 825-10-50-3, and 825-10-50-8 provide guidance for an entity electing the simplified hedge accounting approach. See paragraph 815-10-65-6 for transition guidance on applying the simplified hedge accounting approach.

815-20-25-134 The conditions for the simplified hedge accounting approach determine which cash flow hedging relationships qualify for a simplified version of hedge accounting. If all of the conditions in paragraphs 815-20-25-135 and 815-20-25-137 are met, an entity may assume perfect effectiveness in a cash flow hedging relationship involving a variable-rate borrowing and a receive-variable, pay-fixed interest rate swap.

815-20-25-135 Provided all of the conditions in paragraph 815-20-25-137 are met, the simplified hedge accounting approach may be applied by a **private company** except for a financial institution as described in paragraph 942-320-50-1. An entity may elect the simplified hedge accounting approach for any receive-variable, pay-fixed interest rate swap, provided that all of the conditions for applying the simplified hedge accounting approach specified in paragraph 815-20-25-137 are met. Implementation guidance on the conditions set forth in paragraph 815-20-25-137 is provided in paragraphs 815-20-55-79A through 55-79B.

815-20-25-136 In applying the simplified hedge accounting approach, the documentation required by paragraph 815-20-25-3 to qualify for hedge accounting must be completed by the date on which the first annual **financial statements are available to be issued** after hedge inception rather than concurrently at hedge inception.

815-20-25-137 An eligible entity under paragraph 815-20-25-135 must meet all of the following conditions to apply the simplified hedge accounting approach to a cash flow hedge of a variable-rate borrowing with a receive-variable, pay-fixed interest rate swap:

- a. Both the variable rate on the swap and the borrowing are based on the same index and reset period (for example, both the swap and borrowing are based on one-month London Interbank Offered Rate [LIBOR] or both the swap and borrowing are based on three-month LIBOR).
- b. The terms of the swap are typical (in other words, the swap is what is generally considered to be a “plain-vanilla” swap), and there is no floor or cap on the variable interest rate of the swap unless the borrowing has a comparable floor or cap.
- c. The repricing and settlement dates for the swap and the borrowing match or differ by no more than a few days.
- d. The swap's fair value at inception (that is, at the time the derivative was executed to hedge the interest rate risk of the borrowing) is at or near zero.

- e. The notional amount of the swap matches the principal amount of the borrowing being hedged. In complying with this condition, the amount of the borrowing being hedged may be less than the total principal amount of the borrowing.
- f. All interest payments occurring on the borrowing during the term of the swap (or the effective term of the swap underlying the forward starting swap) are designated as hedged whether in total or in proportion to the principal amount of the borrowing being hedged.

815-20-25-138 A cash flow hedge established through the use of a forward starting receive-variable, pay-fixed interest rate swap may be permitted in applying the simplified hedge accounting approach only if the occurrence of forecasted interest payments to be swapped is probable. When forecasted interest payments are no longer probable of occurring, a cash flow hedging relationship will no longer qualify for the simplified hedge accounting approach and the General Subsections of this Topic shall apply at the date of change and on a prospective basis.

Timing of Hedge Documentation for Certain Private Companies If Simplified Hedge Accounting Approach Is Not Applied

Concurrent Hedge Documentation

815-20-25-139 Concurrent with hedge inception, a **private company** that is not a financial institution as described in paragraph 942-320-50-1 shall document the following:

- a. The hedging relationship in accordance with paragraph 815-20-25-3(b)(1)
- b. The hedging instrument in accordance with paragraph 815-20-25-3(b)(2)(i)
- c. The hedged item in accordance with paragraph 815-20-25-3(b)(2)(ii), including (if applicable) firm commitments or the analysis supporting a last-of-layer designation in paragraph 815-20-25-3(c), or forecasted transactions in paragraph 815-20-25-3(d)
- d. The nature of the risk being hedged in accordance with paragraph 815-20-25-3(b)(2)(iii).

815-20-25-140 A private company that is not a financial institution is not required to perform or document the following items concurrent with hedge inception but rather is required to perform or document them within the time periods discussed in paragraph 815-20-25-142:

- a. The method of assessing hedge effectiveness at inception and on an ongoing basis in accordance with paragraph 815-20-25-3(b)(2)(iv) and (vi)
- b. Initial hedge effectiveness assessments in accordance with paragraph 815-20-25-3(b)(2)(iv)(01) through (04).

815-20-25-141 Example 1A beginning in paragraph 815-20-55-80A illustrates hedge documentation when the critical terms of the hedging instrument and hedged forecasted transaction match. Although that Example illustrates the documentation of the method of assessing hedge effectiveness, private companies that are not financial institutions may complete hedge documentation requirements in accordance with paragraphs 815-20-25-139 through 25-140.

Hedge Effectiveness Assessments

815-20-25-142 For a private company that is not a financial institution, the performance and documentation of the items listed in paragraph 815-20-25-140, as well as required subsequent quarterly hedge effectiveness

assessments, may be completed before the date on which the next interim (if applicable) or annual financial statements are available to be issued. Even though the completion of the initial and ongoing assessments of effectiveness may be deferred to the date on which financial statements are available to be issued the assessments shall be completed using information applicable as of hedge inception and each subsequent quarterly assessment date when completing this documentation on a deferred basis. Therefore, the assessment should be performed to determine whether the hedge was highly effective at achieving offsetting changes in fair values or cash flows at inception and in each subsequent quarterly assessment period up to the reporting date.

Hedge Accounting Provisions Applicable to Certain Not-for-Profit Entities

815-20-25-143 Not-for-profit entities (except for not-for-profit entities that have issued, or are a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market) may apply the guidance on the timing of hedge documentation and hedge effectiveness assessments in paragraphs 815-20-25-139 through 25-142. Specifically, those entities shall document the items listed in paragraph 815-20-25-139 concurrent with hedge inception, but they may perform and document the items listed in paragraph 815-20-25-140 and perform the required subsequent quarterly hedge effectiveness assessments in accordance with paragraph 815-20-25-142 within the time periods discussed in paragraph 815-20-25-142.

Exhibit 3 – Revisions adopted to SSAP No. 86 on December 12, 2022 (Agenda Item 2022-09)

Fair Value Hedges (Note – Paragraphs 26.a. through 26.c. are not affected and are omitted for brevity.)

26. Fair value hedges qualify for hedge accounting if all of the following criteria are met:

- d. The hedged item is specifically identified as either all, ~~or~~ a specific portion, or the partial term of a recognized asset, or all or a specific portion of ~~or~~ a recognized liability or of an unrecognized firm commitment. The hedged item is a single asset or liability (or a specific portion or partial term thereof) or is a portfolio of similar assets or a portfolio of similar liabilities (or a specific portion thereof) or a closed portfolio of assets (pursuant to paragraph 26.f. and Exhibit A, paragraph 46) where assumed layer or layers is anticipated to be outstanding (or a specific portion thereof)³. For a partial term hedge of one or more consecutive selected contractual cash flows where the hedged item begins when the first hedge cash flow begins to accrue and ends at the end of the designation hedge period, the assumed maturity of the hedged item occurs at the end of the designated hedge period; (ASC 815-25-35-13B Partial Term Hedging.)
- e. If similar assets or similar liabilities are aggregated and hedged as a portfolio, the individual assets or individual liabilities must share the risk exposure for which they are designated as being hedged. The change in fair value attributable to the hedged risk for each individual item in a hedged portfolio must be expected to respond in a generally proportionate manner to the overall change in fair value of the aggregate portfolio attributable to the hedged risk; and
- f. For a closed portfolio of financial assets or one or more beneficial interests secured by a portfolio of financial instruments, an entity may designate as the hedged item or items a hedged layer or layers (this designation is referred to throughout as the “portfolio layer method” (detailed in Exhibit A). (ASC 815-20-25-12A Portfolio Layer Method)
- ~~f.g.~~ If the hedged item is a financial asset or liability, a recognized loan servicing right, or a nonfinancial firm commitment with financial components, the designated risk being hedged is:
 - i. The risk of changes in the overall fair value of the entire hedged item;
 - ii. The risk of changes in its fair value attributable to changes in benchmark interest rate;
 - iii. The risk of changes in its fair value attributable to changes in the related foreign currency exchange rates; or
 - iv. The risk of changes in its fair value attributable to both changes in the obligor’s creditworthiness and changes in the spread over the benchmark interest rate with respect to the related financial asset’s or liability’s credit sector at inception of the hedge (referred to as credit risk).

³ For clarity, partial-term hedges and portfolio hedges addressed in paragraph 26.f. are limited to the situations in which the hedged item(s) is a recognized asset or a closed portfolio of financial assets. These hedging accounting methods are not permitted to hedge liabilities.

If the risk designated as being hedged is not the risk in paragraph 26.f.i., two or more of the other risks (benchmark interest rate risk, foreign currency exchange risk, and credit risk) may simultaneously be designated as being hedged.

The benchmark interest rate being hedged in a hedge of interest rate risk must be specifically identified as part of the designation and documentation at the inception of the hedging relationship. In calculating the change in the hedged item's fair value attributable to changes in the benchmark interest rate, the estimated coupon cash flows used in calculating fair value shall must be based on either all of the full contractual cash flows of the entire hedged item or the benchmark rate component of the contractual coupon cash flows of the hedged item determined at hedge inception. An entity may designate a fair value hedge of interest rate risk in which the hedged item is a prepayment instrument. The entity may consider only how changes in the benchmark interest rate affect the decision to settle the hedged item before its scheduled maturity (for example, an entity may consider only how change in the benchmark interest rate affect an obligor's decision to call a debt instrument when it has the right to do so.) The entity need not consider other factors that would affect this decision (for example, credit risk) when assessing hedge effectiveness. (ASU 815-25-35-13 & 815-20-25-6B) Excluding some of the hedged item's contractual cash flows (for example, the portion of the interest coupon in excess of the benchmark interest rate) from the calculation is not permitted.⁴ An entity may not simply designate prepayment risk as the risk being hedged for a financial asset. However, it can designate the option component of a prepayable instrument as the hedged item in a fair value hedge of the entity's exposure to changes in the fair value of that "prepayment" option, perhaps thereby achieving the objective of its desire to hedge prepayment risk. The effect of an embedded derivative of the same risk class must be considered in designating a hedge of an individual risk. For example, the effect of an embedded prepayment option must be considered in designating a hedge of benchmark interest rate risk.

Disclosure Requirements

62. Reporting entities shall disclose the following for all derivative contracts used:
- a. General disclosures:
 - vii. The net gain or loss recognized in unrealized gains or losses during the perioding period resulting from derivatives that no longer qualify for hedge accounting. For portfolio layer method hedges, disclose circumstances that led to the breach. (ASC 815-10-50-5C.)

Relevant Literature

64. This statement adopts the framework established by FAS 133, *FASB Statement No. 137, Accounting for Derivative Instruments and Hedging Activities—Deferral of the Effective Date of FASB Statement No. 133, An amendment of FASB Statement No. 133* (FAS 137) and *FASB Statement No. 138, Accounting for Certain Derivative Instruments and Certain Hedging Activities, An amendment of FASB Statement No. 133* (FAS 138), for fair value and cash flow hedges, including its technical guidance to the extent such guidance is consistent with the statutory accounting approach to derivatives utilized in this statement. This statement adopts the provisions of FAS 133 and 138 related to foreign currency hedges. With the exception of guidance specific to foreign currency hedges and amendments specific to refining the hedging of interest rate risk (under FAS 138, the risk of changes in the benchmark interest rate would be a hedged risk), this statement rejects FAS No. 137 and 138 as well as the various related Emerging Issues

⁴ ~~The first sentence of paragraph 26.d. that specifically permits the hedged item to be identified as either all or a specific portion of a recognized asset or liability or of an unrecognized firm commitment is not affected by the provisions in this subparagraph.~~

Task Force interpretations. This statement adopts paragraphs 4 and 25 of *FASB Statement No. 149: Amendment of Statement 133 on Derivative Instruments and Hedging Activities* (FAS 149) regarding the definition of an underlying and guidance for assessing hedge effectiveness. (The adoption from FAS 149 on the assessment of hedge effectiveness is impacted by the adoption with modification of guidance from ASU 2017-12 as detailed in paragraph 65.b., with the guidance from ASU 2017-12 superseding the prior adoption to the extent applicable.) All other paragraphs in FAS 149 are rejected as not applicable for statutory accounting. This statement adopts FSP FAS 133-1 and FIN 45-5: *Disclosures about Credit Derivatives and Certain Guarantees, An Amendment of FASB Statement No. 133 and FASB Interpretation No.45 and Clarification of the Effective Date of FASB Statement No. 161* (FSP FAS 133-1 and FIN 45-4) and requires disclosures by sellers of credit derivatives. This statement rejects *FSP FIN 39-1, Amendments of FASB Interpretation No. 39, and ASU 2014-03, Derivatives and Hedging – Accounting for Certain Receive-Variable, Pay-Fixed Interest Rate Swaps – Simplified Hedge Accounting Approach*.

65. This statement adopts, with modification, certain revisions to ASC 815-20 included in ASU 2017-12. Remaining provisions of ASU 2017-12 will be subsequently assessed for statutory accounting and shall not be considered adopted for statutory accounting until that assessment is complete.
- a. Revisions effective January 1, 2019 with early adoption permitted, are limited to specific provisions, and related transition guidance, pertaining to the documentation and assessment of hedge effectiveness and only includes: 1) provisions allowing more time to perform the initial quantitative hedge effectiveness assessment; 2) provisions allowing subsequent assessments of hedge effectiveness to be performed qualitatively if certain conditions are met; and 3) revisions regarding use of the critical terms and short-cut methods for assessing hedge effectiveness.
 - b. Revisions effective January 1, 2023, with early adoption permitted, are limited to the criteria for initial and subsequent hedge effectiveness detailed in the FASB Accounting Standards Codification (ASC) paragraphs 815-20-25-72 through 815-20-35-20, as modified through the issuance of ASU 2017-12. This adoption reflects statutory modifications to specify that the accounting and reporting of hedging instruments, including excluded components of the instruments, shall follow statutory specific guidance detailed in the statement. The intent of this guidance is to clarify that the determination of whether a hedging instrument qualifies as an effective hedge shall converge with U.S. GAAP, but that the measurement method shall continue to follow statutory specific provisions. The adoption of the referenced ASC paragraphs only extends to revisions incorporated through ASU 2017-12; therefore, any subsequent U.S. GAAP edits would require statutory accounting consideration before considered adopted.
 - c. Revisions effective January 1, 2022, with early adoption permitted, are limited to the criteria for the portfolio layer method detailed in ASU 2022-01, criteria to only consider how changes in the benchmark interest rate affect the decision to settle the hedged item before its scheduled maturity date in 815-20-25-6B, adding option in calculating the change in the hedged item's fair value attributed to changes in the benchmark interest rate based on the benchmark rate components of the contractual cash flows detailed in FASB ASC 815-25-35-13, and the partial-term hedging method detailed in FASB ASC 815-25-35-13B. The adoption of the partial term hedging method reflects statutory modifications that limits its use only when the hedged item is a recognized asset. This is different than U.S. GAAP, which permits the partial term method for hedged liabilities. The statutory limitation is established to prevent interim basis adjustments to hedged liabilities that could present a reduction of reported liabilities on the financial statements when the actual liability has not been reduced. Reconsideration of this statutory limitation may occur after a broader project to consider how derivative basis adjustments to hedged liabilities shall be reflected in the financial statements.

Effective Date and Transition

~~74.~~73. This statement is effective for derivative transaction entered into or modified on or after January 1, 2003. A modification is any revision or change in contractual terms of the derivative. SSAP No. 31 applies to derivative transaction prior to January 1, 2003. Alternatively, an insurer may choose to apply this statement to all derivatives to which the insurer is a party as of January 1, 2003. In either case, the insurer is to disclose the transition approach that is being used.

- a. Revisions adopted to paragraph 64 to reject FSP FIN 39-1 is effective January 1, 2013, for companies that have previously reported a position in the balance sheet that was net of counterparty agreements. (Companies that have previously reported derivative instruments and/or related collateral gross shall not be impacted by these revisions.)
- b. Revisions adopted in paragraph 16 clarify the reporting for amounts received/paid to adjust variation margin until the derivative contract has ended and are effective January 1, 2018, on a prospective basis, for reporting entities that have previously considered these amounts to reflect settlement or realized gains/losses. (Companies that have previously reported variation margin changes in line with the revisions shall not be impacted by these revisions.)
- c. Revisions to incorporate limited provisions from ASU 2017-12 pertaining to the documentation of hedge effectiveness (detailed in paragraph 65) are effective January 1, 2019, with early adoption permitted for year-end 2018. However, if the reporting entity is a U.S. GAAP filer, the reporting entity may only elect early adoption if the entity has also elected early adoption of ASU 2017-12 for year-end 2018.
- d. Revisions adopted April 2019 to explicitly include structured notes in scope of this statement are effective December 31, 2019. Revisions adopted July 2020 to define “derivative premium,” require gross reporting of derivatives without the impact of financing premiums and require separate recognition of premiums payable and premiums receivable, are effective January 1, 2021.
- e. Revisions adopted August 2022 that adopt with modification the criteria for initial and subsequent hedge effectiveness detailed in the FASB ASC paragraphs 815-20-25-72 through 815-20-35-20, as modified through the issuance of ASU 2017-12 and that incorporate statutory accounting revisions for the accounting and reporting of excluded components are effective January 1, 2023, with early adoption permitted. These revisions shall be applied prospectively for all new and existing hedges. Entities shall detail the adoption of this guidance as a change in accounting principle pursuant to *SSAP No. 3—Accounting Changes and Corrections of Errors*.
- f. [Revisions adopted December 12, 2022 that adopt U.S. GAAP guidance for the portfolio layer method, U.S. GAAP guidance to only consider how changes in the benchmark interest rate affect the decision to settle the hedged item before its scheduled maturity, U.S. GAAP guidance adding option in calculating the change in the hedged item’s fair value attributed to changes in the benchmark interest rate based on the benchmark rate component of the contractual coupon cash flows, that and adopt with modification U.S. GAAP guidance for partial term hedging are effective January 1, 2023, with early adoption permitted. These revisions shall be applied prospectively to qualifying new hedges.](#)

Edits to New Exhibit A – Discussion of Hedge Effectiveness

17. All of the following conditions apply to both fair value hedges and cash flow hedges: (815-20-25-104)
- e. The interest-bearing asset or liability is not prepayable, that is, able to be settled by either party before its scheduled maturity, or the assumed maturity date if the hedged item is measured as a partial-term hedge of interest rate risk in which the assumed maturity of the hedged items occur on the date in which the last hedged cash flow is due and payable ends at the end of the designated hedge period, in accordance with paragraph 815-25-35-13B, with the following qualifications:
 - i. This criterion does not apply to an interest-bearing asset or liability that is prepayable solely due to an embedded call option (put option) if the hedging instrument is a compound derivative composed of an interest rate swap and a mirror-image call option (put option).
 - ii. The call option embedded in the interest rate swap is considered a mirror image of the call option embedded in the hedged item if all of the following conditions are met:
18. All of the following incremental conditions apply to fair value hedges only: (815-20-25-105 & 815-25-35-13B)
- a. The expiration date of the interest rate swap matches the maturity date of the interest-bearing asset or liability or the assumed maturity date if the hedged item is measured as a partial-term hedge of interest rate risk in which the assumed maturity of the hedged items ends at the end of the designated hedge period ~~occur on the date in which the last hedged cash flow is due and payable~~ in accordance with paragraph 815-25-35-13B.

Portfolio Layer Method (New paragraphs at the end of Exhibit A.)

46. For a closed portfolio of financial assets or one or more beneficial interests secured by a portfolio of financial instruments, an entity may designate as the hedged item or items a hedged layer or layers (this designation is referred to throughout as the “portfolio layer method.”) (ASU 815-20-25-12A)
- a. As part of the initial hedge documentation, an analysis is completed and documented to support the entity’s expectation that the hedged item or items (that is, the hedged layer or layers in aggregate) is anticipated to be outstanding for the designated hedge period. That analysis shall incorporate the entity’s current expectations of prepayments, defaults, and other factors affecting the timing and amount of cash flows associated with the closed portfolio.
 - b. For purposes of its analysis in paragraph 46.a., the entity assumes that as prepayments, defaults, and other factors affecting the timing and amount of cash flows occur, they first will be applied to the portion of the closed portfolio that is not hedged; and
 - c. The entity applies the partial-term hedging guidance to the assets or beneficial interest used to support the entity’s expectation in paragraph 46.a. An asset that matures on a hedged layer’s assumed maturity date meets this requirement.
47. After a closed portfolio is established in accordance with paragraph 46, and entity may designate new hedging relationships associated with the closed portfolio without dedesignating any existing hedging

relationships associated with the closed portfolio if the criteria of paragraph 46 are met for those newly designated hedging relationships. (ASU 815-20-25-12B)

48. For the portfolio layer method if both of the following conditions exist, the quantitative test described for similar assets (shared risk exposure) may be performed qualitatively on a hedge-by-hedge basis and only at hedge inception:

- a. The hedged item is a hedged layer in a portfolio layer hedge and designated in accordance with paragraph 26.f. of SSAP No. 86.
- b. An entity measures the change in fair value of the hedged item based on the benchmark rate component of the contractual coupon cash flows.

Using the benchmark rate component of the contractual coupon cash flows when all assets have the same assumed maturity date and prepayment risk does not affect the measurement of the hedged item results in all hedged items having the same benchmark rate component coupon cash flows. (ASU 815-20-55-14A)

49. For one or more hedging relationships designated under the portfolio layer method, an entity shall discontinue (or partially discontinue) hedge accounting in the following circumstances: (ASU 815-25-40-8)

- a. If the entity cannot support on a subsequent testing date that the hedged layer or layers are anticipated to be outstanding for the designated hedge (that is, a breach is anticipated), it shall discontinue (or partially discontinue) hedge accounting for one or more hedging relationships for the portion of the hedged item that is no longer anticipated to be outstanding for the designated hedge period.
- b. If on a subsequent testing date the outstanding amount of the closed portfolio of financial assets or one or more beneficial interests is less than the hedged layer or layers (that is, a breach has occurred), the entity shall discontinue (or partially discontinue) hedge accounting for one or more hedging relationships for the portion of the hedged item that is no longer outstanding.

50. In the event of either an anticipated breach (as described in paragraph 49.a.) or a breach that has occurred (as described in paragraph 49.b.) for portfolio layer method, if multiple hedged layers are associated with a closed portfolio, an entity shall determine which hedge or hedges to discontinue (or partially discontinue) in accordance with an accounting policy election. That accounting policy election shall specify a systematic and rational approach to determining which hedge or hedges to discontinue (or partially discontinue). An entity shall establish its accounting policy no later than when it first anticipates a breach or when a breach has occurred (whichever comes first). After an entity establishes its accounting policy, it shall consistently apply its accounting policy to all portfolio layer method breaches (anticipated and occurred). (ASU 815-25-40-8A)

U.S. GAAP references not pulled into Exhibit will also be updated as follows:

Consideration of Prepayment Risk Using the ~~Last-of-Layer~~ Portfolio Layer Method

815-20-25-118A In a fair value hedge of interest rate risk designated under the portfolio layer ~~last-of-layer~~ method in accordance with paragraph 815-20-25-12A, an entity may exclude prepayment risk when measuring the change in fair value of the hedged item attributable to interest rate risk.

Edits to Exhibit ~~C~~B – Specific Hedge Accounting Procedures for Derivatives

2. Swaps, Collars, and Forwards (see also discussion in Introduction above):
 - d. Gain/Loss on Termination of a swap, collar or forward accounted for under hedge accounting (includes closing, exercise, maturity, and expiry):
 - i. Exercise—The remaining book value of the derivative shall become an adjustment to the cost or proceeds of the hedged item(s) received or disposed of individually or in aggregate;
 - ii. Sale, maturity, expiry, or other closing transaction of a derivative which is an effective hedge—Any gain or loss on the transaction, except for excluded components, will adjust the basis (or proceeds) of the hedged item(s) individually or in aggregate. If a portfolio layer method hedging relationship is discontinued (or partially discontinued) in a voluntary dedesignation or in anticipation of a breach, the basis adjustment associated with the dedesignated amount as of the discontinuation date shall be allocated to the remaining individual assets in the closed portfolio that supported the dedesignated hedged layer using a systematic and rational method. Alternatively, if the item being hedged is subject to IMR, the gain or loss on the terminated hedging derivative may be realized and shall be subject to IMR upon termination. (ASU 815-25-40-9)
 - iii. Gain/loss on termination of derivatives will be recognized currently in net income (realized gain/loss) to the extent they ceased to be effective hedges.
 - iv. Upon the redesignation of a derivative from a currently effective hedging relationship,
 - (a) with an item(s) carried at amortized cost to another effective hedging relationship with an item(s) carried at amortized cost, the derivative shall continue to be recorded at amortized cost and no gain or loss on the derivative shall be recognized.
 - (b) with an item(s) carried at amortized cost or fair value to an effective relationship with an item(s) carried at fair value, the accounting for the derivative shall be consistent with (ii) above.
 - (c) with an item(s) carried at fair value to an effective relationship with an item(s) carried at amortized cost, the accounting for the derivative shall be consistent with (ii.) above.

<https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/NationalMeetings/A.NationalMeetingMaterials/2023/3-22-23-Spring/Adoptions/17-33-IPDerivatives-2022.docx>

**Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A**

Issue: SSAP No. 25 – Affiliate Reporting Clarification

Check (applicable entity):

	P/C	Life	Health
Modification of Existing SSAP	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
New Issue or SSAP	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Interpretation	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Description of Issue:

At its May 24, 2022, meeting, the Statutory Accounting Principles (E) Working Group adopted agenda item 2021-21: Related Party Reporting, which included revisions to clarify application of the existing affiliate definition as well as to incorporate new disclosure requirements for investments acquired through, or in, related parties, regardless of if they meet the affiliate definition. During the meeting discussion, it was suggested that there needs to be a clarification of when an investment is considered to be and affiliated investment and reported on the affiliated line in the investment schedules. When agenda item 2021-21 was adopted, it included a recommendation that NAIC staff look to further clarify when investments should be classified as affiliated in the reporting schedules. This agenda item intends to clarify that an investment held from an affiliate is considered an affiliated investment.

Existing Authoritative Literature:

The *Insurance Holding Company System Regulatory Act* (Model #440) establishes the laws for holding company structures. The Act also establishes the concept of an affiliate in Section 1A, and this definition is used for statutory accounting purposes.

A. "Affiliate." An "affiliate" of, or person "affiliated" with, a specific person, is a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, the person specified.

SSAP No. 25—Affiliates and Other Related Parties establishes statutory accounting principles for affiliates and related parties. This definition is the language that is used to help define when an investment is affiliated or nonaffiliated for reporting in the various investment schedules.

5. An affiliate is defined as an entity that is within the holding company system or a party that, directly or indirectly, through one or more intermediaries, controls, is controlled by, or is under common control with the reporting entity. An affiliate includes a parent or subsidiary and may also include partnerships, joint ventures, and limited liability companies as defined in *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*. Those entities are accounted for under the guidance provided in *SSAP No. 48*, which requires an equity method for all such investments. An affiliate is any person that is directly or indirectly, owned or controlled by the same person or by the same group of persons, that, directly or indirectly, own or control the reporting entity.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups):

In March 2021, the Statutory Accounting Principles (E) Working Group adopted revisions to *SSAP No. 25* pursuant to agenda item 2019-34: Related Parties, Disclaimers of Affiliation and Variable Interest Entities. Additionally, a new reporting Schedule Y, Part 3 was adopted by the Blanks (E) Working Group in proposal 2020-37BWG, with an initial effective date of Dec. 31, 2021, to capture information on all entities with ownership greater than 10%, the ultimate controlling parties of those owners and other entities that the ultimate controlling party controls.

On May 24, 2022, the Working Group adopted revisions to SSAP No. 25 and *SSAP No. 43R—Loan-Backed and Structured Securities*, to clarify application of the existing affiliate definition as well as to incorporate new disclosure requirements for investments acquired through, or in, related parties, regardless of if they meet the affiliate definition, and included a new disclosure that was adopted by the Blanks (E) Working Group in proposal 2021-22BWG, which adds a new electronic-only column for the investment schedules and the related instructions which describes the nature of any related party relationship that exists related to the investment.

Information or issues (included in *Description of Issue*) not previously contemplated by the Working Group:
None

Convergence with International Financial Reporting Standards (IFRS): None

Staff Recommendation: NAIC staff recommends that the Working Group move this item to the active listing, categorized as a SAP clarification, and expose revisions to SSAP No. 25 to clarify that any invested asset held by a reporting entity which is issued by an affiliated entity, or which includes the obligations of an affiliated entity is an affiliated investment. Staff also recommend that Working Group direct the Blanks (E) Working Group to modify the Annual Statement Instructions as illustrated below.

Proposed edits to SSAP No. 25:

5. An affiliate is defined as an entity that is within the holding company system or a party that, directly or indirectly, through one or more intermediaries, controls, is controlled by, or is under common control with the reporting entity. An affiliate includes a parent or subsidiary and may also include partnerships, joint ventures, and limited liability companies as defined in *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*. Those entities are accounted for under the guidance provided in SSAP No. 48, which requires an equity method for all such investments. An affiliate is any person that is directly or indirectly, owned or controlled by the same person or by the same group of persons, that, directly or indirectly, own or control the reporting entity. [Any invested asset held by a reporting entity which is issued by an affiliated entity, or which includes the obligations of an affiliated entity is an affiliated investment.](#)

Proposed Annual Statement Reporting Changes: (These will be captured in a blanks proposal.)

This will be included in the Investment Schedules General Instructions in several places covering several different types of investment, and this revision is proposed to be included in each place under the header “Parent, Subsidiaries and Affiliates.”

Parent, Subsidiaries and Affiliates:

Defined by *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*. [Any invested asset held by a reporting entity which is issued by an affiliated entity, or which includes the obligations of an affiliated entity is an affiliated investment.](#)

Staff Review Completed by: Jake Stultz—NAIC Staff, November 2022

Status:

On December 13, 2022, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a SAP clarification, and exposed revisions to SSAP No. 25 to clarify that any invested asset held by a reporting entity which is issued by an affiliated entity, or which includes the obligations of an affiliated entity is an affiliated investment.

On March 22, 2023, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed revisions illustrated above to SSAP No. 25 which clarify that any invested asset held by a reporting entity which is issued by an affiliated entity, or which includes the obligations of an affiliated entity is an affiliated investment.

<https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/NationalMeetings/A.NationalMeetingMaterials/2023/3-22-23-Spring/Adoptions/22-15-AffiliateReporting.docx>

**Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A**

Issue: *ASU 2022-03, Fair Value Measurement of Equity Securities Subject to Contractual Sale Restrictions*

Check (applicable entity):

	P/C	Life	Health
Modification of Existing SSAP	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
New Issue or SSAP	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Interpretation	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Description of Issue:

In June 2022, the Financial Accounting Standards Board (FASB) issued *ASU 2022-03, Fair Value Measurement of Equity Securities Subject to Contractual Sale Restrictions* to 1) clarify the guidance in Topic 820, Fair Value Measurement, when measuring the fair value of an equity security subject to contractual restrictions that prohibit the sale of an equity security, 2) amend a related illustrative example, and 3) add a new disclosure of the fair value of equity securities subject to contractual sale restrictions, nature and remaining duration of the restrictions, and circumstances that could cause a lapse in the restrictions, in accordance with Topic 820.

These amendments do not change the principles of fair value measurement. They provide clarity in situations involving equity securities that have restrictions related to the sale of the asset. This ASU provides updated guidance for two specific scenarios, one where the restriction is based on the entity holding the equity security and one where the restriction is a characteristic of the equity security.

- First, it clarifies situations where an equity security cannot be sold on the measurement date because of a contractual sale restriction where the entity is not allowed to sell an asset. An example of this would be lock-up periods, where the assets cannot be sold for a set period but can be readily priced based on a public security exchange.
- Second, it provides guidance for situations where the restriction is based on characteristics of the asset that limits if it can be sold in regular markets. An example would be an equity security issued through a private placement and not SEC registered and are legally restricted from being sold on a national securities exchange or an over-the-counter market. These assets would be available to be sold on an existing market (not on the public exchange) but would have a fair value based on the market price of the similar unrestricted equity security adjusted to reflect the effect of the restriction.

Guidance for restricted assets is in *SSAP No. 4—Assets and Nonadmitted Assets*, and additional guidance specific to securities in ASU 2022-03 are included in *SSAP No. 30R—Unaffiliated Common Stock*, *SSAP No. 32R—Preferred Stock*, and *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*. Under these SSAPs, restricted securities are generally considered to be admitted assets to the extent that they can be used to cover policyholder obligations.

Existing Authoritative Literature:

The primary guidance for fair value is in *SSAP No. 100R—Fair Value*. *SSAP No. 30R—Unaffiliated Common Stock* and *SSAP No. 32R—Preferred Stock*, include some guidance on restricted investments involving common and preferred stock, but neither goes into detail on the specific guidance discussed in ASU 2022-03. Additionally, *SSAP No. 1—Accounting Policies, Risks & Uncertainties, and Other Disclosures* and *SSAP No. 4—Assets and Nonadmitted Assets* include references to restricted assets, primarily related to disclosures.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): None
Information or issues (included in *Description of Issue*) not previously contemplated by the Working Group:

None

Convergence with International Financial Reporting Standards (IFRS): None

Staff Recommendation:

NAIC staff recommends that the Working Group move this item to the active listing, categorized as a SAP clarification, and expose revisions to SSAP No. 100R—*Fair Value* to adopt ASU 2022-03, *Fair Value Measurement of Equity Securities Subject to Contractual Sale Restrictions* with modification to be consistent with statutory language in the respective statutory accounting statements. Proposed revisions are illustrated below.

Proposed edits to SSAP No. 100R:

Equity Securities Subject to Contractual Sale Restrictions

15. An equity security that an entity cannot sell on the measurement date because of a contractual sale restriction shall be measured at fair value on the basis of the price in the principal (or most advantageous) market^{FN}. A contractual sale restriction does not change the market in which that equity security would be sold. A discount applied to the price of an equity security because of a contractual sale restriction is not a characteristic of the equity security. A contractual sale restriction is a characteristic of the reporting entity holding the equity security rather than a characteristic of the asset and, therefore, is not considered in measuring the fair value of an equity security. A contractual sale restriction prohibiting the sale of an equity security is a characteristic of the reporting entity holding the equity security and shall not be separately recognized as its own unit of account.

16. The effect on a fair value measurement arising from a restriction on the sale or use of an asset by a reporting entity will differ depending on whether the restriction would be taken into account by market participants when pricing the asset. When the restriction is a characteristic of the asset, the restriction ~~is a characteristic of the asset and~~ should be considered in measuring the fair value of the asset. For example, an equity security issued through a private placement is not registered and is legally restricted from being sold on a national securities exchange or an over-the-counter market until the shares are registered or the conditions necessary for an exemption from registration have been satisfied. A market participant would sell the private placement equity securities in a different market than the market used for registered equity securities on the measurement date. Because that restriction would be a characteristic of the equity security, a market participant would consider the inability to resell the security on a national securities exchange or an over-the-counter market when pricing the equity security; therefore, the reporting entity that holds the Class A shares acquired through a private placement transaction would consider that restriction a characteristic of the asset, and the reporting entity should measure the fair value of the equity security on the basis of the market price of the similar unrestricted equity security adjusted to reflect the effect of the restriction^{FN}.

FN—Refer to SSAP No. 4—*Assets and Nonadmitted Assets* for admissibility guidance for restricted equity securities.

60. For equity securities that are subject to contractual sales, disclose the fair value of equity securities subject to contractual sale restrictions.

65. This standard adopts ASU 2022-03, *Fair Value Measurement of Equity Securities Subject to Contractual Sale Restrictions*, with modification to be consistent with statutory language in the respective statutory accounting statements.

Staff Review Completed by: Jake Stultz– NAIC Staff, November 2022

Status:

On December 13, 2022, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a SAP clarification, and exposed revisions to SSAP No. 100R to adopt ASU 2022-03,

Fair Value Measurement of Equity Securities Subject to Contractual Sale Restrictions with modification to be consistent with statutory language in the respective statutory accounting statements, as illustrated above. Note that this agenda item does not recommend incorporating the new proposed GAAP disclosures on sales restrictions, but identifies that items restricted as to sale would be captured as restricted assets per SSAP No. 1 and subject to admittance considerations under SSAP No. 4.

On March 22, 2023, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed revisions, as illustrated above, to SSAP No. 100R to adopt ASU 2022-03 with modification to be consistent with statutory language in the respective statutory accounting statements. The adoption does not incorporate the new GAAP disclosures on sales restrictions, as items restricted as to sale would be captured as restricted assets per SSAP No. 1 and subject to admittance considerations under SSAP No. 4.

<https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/NationalMeetings/A.NationalMeetingMaterials/2023/3-22-23-Spring/Adoptions/22-16-ASU2022-03-FV.docx>

**Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A**

Issue: Interest Income Disclosure Update

Check (applicable entity):

	P/C	Life	Health
Modification of Existing SSAP	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
New Issue or SSAP	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Interpretation	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Description of Issue:

This agenda item is the result of comments received from interested parties from the Principles-Based Bond Project. In the Oct. 7, 2022, comment letter, which provided comments on the Aug. 10 exposure by the Working Group, interested parties suggested some revisions to further enhance reporting of interest income on Schedule D-1-1 Bonds, and recommended that NAIC staff look further at if this should be added to any of the other reporting schedules where interest income is reported in accordance with *SSAP No. 34—Investment Income Due and Accrued*.

There were two distinct items noted in the interested parties’ comments that are addressed by this agenda item. First, they suggested data capturing the gross, nonadmitted and admitted amounts for interest income due and accrued. Second, they suggested that a data element that is included in the bond proposal project be changed to reflect the cumulative amount of paid-in-kind (PIK) interest included in the current principal balance.

With this agenda item, the Working Group will sponsor a proposal at the Blanks (E) Working Group to expand disclosures, with data capturing, to include gross, nonadmitted and admitted amounts for interest income due and accrued. The blanks proposal will also include cumulative amounts of paid-in-kind (PIK) interest included in the current principal balances.

Existing Authoritative Literature:

The guidance for disclosure of interest income is included in *SSAP No. 34—Investment Income Due and Accrued*.

Disclosures

7. The following disclosures shall be made for investment income due and accrued in the financial statements. (SSAP No. 37 captures disclosures for mortgage loans on nonaccrual status pursuant to paragraph 6.)
 - a. The bases by category of investment income for excluding (nonadmitting) any investment income due and accrued;
 - b. Disclose total amount excluded.
8. Refer to the Preamble for further discussion regarding disclosure requirements.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups):

As noted above, this agenda item comes from a suggestion from interested parties, which was included in their Oct. 7, 2022, comment letter.

Information or issues (included in *Description of Issue*) not previously contemplated by the Working Group:

None

Convergence with International Financial Reporting Standards (IFRS): None

Staff Recommendation: NAIC staff recommends that the Working Group move this item to the active listing, categorized as a SAP clarification, and expose revisions to *SSAP No. 34—Investment Income Due and Accrued* to add additional disclosures to data capture the gross, nonadmitted and admitted amounts for interest income due and to add disclosure of the cumulative amount of paid-in-kind (PIK) interest included in the current principal balance. Adoption of this agenda item will also signify support for a corresponding Blanks (E) Working Group proposal to add these disclosures to Note 7 of the annual statement blanks.

Proposed edits to SSAP No. 34:**Disclosures**

7. The following disclosures shall be made for investment income due and accrued in the financial statements. (SSAP No. 37 captures disclosures for mortgage loans on nonaccrual status pursuant to paragraph 6.)
- a. The bases by category of investment income for excluding (nonadmitting) any investment income due and accrued;
 - b. Disclose total amount excluded;
 - c. Disclose the gross, nonadmitted and admitted amounts for interest income due and accrued.
 - d. Disclose aggregate deferred interest and cumulative amounts of paid-in-kind (PIK) interest included in the current principal balance.
8. Refer to the Preamble for further discussion regarding disclosure requirements.

Staff Review Completed by: Jake Stultz—NAIC Staff, November 2022

Status:

On December 13, 2022, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a SAP clarification, and exposed revisions to SSAP No. 34, to add additional disclosures, as illustrated above, and to data-capture the disclosures.

On March 22, 2023, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed revisions, with minor edits as illustrated below, to SSAP No. 34 to add additional disclosures to data capture the gross, nonadmitted and admitted amounts for interest income due and to add disclosure of the cumulative amount of paid-in-kind (PIK) interest included in the current principal balance. These disclosures are effective for year-end 2023 reporting.

Disclosures

7. The following disclosures shall be made for investment income due and accrued in the financial statements. (SSAP No. 37 captures disclosures for mortgage loans on nonaccrual status pursuant to paragraph 6.)
- a. The bases by category of investment income for excluding (nonadmitting) any investment income due and accrued;
 - b. Disclose total amount excluded;

- c. Disclose the gross, nonadmitted and admitted amounts for interest income due and accrued;
- d. Disclose aggregate deferred interest;
- e. Disclose cumulative amounts of paid-in-kind (PIK) interest included in the current principal balance.

[https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2023/3-22-23 - Spring/Adoptions/22-17 - Interest Income.docx](https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/NationalMeetings/A.NationalMeetingMaterials/2023/3-22-23-Spring/Adoptions/22-17-InterestIncome.docx)

**Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A**

Issue: ASU 2022-04, Disclosure of Supplier Finance Program Obligations

Check (applicable entity):

	P/C	Life	Health
Modification of Existing SSAP	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
New Issue or SSAP	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Interpretation	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Description of Issue:

In September 2022, the Financial Accounting Standards Board (FASB) issued *Accounting Standards Update 2022-04, Liabilities—Supplier Finance Programs (Subtopic 405-50) Disclosure of Supplier Finance Program Obligations*. The Board issued ASU 2022-04 to enhance the transparency of supplier finance programs. ASU 2022-04 is effective for fiscal years beginning after December 15, 2022.

The amendments in ASU 2022-04 apply to all entities that use supplier finance programs in connection with the purchase of goods and services (described as buyer parties). Supplier finance programs, which also may be referred to as reverse factoring, payables finance, or structured payables arrangements, allow a buyer to offer its suppliers the option to access payment in advance of an invoice due date through a third-party finance provider or intermediary on the basis of invoices that the buyer has confirmed as valid.

Typically, a buyer in a program 1) enters into an agreement with a finance provider or an intermediary to establish the program, 2) purchases goods and services from suppliers with a promise to pay at a later date, and 3) notifies the finance provider or intermediary of the supplier invoices that it has confirmed as valid. Suppliers may then request early payment from the finance provider or intermediary for those confirmed invoices. Suppliers generally agree to accept an amount less than owed to receive payment from the intermediary timelier than the invoice due date. The full amount owed by the buyer is then paid to the intermediary, resulting in a spread income to the financing intermediary.

The ASU amendments require that a buyer in a supplier finance program disclose sufficient information about the program to allow a user of financial statements to understand the program's nature, activity during the period, changes from period to period, and potential magnitude. These disclosures were supported as buyers who utilize these programs are getting a form of financing, but the amounts owed to the financial intermediaries have been reported differently, with some entities reporting as trade payables and others reporting as debt. As such, users of the financial statements do not have clear information on the use of these financing structures. ASU 2022-04 requires the buyer to make the following annual disclosures of qualitative and quantitative information about its supplier finance programs:

1. The key terms of the program, including a description of the payment terms (including payment timing and basis for its determination) and assets pledged as security or other forms of guarantees provided for the committed payment to the finance provider or intermediary
2. For the obligations that the buyer has confirmed as valid to the finance provider or intermediary:
 - a. The amount outstanding that remains unpaid by the buyer as of the end of the annual period (the outstanding confirmed amount)
 - b. A description of where those obligations are presented in the balance sheet
 - c. A rollforward of those obligations during the annual period, including the amount of obligations confirmed and the amount of obligations subsequently paid.

In each interim reporting period, the buyer should disclose the amount of obligations outstanding that the buyer has confirmed as valid to the finance provider or intermediary as of the end of the interim period.

SSAP No. 105R—Working Capital Finance Investments addresses programs similar to some of the ones described in ASU 2022-04, however it addresses such programs from the perspective of evaluating investments in such programs for admissibility for the **investor** in such programs. That is, the insurers tend to act as a finance provider or an investor in the supplier chain finance program, not the “buyer.” Insurers are not typically “buyers” in such programs as they are described in ASU 2022-04. The guidance in SSAP No. 105R would describe the “buyer” in the ASU 2022-04 as an obligor of the working capital finance program. Therefore, since the disclosures in ASU 2022-04 are for buyers/obligors of supplier finance programs, not for providers of liquidity – the investors, the disclosures do not seem relevant to require of the investors in such programs for statutory accounting.

Note that if an insurer were to sell its premium receivables, existing guidance in *SSAP No. 42—Sale of Premium Receivables* and *SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishment of Liabilities* provide guidance which distinguishes sales from financing transactions. Therefore, the new GAAP disclosures in ASU 2022-04 are not recommended for incorporation into statutory accounting.

Existing Authoritative Literature:

SSAP No. 105R—Working Capital Finance Investments

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.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups):

The Working Group most recently updated SSAP No. 105R with substantive revisions which were effective June 30, 2020. Revisions to SSAP No. 105R were from agenda item 2019-25: Working Capital Finance Notes which also resulted in *Issue Paper No. 163—Working Capital Finance Investment Updates*. In agenda item 2019-25 the Working Group reviewed ten industry requests and incorporated 7 out of 10 revisions to SSAP No. 105R.

Information or issues (included in *Description of Issue*) not previously contemplated by the Working Group:

None

Convergence with International Financial Reporting Standards (IFRS): None

Staff Recommendation:

NAIC staff recommends that the Working Group move this item to the active listing, categorized as a SAP clarification, and expose revisions to SSAP No. 105R to reject ASU 2022-04 as illustrated below. As insurance reporting entities are not the buyers (obligors) of supplier chain finance programs, the disclosures in ASU 2022-04 are not relevant. Reporting entities that invest in working capital finance programs are the providers of capital (investors) not the buyers (obligors) of such programs. Revisions to SSAP No. 105R:

[33. ASU 2022-04, Disclosure of Supplier Finance Program Obligations is rejected.](#)

Staff Review Completed by: Robin Marcotte– NAIC Staff, November 2022

Status:

On December 13, 2022, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a SAP clarification, and exposed revisions to SSAP No. 105R to reject ASU 2022-04 for statutory accounting as the disclosures are not relevant for insurance entity preparers.

On March 22, 2023, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed revisions to SSAP No. 105R, as illustrated above, to reject ASU 2022-04 for statutory accounting.

<https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/NationalMeetings/A.NationalMeetingMaterials/2023/3-22-23-Spring/Adoptions/22-18ASU2022-04supplychain.docx>

Actuarial Guideline XLIX-A

THE APPLICATION OF THE LIFE ILLUSTRATIONS MODEL REGULATION TO POLICIES WITH INDEX-BASED INTEREST SOLD (On or After December 14, 2020)

Background

The *Life Insurance Illustrations Model Regulation* (#582) was adopted by the NAIC in 1995. Since that time there has been continued evolution in product design, including the introduction of benefits that are tied to an index or indices. Although these policies are subject to Model #582, not all of their features are explicitly referenced in the model, resulting in a lack of uniform practice in its implementation. In the absence of uniform guidance, two illustrations that use the same index and crediting method often illustrated different credited rates. The lack of uniformity can be confusing to potential buyers and can cause uncertainty among illustration actuaries when certifying compliance with Model #582.

~~In 2019, the NAIC decided that illustrations of products with multipliers, cap buy ups, and other enhancements that are linked to an index or indices should not illustrate better than products without such features. This new requirement is intended to apply to illustrations on policies sold on or after the effective date of this guideline while the existing requirements continue to apply for in-force illustrations on policies sold before the effective date of this guideline.~~

This guideline provides uniform guidance for policies with index-based interest. In particular, this guideline:

- (1) Provides guidance in determining the maximum crediting rate for the illustrated scale and the earned interest rate for the disciplined current scale.
- (2) Limits the policy loan leverage shown in an illustration.
- (3) Requires additional consumer information (side-by-side illustration and additional disclosures) that will aid in consumer understanding.

Text

1. Effective Date

This Actuarial Guideline shall be effective for all new business and in force illustrations on policies sold on or after December 14, 2020.

2. Scope

This Actuarial Guideline shall apply to any life insurance illustration that meets both (i) and (ii), below:

- i. The policy is subject to Model #582.
- ii. The policy offers Indexed Credits.

3. Definitions

- A. Alternate Scale: A scale of non-guaranteed elements currently being illustrated such that:

- i. The Annual Rate of Indexed Credits for each Index Account does not exceed the lesser of the maximum Annual Rate of Indexed Credits for the illustrated scale less 100 basis points and the credited rate for the Fixed Account. If the insurer does not offer a Fixed Account with the illustrated policy, the Annual Rate of Indexed Credits for each Index Account shall not exceed the average of the maximum Annual Rate of Indexed Credits for the illustrated scale and the guaranteed Annual Rate of Indexed Credits for that account. However, the Annual Rate of Indexed Credits for each Index Account shall never be less than the guaranteed Annual Rate of Indexed Credits for that account.
 - ii. If the illustration includes a loan, the illustrated Policy Loan Interest Credited Rate shall not exceed the illustrated Policy Loan Interest Rate. For example, if the illustrated Policy Loan Interest Rate is 4%, the Policy Loan Interest Credited Rate shall not exceed 4%.
 - iii. All other non-guaranteed elements are equal to the non-guaranteed elements for the illustrated scale.
- B. Annual Net Investment Earnings Rate: Gross portfolio annual earnings rate of the general account assets (excluding hedge assets for Indexed Credits), less provisions for investment expenses and default cost, allocated to support the policy. Charges of any kind cannot be used to increase the Annual Net Investment Earnings Rate.
- C. Annual Rate of Indexed Credits: The total annualized Indexed Credits expressed as a percentage of the account value used to determine the Indexed Credits.
- D. Benchmark Index Account: An Index Account with the following features:
- i. The interest calculation is based on the percent change in S&P 500[®] Index value only, over a one-year period using only the beginning and ending index values. (S&P 500[®] Index ticker: SPX)
 - ii. An annual cap is used in the interest calculation.
 - iii. The annual floor used in the interest calculation shall be 0%.
 - iv. The participation rate used in the interest calculation shall be 100%.
 - v. Interest is credited once per year.
 - vi. The Hedge Budget used to determine the cap in 3 (D) (ii) does not exceed the Annual Net Investment Earnings Rate. Charges of any kind cannot be used to increase the annual cap.
 - vii. There are no enhancements or similar features that provide additional Indexed Credits in excess of the interest provided by 3 (D) (i) through 3 (D) (v), including but not limited to experience refunds, multipliers, or bonuses.
 - viii. There are no limitations on the portion of account value allocated to the account.
 - ix. A single Benchmark Index Account will be determined for each policy. This can be either an Index Account offered with the illustrated policy or determined according to Section 4 (A) (ii) for purposes of complying with this guideline. A policy shall have no more than one Benchmark Index Account.

- E. Fixed Account: An account where there are no Indexed Credits.
- F. Hedge Budget: For each Index Account, the total annualized amount assumed to be used to generate the Indexed Credits of the account, expressed as a percent of the account value in the Index Account. This total annualized amount should be consistent with the hedging program of the company.
- G. Index Account: An account where some or all of the amounts credited are Indexed Credits.
- H. Indexed Credits: Any interest credit, multiplier, factor, bonus, charge reduction, or other enhancement to policy values that is linked to an index or indices. Amounts credited to the policy resulting from a floor greater than zero on an account with any interest credit, multiplier, factor, bonus, charge reduction, or other enhancement to policy values that is linked to an index or indices are included.
- I. Loan Balance: Any outstanding policy loan and loan interest, as defined in the policy.
- J. Policy Loan Interest Rate: The current annual interest rate as defined in the policy that is charged on any Loan Balance. This does not include any other policy charges.
- K. Policy Loan Interest Credited Rate: The annualized interest rate credited that applies to the portion of the account value backing the Loan Balance:
 - i. For the portion of the account value in the Fixed Account that is backing the Loan Balance, the Policy Loan Interest Credited Rate is the applicable annual interest crediting rate.
 - ii. For the portion of the account value in an Index Account that is backing the Loan Balance, the Policy Loan Interest Credited Rate is the Annual Rate of Indexed Credits, net of any applicable Supplemental Hedge Budget, for that account.
- L. Supplemental Hedge Budget: For each Index Account, the Hedge Budget minus the minimum of the Annual Net Investment Earnings Rate and the Hedge Budget that is used in the determination of the Benchmark Index Account. The Supplemental Hedge Budget will never be less than zero. This amount should be consistent with the hedging program of the company.

4. Illustrated Scale

The total Annual Rate of Indexed Credits for the illustrated scale for each Index Account shall be limited as follows:

- A. Calculate the geometric average annual credited rate for the Benchmark Index Account for the 25-year period starting on 12/31 of the calendar year that is 66 years prior to the current calendar year (e.g., 12/31/1949 for 2015 illustrations) and for each 25-year period starting on each subsequent trading day thereafter, ending with the 25- year period that ends on 12/31 of the prior calendar year.
 - i. If the insurer offers a Benchmark Index Account with the illustrated policy, the illustration actuary shall use the current annual cap for the Benchmark Index Account in 4 (A).
 - ii. If the insurer does not offer a Benchmark Index Account with the illustrated policy, the illustration actuary shall use actuarial judgment to determine a hypothetical, supportable current annual cap for a hypothetical, supportable Index Account that meets the definition

of the Benchmark Index Account, and shall use that cap in 4 (A).

- B. For the Benchmark Index Account the Annual Rate of Indexed Credits shall not exceed the minimum of (i) and (ii):
- i. The arithmetic mean of the geometric average annual credited rates calculated in 4 (A).
 - ii. 145% of the Annual Net Investment Earnings Rate.
- C. For any other Index Account that is not the Benchmark Index Account in 3 (D), the Annual Rate of Indexed Credits illustrated as a percentage of the account value in the Index Account prior to the deduction of any charges used to fund a Supplemental Hedge Budget shall not exceed the minimum of (i) and (ii) for policies sold prior to May 1, 2023, and shall not exceed the minimum of (i), (ii), and (iii) for policies sold on or after May 1, 2023:
- i. The Annual Rate of Indexed Credits for the Benchmark Index Account calculated in 4 (B) plus the Supplemental Hedge Budget for the Index Account.
 - ii. The Annual Rate of Indexed Credits reflecting the fundamental characteristics of the Index Account and the appropriate relationship to the expected risk and return of the Benchmark Index Account. The illustration actuary shall use actuarial judgment to determine this value using lookback methodology consistent with 4 (A) and 4 (B) (i) where appropriate.
 - iii. The lesser of (1) and (2) multiplied by the Annual Rate of Index Credits for the Benchmark Index Account, calculated in 4 (B), divided by (2); plus, the Supplemental Hedge Budget for the Index Account:
 1. The Hedge Budget of the Index Account
 2. Hedge Budget of the Benchmark Index Account.
- D. For the purposes of compliance with Section 6 (C) of Model #582, the Supplemental Hedge Budget is subtracted from the Annual Rate of Indexed Credits before comparing to the earned interest rate underlying the disciplined current scale.

At the beginning of each calendar year, the insurer shall be allowed up to three (3) months to update the credited rate for each Index Account in accordance with 4 (B) and 4 (C).

5. Disciplined Current Scale

The earned interest rate for the disciplined current scale shall be limited as follows:

- A. If an insurer engages in a hedging program for Indexed Credits in an account, the assumed earned interest rate underlying the disciplined current scale for that account, inclusive of all general account assets, both hedge and non-hedge assets, that support the policy, net of default costs and investment expenses (including the amount spent to generate the Indexed Credits of the policy) shall not exceed the lesser of (i) and (ii):
- i. The Annual Net Investment Earnings Rate, plus 45% of the lesser of (1) and (2):
 1. Hedge Budget minus any annual floor, to the extent that the floor is supported by the Hedge Budget.

2. The minimum of the Annual Net Investment Earnings Rate and the Hedge Budget that is used in the determination of the Benchmark Index Account.
- ii. The Annual Rate of Indexed Credits plus the Annual Net Investment Earnings Rate minus the Hedge Budget.

These rates should be adjusted for timing differences in the hedge cash flows to ensure that fixed interest is not earned on the Hedge Budget minus any annual floor, to the extent that the floor is supported by the Hedge Budget.

Guidance Note: The above approach does not stipulate any required methodology as long as it produces a consistent limit on the assumed earned interest rate underlying the disciplined current scale.

For a policy with multiple Index Accounts, a maximum rate in 5 (A) should be calculated for each account. All accounts, fixed and indexed, within a policy can be tested in aggregate.

- B. If an insurer does not engage in a hedging program for Indexed Credits, the assumed earned interest rate underlying the disciplined current scale shall not exceed the Annual Net Investment Earnings Rate.
- C. These experience limitations shall be included when testing for self-support and lapse-support under Model #582, accounting for all illustrated benefits including any illustrated benefits and bonuses that impact the policy's account value.

6. Policy Loans

If the illustration includes a loan, the illustrated Policy Loan Interest Credited Rate shall not exceed the illustrated Policy Loan Interest Rate by more than 50 basis points. For example, if the illustrated Policy Loan Interest Rate is 4.00%, the Policy Loan Interest Credited Rate shall not exceed 4.50%.

7. Additional Standards

The basic illustration shall also include the following:

- A. A ledger using the Alternate Scale shall be shown alongside the ledger using the illustrated scale with equal prominence.
- B. A table showing the minimum and maximum of the geometric average annual credited rates calculated in 4 (A).
- C. For each Index Account illustrated, a table showing actual historical index changes and corresponding hypothetical Indexed Credits using current index parameters for the most recent 20-year period.

Adopted by the Life Actuarial (A) Task Force – Dec. 11, 2022

Adopted by the Life Insurance and Annuities (A) Committee – Feb. 24, 2023

Adopted by the Executive (EX) Committee and Plenary – March 25, 2023

Actuarial Guideline LIV

Nonforfeiture Requirements for Index-Linked Variable Annuity Products

Background

The purpose of this guideline is to specify the conditions under which an Index-Linked Variable Annuity (ILVA) is consistent with the definition of a variable annuity and exempt from Model 805 and specify nonforfeiture requirements consistent with variable annuities.

A number of insurers have developed and are issuing annuity products with credits based on the performance of an index with caps on returns, participation rates, spreads or margins, or other crediting elements, that include a risk of negative index returns subject to limitations on the loss, such as a floor or a buffer. These products are not unitized and do not invest directly in the assets whose performance forms the basis for the credits.

There is no established terminology for these annuity products. These products go by several names, including structured annuities, registered index-linked annuities (RILA), or index-linked variable annuities, among others. This guideline refers to these products as index-linked variable annuities (ILVA).

Variable annuities are exempted from the scope of NAIC Model 805, *Standard Nonforfeiture Law for Individual Deferred Annuities*; however, NAIC Model 805 does not define the term "variable annuity".

NAIC Model 250, *Variable Annuity Model Regulation*, defines variable annuities as "contracts that provide for annuity benefits that vary according to the investment experience of a separate account." Section 7B of NAIC Model 250 provides that "to the extent that a variable annuity contract provides benefits that do not vary in accordance with the investment performance of a separate account" the contract shall satisfy the requirements of the NAIC Model 805.

The application of the NAIC Model 250 to a traditional variable annuity with unitized values is straightforward. The unitized feature provides an automatic linkage between annuity values and the investment experience of a separate account. Daily values (market values of the separate account assets) are the basis of all the benefits, including surrender values.

The fact that ILVA accounts are not unitized means they do not have values determined directly by the market prices of the underlying assets. Therefore, this guideline sets forth principles and requirements for determining values, including death benefit, withdrawal amount, annuitization amount or surrender values, such that an ILVA is considered a variable annuity and thereby exempt from Model 805. An ILVA that does not comply with the principles and requirements of this guideline is not considered a variable annuity and therefore is subject to Model 805.

Drafting Note: This guideline interprets the term "variable annuity" for purposes of exemption from Model 805. It is not intended to modify the definition of a variable annuity under Model 250 or other Model Regulations.

Scope

This guideline applies to any index-linked annuity exempt from the NAIC Model 805 on the basis that it is a variable annuity and includes index-linked crediting features that are built into policies or contracts (with or without unitized subaccounts) or added to such by rider, endorsement, or amendment.

Principles

This guideline is based on the following principles:

1. Interim Values defined in the contract provide equity between the contract holder and the insurance company.
2. Interim Values are consistent with the value of the Hypothetical Portfolio over the Index Strategy Term.

Definitions

“Derivative Asset Proxy” means a package of hypothetical derivative assets established at the beginning of an Index Strategy Term that is designed to replicate credits provided by an Index Strategy at the end of an Index Strategy Term.

“Fixed Income Asset Proxy” is a hypothetical fixed income asset.

“Hypothetical Portfolio” means a hypothetical portfolio composed of a Fixed Income Asset Proxy and a Derivative Asset Proxy.

“Index” means a benchmark designed to track the performance of a defined portfolio of securities.

“Index Strategy” means a method used to determine index credits with specified index or indices and cap, buffer, participation rate, spread, margin or other index crediting elements.

“Index Strategy Base” means the notional amount used to determine index credits that does not change throughout the Index Strategy Term except for withdrawals, transfers, deposits, loans, and any explicit charges.

“Index Strategy Term” means the period of time from the term start date to the term end date over which an index changes and the index credit is determined.

“Interim Value” means the Strategy Value at any time other than the start date and end date of an Index Strategy Term.

“Strategy Value” means the value, attributable to an Index Strategy, used in determining values including death benefit, withdrawal amount, annuitization amount or surrender values.

“Trading Cost” means the additional cost of liquidating the derivative assets in the Derivative Asset Proxy or actual derivative assets supporting the Index Strategy that is not accounted for in the Derivative Asset Proxy calculation.

Text

The Index Strategy Base must equal the Strategy Value at the Index Strategy Term start date.

The Fixed Income Asset Proxy is assumed to be a hypothetical fixed income asset with a yield that results in

- i. At the beginning of the Index Strategy Term, the book value of the Fixed Income Asset Proxy equal to the Index Strategy Base less the Derivative Asset Proxy value; and
- ii. At the end of the Index Strategy Term, the book value of the Fixed Income Asset Proxy, assuming no change in yield, projected to equal the Index Strategy Base.

Drafting Note: The guideline defines the conditions under which an index-linked variable annuity is exempt from Model 805 on the basis that it is a variable annuity. A variable annuity provides daily values (analogous to Interim Values in this guideline) based on the market value of separate account assets. In order to more closely align an ILVA to a variable annuity Interim Values should be consistent with the market value of hypothetical assets supporting the ILVA (i.e. Hypothetical Portfolio). The market value of the assets may be determined by a fair value methodology or by applying an MVA to the book value. A state may want to consider whether including or

excluding an MVA is appropriate. In making a determination regarding whether including or excluding an MVA is appropriate and, if applicable, what an acceptable MVA formula is, the state should consider whether the Interim Values provide reasonable equity between the contract holder and the insurance company.

The value of the package of derivative assets is determinable daily. Assumptions used to determine the market value of the Derivative Asset Proxy including implied volatilities, risk-free rates, and dividend yields must be consistent with the observable market prices of derivative assets, whenever possible.

Interim Values must be materially consistent with the value of the Hypothetical Portfolio over the Index Strategy Term less a provision for the cost attributable to reasonably expected or actual Trading Costs at the time the Interim Value is calculated.

If a contract provides Interim Values determined using a methodology other than a Hypothetical Portfolio methodology as described in this guideline, the company must demonstrate that the contractually defined Interim Values will be materially consistent over the Index Strategy Term with the Interim Values that would be produced using the Hypothetical Portfolio methodology for each combination of Index Strategy and Index Strategy Term under a reasonable number of realistic economic scenarios that include index changes that test crediting constraints and recognize initial option pricing market conditions.

The company must provide an actuarial memorandum with each ILVA product filing that includes the following:

1. Actuarial certifications must be included with each ILVA product filing and must include the following:
 - a. Interim Values defined in the contract provide equity between the contract holder and the insurance company;
 - b. The assumptions used to determine the market value of the Derivative Asset Proxy including implied volatilities, risk-free rates, dividend yields, and other parameters required to value the derivatives are consistent with the observable market prices of derivative assets over the Index Strategy Term, whenever possible. Valuation techniques include the standard Black-Scholes method, Monte-Carlo Simulation techniques, and other market consistent option valuation techniques for more complex options;
 - c. The contractually defined Interim Values are materially consistent with the Interim Values that would be produced using the Hypothetical Portfolio methodology for each combination of Index Strategy and Index Strategy Term over the Index Strategy Term less a provision for the Trading Costs at the time the Interim Value is calculated; and
 - d. Any Trading Costs represent reasonably expected or actual costs at the time the Interim Value is calculated.
2. If the Interim Values are determined using a methodology other than the Hypothetical Portfolio methodology described in this guideline, the actuary shall describe the testing performed to verify that the values are materially consistent with the Hypothetical Portfolio methodology. The actuary should define any parameters or assumptions used in determining material consistency and provide a summary of the results of the testing.
3. Descriptions of
 - a. The value of the Fixed Income Asset Proxy;
 - b. The market value adjustment formula, if any;
 - c. The market value of the Derivative Asset Proxy including any Trading Costs; and
 - d. All formulas, methodologies and assumptions used to calculate these values for each Index Strategy and Index Strategy Term as well as the sources for all assumptions.

ILVA nonforfeiture benefits for Index Strategies subject to this guideline must comply with Section 7 of Model 250 not including Section 7.B with net investment return consistent with the requirements for determining Interim Values in this guideline.

Effective Date

The Guideline applies to all contracts (including associated riders, endorsements, or amendments) issued on or after July 1, 2024.

**Revisions to the
As of March 2023 Accounting Practices and Procedures Manual**

On **May 16, 2023**, the Statutory Accounting Principles (E) Working Group adopted the following revisions to the *As of March 2023 Accounting Practices and Procedures Manual*. Documents associated with these revisions are linked to the reference items in bold text.

Ref #	SSAP/ Appendix	Title	Summary
INT 22-02	SSAP No. 9 SSAP No. 101	<p>INT 22-02: Third Quarter 2022 through Second Quarter 2023 Reporting of the Inflation Reduction Act - Corporate Alternative Minimum Tax</p> <p style="text-align: center;"><i>SAP Clarification</i></p> <p style="text-align: center;">Effective Immediately (May 16, 2023)</p>	<p>Adoption of <i>INT 22-02</i> extends this interpretation for the second quarter 2023 statutory financial statements. For application to the second quarter 2023 financial statements, reporting entities shall follow the guidance in this interpretation paragraphs 17 a-c.</p>
2023-11EP	SSAP No. 86 Various	<p>Editorial and Maintenance Update</p> <p style="text-align: center;"><i>Editorial Revisions</i></p> <p style="text-align: center;">Effective Immediately (May 16, 2023)</p>	<p>Revisions change SSAP No. 86 references of “Intrinsic Value” to reflect “Volatility Value”. In addition, “percent” is changed to “%” and all citations to <i>the Purposes and Procedures Manual of the NAIC Investment Analysis Office</i> are streamlined so they do not reflect a specific location in the Manual or a webpage.</p>

[https://naiconline.sharepoint.com/teams/frsstatutoryaccounting/national meetings/a. national meeting materials/2023/-23/adoptions/adoptions_2023 toc.docx](https://naiconline.sharepoint.com/teams/frsstatutoryaccounting/national%20meetings/a.%20national%20meeting%20materials/2023/-23/adoptions/adoptions_2023_toc.docx)

Interpretation of the Statutory Accounting Principles (E) Working Group

INT 22-02: Third Quarter 2022 through ~~First~~ Second Quarter 2023 Reporting of the Inflation Reduction Act - Corporate Alternative Minimum Tax

INT 22-02 Dates Discussed

October 6, 2022; October 24, 2022, November 16, 2022; December 13, 2022; [April 12, 2023](#); [May 16, 2023](#)

INT 22-02 References

Current:

SSAP No. 9—Subsequent Events

SSAP No. 101—Income Taxes

INT 22-02 Issue

Key Provisions of the Inflation Reduction Act

1. The Inflation Reduction Act (Act) was enacted on August 16, 2022, and included a new corporate alternative minimum tax (CAMT). The Act and the CAMT go into effect for tax years beginning after 2022. Reporting entities shall refer to the Act and the resulting regulations and other tax guidance to determine application, but a non-authoritative high-level summary based on information at the time of initial INT discussion regarding the CAMT is as follows:

- a. The CAMT is 15% of the corporation’s “adjusted financial statement income” for the tax year, reduced by corporate alternative minimum foreign tax credit.
- b. The CAMT will only apply to “applicable corporations” (determined on an affiliated group basis) with average adjusted financial statement income in excess of \$1 billion for the three prior tax years. This threshold is reduced to \$100 million in the case of certain foreign-parented corporations. When a corporation becomes subject to the CAMT, it remains an applicable corporation for purposes of the CAMT, even if its average adjusted financial statement income is less than \$1 billion, unless an exception applies.
- c. A corporation's adjusted financial statement income is the amount of net income or loss the corporation reports on its applicable financial statement. The income is adjusted for various purposes including certain adjustments in the case of consolidated returns or for foreign income.
- d. The Act includes references to the tax codes which provides a hierarchy for determining the “applicable financial statement.” At a high level, the first choice is U.S. generally accepted accounting principles (GAAP) financial statements; the second choice is international financial reporting standards (IFRS) financial statements. If GAAP and IFRS financial statements are not available, the financial statements filed by the taxpayer with any other regulatory or government body is acceptable. If the taxpayer is part of an affiliated group of corporations filing a consolidated return, the adjustable financial statement income for the group considers the group's applicable financial statement.
- e. To determine its U.S. federal income tax liability, an applicable corporation will need to compute taxes under both systems—the regular tax system and the CAMT system. The CAMT is payable to the extent the tentative CAMT exceeds the regular corporate income

tax. Any CAMT paid is available indefinitely as a credit carryover that could reduce future regular tax in future years if the regular tax liability is in excess of CAMT tax liability.

- f. The Act directs the Treasury to issue regulations and other guidance relate to implementing the CAMT, so several issues are pending detailed clarifications including clarifying the definition of an applicable corporation, and providing guidance on the starting point for, and adjustments to, adjusted financial statement income, as well as the handling of separate company tax returns when required under current tax law that are unique to the insurance industry.

Interpretation Issues

2. This interpretation is focused on addressing third quarter 2022 transition accounting and reporting aspects of the new CAMT. While most insurers will not be subject to the CAMT, for those that know that they are subject, and those that could be subject to the CAMT, there are a variety of reporting uncertainties, particularly regarding reporting for third quarter 2022.

3. The CAMT is effective for the tax years on or after 2023.

4. Both statutory accounting principles and U.S. GAAP require the effects of tax changes on deferred taxes, including the valuation allowance (future realizability of existing DTAs) in the period in which the legislation is enacted (third quarter 2022). *SSAP No. 101—Income Taxes*, paragraph 7.e. requires the statutory valuation allowance adjustment as a direct reduction in the gross DTA if, based on the weight of available evidence, it is more likely than not that some or all of the gross DTAs will not be realized. Gross DTA less the statutory valuation allowance results in adjusted gross DTAs. The statutory valuation allowance adjustment is not reported as a separate line in the statutory financial statements (it is an off-balance sheet item that reduces the gross DTAs). The statutory valuation allowance is disclosed.

5. The statutory accounting calculation for admissible DTAs is determined using adjusted gross DTAs (gross DTAs reduced by the valuation allowance). For statutory accounting, admittance of adjusted gross DTAs in *SSAP No. 101* depends on a three-component calculation, for which the second step limits admittance of adjusted gross DTAs to those that are expected to be realized in a timeframe that does not exceed three years. The actual number of years permitted depends on specifics for each reporting entity (type and other information about the reporting entity), but the maximum timeframe is three years. The last step admits DTAs which can be offset by DTLs.

6. Guidance in *SSAP No. 9—Subsequent Events* requires consideration of Type I and Type II¹ subsequent events through the date of the statutory financial statements and the date of issuance of the audited financial statements, or the date in which audited financial statements are available to be issued. For subsequent events identified after the statutory financial statements are filed (example, March 1), but before the audited financial statements are issued (example, June 1), reporting entities are generally required by their domestic state to amend their filed statutory financial statements to ensure that the statutory financial statements and the audited financial statements are consistent. Under this guidance, as additional information is made available on the impact of the Act, or information becomes available to update estimates and assessments, under existing statutory accounting guidance in *SSAP No. 9*, reporting entities would need to identify updated estimates as a Type I subsequent event in the audited financial statements.

¹ A Type I subsequent event relates to an event or transaction that provides additional evidence with respect to conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements. Under *SSAP No. 9*, entities shall recognize in the financial statements the effects of all material Type I subsequent events. A Type II subsequent event pertains to events or transactions that provide evidence to conditions that did not exist at the balance sheet date but arose after that date. Type II events are disclosed in the financial statements.

Issue 1 – Consideration of the Act for Third Quarter 2022 Financial Statements

7. During the period of enactment (third quarter 2022) reporting entities filing statutory financial statements would normally have to consider the applicability of the CAMT and if applicable, determine the impact on the statutory valuation allowance as well as assess DTAs for admissibility (e.g., realization timeframe). These elements will be collectively referred to as “calculations impacted by the Act” or “calculations impacted by the CAMT.”

8. This interpretation will address the issue for what reporting entities are required to report or disclose regarding the calculations impacted by the CAMT for September 30, 2022, financial statements.

Issue 2 – Consideration of Subsequent Events for Third Quarter 2022 Financial Statements

9. SSAP No. 9 requires consideration of subsequent events through the date of the statutory financial statements and the date of issuance of the audited financial statements, or the date in which audited financial statements are available to be issued.

10. For reporting entities that materially revise or establish calculations impacted by the CAMT subsequent to September 30, 2022 (including the statutory valuation allowance, the timing of determination of net admitted DTAs, and the determination of the applicability of the CAMT), this interpretation will address the extent a Type I or Type II subsequent event assessment is required for third quarter 2022 financial reporting.

INT 22-02 Discussion

11. The Statutory Accounting Principles (E) Working Group consensuses to the noted issues are included below.

Response: Issue 1 – Consideration of the Act for Third Quarter 2022 Financial Statements

12. Reporting entities that are aware they will be subject to the CAMT would normally reflect the effects of the Act on the calculations impacted by the CAMT if reasonably estimable for third quarter 2022. Because of the timing of the adoption of the Act and the considerable number of unknown variables for September 30, 2022, reporting, the Working Group has determined that a reasonable estimate is not determinable for third quarter 2022 interim financial statements for the calculations impacted by the CAMT.

13. Because reasonable estimates of calculations impacted by the CAMT are not determinable, reporting entities shall not recognize impacts related to CAMT for third quarter 2022 financial statements, but shall make the following disclosures regarding the CAMT and the Act:

- a. The Act was enacted during the reporting period on August 16, 2022.
- b. A statement regarding whether the reporting entity (or the controlled group of corporations of which the reporting entity is a member) has determined if it expects to be liable for CAMT in 2023. For example:
 - i. The reporting entity (or the controlled group of corporations of which the reporting entity is a member) has determined that it does not expect to be liable for CAMT in 2023.
 - ii. The reporting entity (or the controlled group of corporations of which the reporting entity is a member) has not determined as of the reporting date if it will be liable

for CAMT in 2023. The third quarter 2022 financial statements do not include an estimated impact of the CAMT because a reasonable estimate cannot be made.

- iii. The reporting entity (or the controlled group of corporations of which the reporting entity is a member) has determined that it expects to be liable for CAMT in 2023. The third quarter 2022 financial statements do not include an estimated impact of the CAMT, because a reasonable estimate cannot be made.

Response: Issue 2 – Consideration of Subsequent Events for Third Quarter 2022 Financial Statements

14. For third quarter 2022 reporting, CAMT updated estimates or other calculations affected by the Act determined subsequent to third quarter statutory financial statement or filing date shall not be recognized as Type I subsequent events. Meaning, amended financial statements are not required to reflect updated estimates subsequent to the third quarter filing date and prior to the filing the third quarter financial statements. With the disclosure required under Issue 1, additional subsequent event disclosure (such as what would be required for Type II event) is not required.

15. Reporting entities shall be working in good faith to complete the accounting for the changes adopted under the Act.

INT 22-02 Status

16. The consensuses in this interpretation were adopted on October 24, 2022, to provide reporting guidance regarding the calculations impacted by the CAMT and provide limited-scope, limited-time exceptions to the valuation allowance and DTA calculations in response to legislation under SSAP No. 101 as well as Type I subsequent event requirements in SSAP No. 9 for September 30, 2022, statutory reporting. As detailed, the exceptions to SSAP No. 101 and SSAP No. 9 are effective for third quarter 2022.

17. On December 13, 2022, the Working Group adopted a consensus to extend this interpretation for December 31, 2022, and first quarter 2023 statutory financial statements. For application as of year-end 2022 and first quarter 2023:

- a. Consistent with paragraphs 12 and 13, the Working Group has concluded that a reasonable estimate is not determinable for December 31, 2022, and March 31, 2023, therefore impacts related to the CAMT in the year-end 2022 and March 31, 2023, financial statements are not required.

~~b. The reporting entity shall include disclosures in paragraph 13 in the year end 2022 and March 31, 2023, financial statements. In addition, the reporting entity shall disclose the following:~~

- ~~i. If, based on information regarding the projected adjusted financial statement income for 2023, the entity or the controlled group of corporations of which the reporting entity is a member has determined if it is an “applicable corporation” to determine if CAMT exceeds the regular federal income tax payable. That is, disclose if the reporting entity (or the controlled group of corporations of which the reporting entity is a member) has determined if average “adjusted financial statement income” is above the thresholds for 2023 tax year that they expect to be required to perform the CAMT calculations. This disclosure is about being applicable corporation, not if the entity is required to pay.~~

Third Quarter 2022 through ~~First~~Second Quarter 2023 Reporting of the Inflation Reduction Act - INT 22-02
Corporate Alternative Minimum Tax

- ~~e.b.~~ Consistent with paragraph 14, CAMT updated estimates or other calculations affected by the Act determined subsequent to filing the December 31, 2022, and March 31, 2023, financial statements shall not be recognized as Type I subsequent events.
- ~~d.c.~~ For year-end 2022 financial statements, the subsequent event exception is expanded to encompass events that occur prior to the issuance of statutory financial statements as well as events that occur before the date the audited financial statements are issued, or available to be issued. This provision intends to prevent reporting entities from having to amend statutory financial statements from material Type I subsequent events as a result of updated information / estimates received after the reporting date of year-end 2022 statutory financial statements pertaining to the accounting for the enactment of the Act.

18. On May 16, 2023, the Working Group adopted a consensus to extend this interpretation for the second quarter 2023 statutory financial statements. For application to the second quarter 2023 financial statements, reporting entities shall follow the guidance in this interpretation paragraphs 17.a. through 17.c.

~~18,19.~~ With the extension, this interpretation will be automatically nullified on ~~June 15, 2023~~August 16, 2023.

~~19,20.~~ No. further discussion is planned.

[https://naiconline.sharepoint.com/teams/frsstatutoryaccounting/national meetings/a. national meeting materials/2023/05-16-23/adoptions/1 int 22-02-may 23 .docx](https://naiconline.sharepoint.com/teams/frsstatutoryaccounting/national%20meetings/a.%20national%20meeting%20materials/2023/05-16-23/adoptions/1%20int%2022-02-may%2023.docx)

NAIC Accounting Practices and Procedures Manual
Editorial and Maintenance Update
May 16, 2023

Maintenance updates provide revisions to the *Accounting Practices and Procedures Manual*, such as editorial corrections, reference changes and formatting.

SSAP/Appendix	Description/Revision
SSAP No. 86	Paragraph 43.g.ii.: Revise “Intrinsic Value” to reflect “Volatility Value”
P&P Manual References	All citations to the <i>Purposes and Procedures Manual of the NAIC Investment Analysis Office</i> (P&P Manual) are proposed to be reviewed and streamlined so they do not reflect a specific location in the P&P Manual or web page. These references will be eliminated to prevent inappropriate citations.
Percent References	Instances in which ‘percent’ is spelled out in combination with a number will be eliminated with retention of the % sign. This is a consistency change as the usage is currently inconsistent within the AP&P Manual.

Recommendation:

NAIC staff recommend that the Statutory Accounting Principles (E) Working Group move this agenda item to the active listing, categorize as a SAP Clarification, and expose editorial revisions as illustrated within.

SSAP No. 86R—Derivatives

Revise the reference to “Intrinsic Value” to reflect “Volatility Value.” This change was proposed by industry to clarify the disclosure category for the excluded component to the Blanks (E) Working Group and a corresponding revision is needed in SSAP No. 86R.

- 43.a. For hedging instruments with excluded components for determining hedge effectiveness:
- i. In the investment schedule, identify hedging instruments with excluded components and report the current fair value of the excluded component, the fair value of the excluded component that is reflected in the reported BACV for the hedging instrument (this item would not be applicable for foreign-currency forwards and currency swaps where the forward points or cross-currency basis, respectively, are the excluded component), and the change in fair value reported as an unrealized gain/loss.
 - ii. In the notes to the financial statements, provide information on the aggregate excluded components by category: Time Value, ~~Intrinsic~~-Volatility Value, Forward Points and Cross Currency Basis Spread. The aggregate amounts reported should include the following (as applicable): current fair value, recognized unrealized gain/loss, the fair value reflected in BACV, and for the excluded forward points (e.g., forward spot rates), the aggregate amount owed at maturity, along with current year and remaining amortization.

Purposes and Procedure Manual References

The following SSAPs will be revised to update references to the P&P Manual.

SSAP No. 25—Affiliates and Other Related Parties

- 21.h. The amount deducted from the value of an upstream intermediate entity or ultimate parent owned, either directly or indirectly, via a downstream subsidiary, controlled, or affiliated entity, in accordance with [SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities](#), ~~the Purposes and Procedure Manual of the NAIC Investment Analysis Office, “Procedures for Valuing Common Stocks and Stock Warrants.”~~

SSAP No. 26R—Bonds

- 4.a. Exchange traded funds (ETFs), which qualify for bond treatment, as identified in ~~Part Three of the Purposes and Procedures Manual of the NAIC Investment Analysis Office~~ and published on the SVO web page ~~at <https://content.naic.org/industry/securitiesvaluation-office>~~. (SVO-identified ETFs are reported on Schedule D – Part 1.)

SSAP No. 30R—Unaffiliated Common Stock

- 4.c. Shares of SEC registered Investment Companies³ 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), including shares of funds referenced in the “NAIC Fixed Income-Like SEC Registered Funds List” as identified in ~~Part Three of the Purposes and Procedures Manual of the NAIC Investment Analysis Office~~ and published on the SVO web page;
- 4.d. Exchange Traded Funds, except for those identified for bond or preferred stock treatment, as identified in ~~Part Three of the Purposes and Procedures Manual of the NAIC Investment Analysis Office~~ and published on the SVO web page ~~at <https://content.naic.org/industry/securities-valuation-office>~~;

SSAP No. 32R—Preferred Stock

- 4.a. Exchange Traded Funds, which qualify for preferred stock treatment, as identified in ~~Part Three of the Purposes and Procedures Manual of the NAIC Investment Analysis Office~~ and published on the SVO web page ~~at <https://content.naic.org/industry/securities-valuationoffice>~~. SVO-identified preferred stock ETFs shall follow the accounting provisions for perpetual preferred stock.

SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities

64. By August 31 or one month after the audit report date of each year, the NAIC shall initiate a review of all SCA investments for which new Sub 2 form filings have been received as well as an annual update review of Sub 2 SCA investments already logged in the VISION database. The NAIC review shall encompass a review of the most recent annual statutory reporting by the parent insurance company's Schedule Y (to ascertain the identity of the members of the holding company system and to ensure that information for all SCA companies has been submitted), a review of the parent's financial statement blank to review the last reported value for the SCA investments and a review of the VISION database to determine whether SCA debt and SCA preferred securities have been assigned NAIC designations. As part of its analysis, the NAIC shall review the portion of the bond investments carried by the parent or a subsidiary insurer with a **Z** notation. If the NAIC determines that the portion of the **Z** bonds shown on the documentation is significant, the NAIC shall not process the Sub 2 filing until the insurance company reports the bonds to permit removal of the **Z** notation. Beginning with year-end 2019, two new suffixes will apply: **YE** and **IF**. **YE** means that the security is a properly filed annual update that the SVO has determined will not be assigned an NAIC designation by the close of the year-end reporting cycle. The symbol **YE** is assigned by the SVO pursuant to the carryover administrative procedure described in ~~Part One, Section 3 f) (iii) of the Purposes and Procedures Manual of the NAIC Investment Analysis Office~~. When the SVO assigns the symbol **YE** it also assigns the NAIC designation in effect for the previous reporting year. **IF** means that the security is an initial filing that has been properly filed with the SVO but which the SVO has determined will not be assigned an NAIC designation by the close of the year-end reporting cycle. The symbol **IF** is assigned by the SVO and communicates that the insurer should self-designate the security for year-end and identify it with the symbol **IF**. **IF**, therefore, also communicates to the regulator that the NAIC designation reported by the insurance company was not derived by or obtained from the SVO, but has been determined analytically by a reporting insurance company.

Percent References

The following SSAPs will be revised to update the percent reference.

SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets:

13. As directed by *SSAP No. 101—Income Taxes*, tax loss contingencies (including related interest and penalties) for current and all prior years, shall be computed in accordance with this SSAP, with the following modifications:
- a. The term “probable” as used in this standard shall be replaced by the term “more likely than not (a likelihood of more than ~~50% percent~~)” for federal and foreign income tax loss contingencies only.
 - b. For purposes of the determination of a federal and foreign income tax loss contingency, it shall be presumed that the reporting entity will be examined by the relevant taxing authority that has full knowledge of all relevant information.
 - c. If the estimated tax loss contingency is greater than ~~50% percent~~ of the tax benefit originally recognized, the tax loss contingency recorded shall be equal to ~~100% percent~~ of the original tax benefit recognized.

As noted in SSAP No. 101, state taxes (including premium, income and franchise taxes) shall also be computed in accordance with this SSAP. These items (as detailed in SSAP No. 101) are not impacted by the modifications detailed in paragraphs 13.a.-13.c.

SSAP No. 16R—Electronic Data Processing Equipment and Software

4. The aggregate amount of admitted EDP equipment and operating system software (net of accumulated depreciation) shall be limited to ~~3% three percent~~ of the reporting entity’s capital and surplus as required to be shown on the statutory balance sheet of the reporting entity for its most recently filed statement with the domiciliary state commissioner adjusted to exclude any EDP equipment and operating system software, net deferred tax assets and net positive goodwill.^(INT 01-18)

SSAP No. 43R—Loan-Backed and Structured Securities

FN 10: Changes in the interest rate of a “plain-vanilla,” variable-rate beneficial interest (a plain-vanilla, variable-rate beneficial interest does not include those variable-rate beneficial interests with interest rate reset formulas that involve either leverage or an inverse floater) generally should not result in the recognition of an other-than-temporary impairment. For plain-vanilla, variable-rate beneficial interests, the yield is changed to reflect the revised interest rate based on the contractual interest rate reset formula. For example, if a beneficial interest pays interest quarterly at a rate equal to LIBOR plus ~~2% percent~~, the yield of that beneficial interest is changed prospectively to reflect changes in LIBOR. However, changes in the fair value of a plain-vanilla, variable-rate beneficial interest due to credit events should be considered when evaluating whether there has been an other-than-temporary impairment.

SSAP No. 57—Title Insurance

- 19.g. An investment in a title plant or plants in an amount equal to the actual cost shall be allowed as an admitted asset for title insurers. The aggregate carrying value of an investment in a title plant or plants shall not exceed the lesser of 20% of admitted assets or ~~forty percent (40%)~~ of surplus to policyholders, both as required to be shown on the statutory balance sheet of the insurer for its most recently filed statement with the domiciliary state commissioner; if the amount of the investment exceeds the above limits, the excess amount shall be recorded as a nonadmitted asset.

SSAP No. 60—Financial Guarantee Insurance

10. The contingency reserve shall be the greater of ~~50%~~~~fifty percent~~ of premiums written for each category or the amount provided by applying the following percentages to the principal guaranteed in each calendar year. The premiums written shall be net of reinsurance if the reinsurer has established a contingency reserve.
- | | | |
|----|--|--------------------------|
| a. | Municipal obligation bonds | 0.55% percent |
| b. | Special revenue bonds | 0.85% percent |
| c. | Investment grade Industrial Development Bonds (IDBs) secured by collateral or having a term of seven years or less, and utility first mortgage obligations | 1.00% percent |
| d. | Other investment grade IDBs | 1.50% percent |
| e. | Other IDBs | 2.50% percent |
| f. | Investment grade obligations, secured by collateral or having a term of seven years or less | 1.00% percent |
| g. | Other investment grade obligations not secured | 1.50% percent |
| h. | Non-investment grade consumer debt obligations | 2.00% percent |
| i. | Non-investment grade asset backed securities | 2.00% percent |
| j. | All other non-investment grade obligations | 2.50% percent |

SSAP No. 62R—Property and Casualty Reinsurance

- 116.a. The written premium ceded to the reinsurer by the reporting entity or its affiliates represents ~~fifty percent~~ (50%) or more of the entire direct and assumed premium written by the reinsurer based on its most recently available financial statement; or
- 116.b. ~~Twenty-five percent~~ (25%) or more of the written premium ceded to the reinsurer has been retroceded back to the reporting entity or its affiliates in separate reinsurance contract.

Exhibit C – Assumptions

Premium = \$1,000 (assumes no commissions or allowances)
 Coverage Period = 1 year
 Initial expected recoveries = \$225 per year (at end of year) for five years
 Initial Implicit rate = 4%~~percent~~*

*present value of \$225 per year for five years at 4%~~percent~~ = \$1,000

At the end of Year 2, the timing of anticipated recoveries under the reinsurance contract changes. A reevaluation of the implicit interest rate produces a rate of 3.63%~~percent~~ and an asset of \$640 at the end of the year.

SSAP No. 65—Property and Casualty Contracts

37. If the reporting entity does not hold specific collateral for the policy, amounts accrued for reimbursement of the deductible shall be billed in accordance with the provisions of the policy or the contractual agreement and shall be aged according to the contractual due date. In the absence of a contractual due date, billing date shall be utilized for the aging requirement. Deductible recoverables that are greater than ninety days old shall be nonadmitted. However, if the reporting

entity holds specific collateral for the high deductible policy, ~~10%ten percent~~ of deductible recoverable in excess of collateral specifically held and identifiable on a per policy basis, shall be reported as a nonadmitted asset in lieu of applying the aging requirement; however, to the extent that amounts in excess of the 10% are not anticipated to be collected they shall also be nonadmitted. The collateral requirements of this paragraph may be satisfied when an insured provides one collateral instrument to secure amounts owed under multiple policies, provided that the reporting entity has the contractual right to apply the collateral to the high deductible policy. Collateral obtained at a group level that is not supported by an existing pooling agreement requires a written allocation agreement among all collateral beneficiaries. The terms of such agreement must be fair and equitable. Documentation supporting any allocation of collateral among reporting entities must be maintained to allow proper calculation of the nonadmitted amounts and prohibit double counting of collateral.

SSAP No. 78—Multiple Peril Crop Insurance

3. Catastrophic insurance is designed to provide farmers with protection against extreme crop losses for a small processing fee. Buy-up insurance provides protection against more typical and smaller crop losses in exchange for a policyholder-paid premium. The government subsidizes the total premium for catastrophic insurance and a portion of the premium for buy-up insurance. Farmers who purchase buy-up crop insurance must choose both the coverage level (the proportion of the crop to be insured) and the unit price (such as, per bushel) at which any loss is calculated. With respect to the coverage level of production, farmers can choose to insure as much as ~~85%percent~~ of normal production or as little as ~~50%percent~~ of normal production at different price levels. With respect to the unit price, farmers choose whether to value their insured production at FCICs full estimated market price or at a percentage of the full price.
5. Companies participate in the MPCl program with FCIC through the Standard Reinsurance Agreement (SRA) per the terms of which the insurance companies share in the underwriting results of each policy. The SRA reinsurance terms provide a company the flexibility to limit its exposure on a state-by-state basis. MPCl premium is not expense loaded, therefore FCIC pays the insurance companies, on behalf of the policyholder, a percent of premium for administrative expenses associated with selling and servicing crop insurance policies, including the expenses associated with adjusting claims.
15. FCIC pays the insurance companies a percent of premium for administrative expenses associated with selling and servicing crop insurance policies, including the expenses associated with adjusting claims. The expense payment associated with the catastrophic coverage shall be recorded as a reduction of loss expenses whereas the expense payment for the buy-up coverage shall be recorded as a reduction of other underwriting expenses. The company shall disclose the total amounts received for each type of coverage.

SSAP No. 86—Derivatives

- 26.c. The term highly effective describes a cash flow hedging relationship where the change in fair value of the derivative hedging instrument is within 80 to ~~125%percent~~ of the opposite change in the fair value of the hedged item attributable to the hedged risk. It shall also apply when an R-squared of .80 or higher is achieved when using a regression analysis technique. Further guidance on determining effectiveness can be found within Exhibit A;
- 27.c. The term highly effective describes a cash flow hedging relationship where the change in cash flows or present value of cash flows of the derivative hedging instrument is within 80 to ~~125%percent~~ of the opposite change in the cash flows or present value of the cash flows of the hedged item attributable to the hedged risk. It shall also apply when an R-squared of .80 or higher is achieved when using a regression analysis technique. Further guidance on determining effectiveness can be found within Exhibit A.

Exhibit A, 19.c.ii. The variable-rate asset or liability has a floor or cap and the interest rate swap has a floor or cap on the variable interest rate that is comparable to the floor or cap on the variable-

rate asset or liability. For purposes of this paragraph, comparable does not necessarily mean equal. For example, if an interest rate swap's variable rate is based on LIBOR and an asset's variable rate is LIBOR plus 2% ~~percent~~, a 10% ~~percent~~ cap on the interest rate swap would be comparable to a 12% ~~percent~~ cap on the asset.

Exhibit A, 22

The fixed interest rate on a hedged item need not exactly match the fixed interest rate on an interest rate swap designated as a fair value hedge. Nor does the variable interest rate on an interest-bearing asset or liability need to be the same as the variable interest rate on an interest rate swap designated as a cash flow hedge. An interest rate swap's fair value comes from its net settlements. The fixed and variable interest rates on an interest rate swap can be changed without affecting the net settlement if both are changed by the same amount. That is, an interest rate swap with a payment based on LIBOR and a receipt based on a fixed rate of 5% ~~percent~~ has the same net settlements and fair value as an interest rate swap with a payment based on LIBOR plus 1% ~~percent~~ and a receipt based on a fixed rate of 6% ~~percent~~.

SSAP No. 92—Postretirement Benefits Other Than Pensions

49. As a minimum, amortization of a net gain or loss included in unassigned funds (surplus) shall be included as a component of net periodic postretirement benefit cost for a year if, as of the beginning of the year, that net gain or loss exceeds 10% ~~percent~~ of the greater of the accumulated postretirement benefit obligation or the fair value of plan assets. If amortization is required, the minimum amortization shall be that excess divided by the average remaining service period of active plan participants. If all or almost all of a plan's participants are inactive, the average remaining life expectancy of the inactive participants shall be used instead of the average remaining service period.
75. An employer shall disclose the amount of contributions to multiemployer plans for each annual period for which a statement of income is presented. An employer may disclose total contributions to multiemployer plans without disaggregating the amounts attributable to pension plans and other postretirement benefit plans. The disclosures shall include a description of the nature and effect of any changes affecting comparability, such as a change in the rate of employer contributions, a business combination, or a divestiture. This disclosure shall identify whether the contributions represent more than 5% ~~percent~~ of total contributions to the plan as indicated in the plan's most recently available annual report.

108.b.i ~~Ten~~ 10% ~~percent~~ of the calculated surplus impact as of the transition date; and

SSAP No. 93—Low-Income Housing Tax Credit Property Investments

Exhibit A Assumptions

1. All cash flows (except initial investment) occur at the end of each year.
2. Depreciation expense is computed, for book and tax purposes, using the straight-line method with a 27.5 year life (the same method is used for simplicity).
3. The investor made a \$100,000 investment for a 5% ~~percent~~ limited partnership interest in the project at the beginning of the first year of eligibility for the tax credit.
4. The partnership finances the project cost of \$4,000,000 with 50% ~~percent~~ equity and 50% ~~percent~~ debt.
5. The annual tax credit allocation (equal to 4% ~~percent~~ of the project's original cost) will be received for a period of 10 years.
6. The investor's tax rate is 40% ~~percent~~.

Chart Footnotes:

- (1) End-of-year investment for a ~~5% percent~~ limited liability interest in the project net of amortization in Column (2).
- (3) ~~4% Four percent~~ tax credit on \$200,000 tax basis of the underlying assets.

SSAP No. 100R—Fair Value

- 52.g. If a group of investments would otherwise meet the criteria in paragraph 45 but the individual investments to be sold have not been identified (for example, if a reporting entity decides to sell ~~20% percent~~ of its investments in private equity funds but the individual investments to be sold have not been identified), so the investments continue to qualify for the practical expedient in paragraph 39, the reporting entity shall disclose its plans to sell and any remaining actions required to complete the sale(s).

SSAP No. 101—Income Taxes

2. For purposes of accounting for federal and foreign income taxes, reporting entities shall adopt *FASB Statement No. 109, Accounting for Income Taxes* (FAS 109) with modifications for state income taxes^(INT 18-03), the realization criteria for deferred tax assets, and the recording of the impact of changes in deferred tax balances. One objective of accounting for income taxes is to recognize the estimated amount of taxes payable or refundable for the current year as a tax liability or asset. A second objective is to recognize deferred tax liabilities and assets for the future tax consequences of events that have been recognized in a reporting entity's statutory financial statements or tax returns. However, the second objective is realistically constrained because (a) the tax payment or refund that results from a particular tax return is a joint result of all the items included in that return, (b) taxes that will be paid or refunded in future years are the joint result of events of the current or prior years and events of future years, and (c) information available about the future is limited. As a result, financial statements will recognize current and deferred income tax assets and liabilities in accordance with the provisions of this statement based upon estimates and approximations. For purposes of this statement, only adjusted gross deferred tax assets that are more likely than not (a likelihood of more than ~~50% percent~~) to be realized shall be considered in determining admitted adjusted gross deferred tax assets.
- 3.a.i The term "probable" as used in SSAP No. 5R shall be replaced by the term "more likely than not (a likelihood of more than ~~50% percent~~)" for federal and foreign income tax loss contingencies only.
- 7.e. Gross DTAs are reduced by a statutory valuation allowance adjustment if, based on the weight of available evidence, it is more likely than not (a likelihood of more than ~~50% percent~~) that some portion or all of the gross DTAs will not be realized. The statutory valuation allowance adjustment, determined in a manner consistent with paragraphs 20-25 of FAS 109, shall reduce the gross DTAs to the amount that is more likely than not to be realized (the adjusted gross deferred tax assets).
- 1.3 SSAP No. 101 – Gross DTAs are reduced by a statutory valuation allowance adjustment that is determined on a separate company, reporting entity basis. Pursuant to paragraphs 2 and 7.e. of SSAP No. 101, gross DTAs are adjusted to an amount that is more likely than not to be realized (a likelihood of more than ~~50% percent~~). Only adjusted gross DTAs shall be considered in determining admitted adjusted gross DTAs. See Question 2 for further discussion of the statutory valuation allowance adjustment. See Question 4 for a further discussion of the admissibility test. See Question 12 for further discussion of presentation and disclosure of the statutory valuation allowance adjustment.
- 1.11 SSAP No. 101 – FIN 48 is rejected for statutory accounting pursuant to paragraph 31 of SSAP No. 101. SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets provides guidance in determining the amount of federal and foreign income tax loss contingencies with the following modifications. The term "probable" as used in SSAP No. 5R is replaced by the term "more likely than not (a likelihood of more than ~~50% percent~~)". In determining the amount of a federal or foreign income tax loss contingency, it shall be assumed that the reporting entity will be examined by the

- tax authority that has full knowledge of all relevant information. If the estimated tax loss contingency is greater than 50% of the tax benefit originally recognized, the tax loss contingency recorded shall be equal to 100% of the original tax benefit recognized. See Question 9 for further discussion of income tax loss contingencies.
- 2.1 A – An enterprise shall record a gross deferred tax liability or asset for all temporary differences and operating loss, capital loss and tax credit carryforwards. Temporary differences include unrealized gains and losses and nonadmitted assets but do not include AVR, IMR, Schedule F penalties and, in the case of a mortgage guaranty insurer, amounts attributable to its statutory contingency reserve to the extent that "tax and loss" bonds have been purchased. In general, temporary differences produce taxable income or result in tax deductions when the related asset is recovered or the related liability is settled. A deferred tax asset or liability represents the increase or decrease in taxes payable or refundable in future years as a result of temporary differences and carryforwards at the end of the current year. Additionally, gross DTAs are reduced by a statutory valuation allowance adjustment if, based on the weight of available evidence, it is more likely than not (a likelihood of more than ~~50% percent~~) that some portion or all of the gross DTAs will not be realized. The statutory valuation allowance adjustment, determined in a manner consistent with paragraphs 20-25 of FAS 109, shall reduce gross DTAs to the amount that is more likely than not to be realized (the adjusted gross deferred tax assets). This answer only addresses the recognition of adjusted gross DTAs and gross DTLs and does not address the admissibility of such amounts. See Question 4 for a discussion of the admissibility criteria of SSAP No. 101.
- 5.12 The temporary difference related to property and casualty unearned premiums is typically ~~twenty percent (20%)~~ of the outstanding statutory unearned premium reserve. If a company issues only one-year policies, it is reasonable to assume that the entire temporary difference will reverse in one year. If a company writes multi-year contracts, management will be required to estimate the percentage of the unearned premium that will be earned within each year of the applicable reversal period and apply these percentages to the outstanding temporary difference.
- 5.14 For those temporary differences that do not have a defined reversal period, such as unrealized losses on common stock or deferred compensation liabilities, management will need to determine when the temporary difference is "expected" to reverse. For instance, assume a company has an unrealized loss of \$200 in its equity portfolio and that, on average, the portfolio turns over ~~twenty percent (20%)~~ per year. It would be appropriate for the company to conclude that \$40 of the temporary difference will reverse in each year in the applicable reversal period. When determining when the temporary difference would be "expected" to reverse, management should normally consider events that are likely to occur using information, facts and circumstances in existence as of the reporting date. The estimates used in this circumstance should not be extended to other tests of impairment. For instance, when the entity assumed a 20% turnover in its equity portfolio, it is not involuntarily required to record an impairment in accordance with paragraph 10 of SSAP No. 30R— Unaffiliated Common Stock.
- 10.3 As an example, assume Company X files its 20X1 federal income tax return and reports \$1,000,000 of taxable income comprised of \$800,000 of ordinary income and \$200,000 of capital gain income. Since the company is subject to taxation at a ~~21% percent~~ tax rate on all its income, it incurred federal income tax expense of \$210,000. In preparing its 20X1 statutory income tax provision, the company estimated that its liability for 20X1 federal income tax would be \$147,000 based on \$600,000 of ordinary income and \$100,000 realized capital gains.
- 10.8 For example, assume the reporting entity has DTAs of \$1,000 relating to temporary differences other than unrealized losses, and a \$100 DTL relating to unrealized gains as of the beginning of the year. Since the entity is subject to tax at ~~21% percent~~ and all of its DTAs are expected to reverse within one year, the entity recorded a \$900 net admitted DTA as of the beginning of the year.
- 12.20 The Company has not recognized a deferred tax liability of approximately \$30,000 of foreign withholding taxes for the undistributed earnings of its ~~100% percent~~ owned foreign subsidiaries that arose in 20X2 and prior years because the Company does not expect those unremitted earnings to reverse and become taxable to the Company in the foreseeable future. A deferred tax liability will be recognized when the Company expects that it will recover those undistributed earnings in a

taxable manner, such as through receipt of dividends or sale of the investments. As of December 31, 20X2, the undistributed earnings of these subsidiaries were approximately \$200,000.

SSAP No. 102—Pensions

22. As a minimum, amortization of a net gain or loss included in unassigned funds (surplus) shall be included as a component of net pension cost for a year if, as of the beginning of the year, that net gain or loss exceeds 10% ~~percent~~ of the greater of the projected benefit obligation or the fair value of plan assets. If amortization is required, the minimum amortization shall be that excess divided by the average remaining service period of active employees expected to receive benefits under the plan. If all or almost all of a plan's participants are inactive, the average remaining life expectancy of the inactive participants shall be used instead of average remaining service.
79. A reporting entity shall disclose the amount of contributions to multiemployer plans for each annual period for which a statement of income is presented. A reporting entity may disclose total contributions to multiemployer plans without disaggregating the amounts attributable to pension plans and other postretirement benefit plans. The disclosures shall include a description of the nature and effect of any changes affecting comparability, such as a change in the rate of employer contributions, a business combination, or a divestiture. This disclosure shall identify whether the contributions represent more than 5% ~~percent~~ of total contributions to the plan as indicated in the plan's most recently available annual report.
- 93.b.i. ~~Ten~~ 10% ~~percent~~ of the calculated surplus impact as of the transition date;

SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities

22. An exchange of debt instruments with substantially different terms is also considered a debt extinguishment and shall be accounted for in accordance with paragraph 21. A debtor's exchange of debt instruments (in a nontroubled debt situation) is accomplished with debt instruments that are substantially different if the present value of the cash flows under the terms of the new debt instrument is at least 10% ~~percent~~ different from the present value of the remaining cash flows under the terms of the original instrument. If the difference between the present value of the cash flows under the terms of the new debt instrument and the present value of the remaining cash flows under the terms of the original debt instrument is less than 10% ~~percent~~, a creditor should evaluate whether the modification is more than minor based on the specific facts and circumstances (and other relevant considerations) surrounding the modification.
91. The reporting entity shall receive collateral having a fair value as of the transaction date at least equal to 102% ~~percent~~ of the fair value of the loaned securities at that date. If at any time the fair value of the collateral received from the counterparty is less than 100% ~~percent~~ of the fair value of the loaned securities, the counterparty shall be obligated to deliver additional collateral by the end of the next business day, the fair value of which, together with the fair value of all collateral then held in connection with the transaction at least equals 102% ~~percent~~ of the fair value of the loaned securities. If the collateral received from the counterparty is less than 100% ~~percent~~ at the reporting date, the difference between the actual collateral and 100% ~~percent~~ will be nonadmitted. Collateral value is measured and compared to the loaned securities in aggregate by counterparty.
92. In the event that foreign securities are loaned and the denomination of the currency of the collateral is other than the denomination of the currency of the loaned foreign securities, the amount of collateral shall be at least equal to 105% ~~percent~~ of the fair value of the loaned securities at that date. If at any time the fair value of the collateral received from the counterparty is less than 102% ~~percent~~ of the fair value of the loaned securities, the reporting entity must obtain additional collateral by the end of the next business day, the fair value of which together with the fair value of all collateral then held in connection with the transaction at least equals 105% ~~percent~~ of the fair value of the loaned securities. If the collateral received from the counterparty is less than 100% ~~percent~~ at the reporting date, the difference between the actual collateral and 100% ~~percent~~ will be nonadmitted. Collateral value is measured and compared to the loaned securities in aggregate by counterparty.

113. The collateral requirements for repurchase and reverse repurchase agreements are as follows:

Repurchase Transaction

- a. The reporting entity shall receive collateral having a fair value as of the transaction date at least equal to ~~95% percent~~ of the fair value of the securities transferred by the reporting entity in the transaction as of that date. If at any time the fair value of the collateral received from the counterparty is less than ~~95% percent~~ of the fair value of the securities so transferred, the counterparty shall be obligated to deliver additional collateral by the end of the next business day the fair value of which, together with the fair value of all collateral then held in connection with the transaction, at least equals ~~95% percent~~ of the fair value of the transferred securities. If the collateral is less than ~~95% percent~~ at the reporting date, the difference between the actual collateral and ~~95% percent~~ will be nonadmitted.

Reverse Repurchase Transaction

- b. The reporting entity shall receive as collateral transferred securities having a fair value at least equal to ~~102% percent~~ of the purchase price paid by the reporting entity for the securities. If at any time the fair value of the collateral is less than ~~100% percent~~ of the purchase price paid by the reporting entity, the counterparty shall be obligated to provide additional collateral, the fair value of which, together with fair value of all collateral then held in connection with the transaction, at least equals ~~102% percent~~ of the purchase price.

130. Exchanges of debt instruments or debt instrument modifications are considered extinguishments if the exchange or modification results with substantially different terms or is considered more than minor. If the cash flows under the terms of the new debt instrument are at least ~~10% percent~~ different from the present value of the remaining cash flows under the terms of the original instrument, then the exchange of, or modification to, debt instruments is considered substantially different and/or more than minor.

Illustration 3 Company C originates \$1,000 of loans that yield ~~10% percent~~ interest income for their estimated lives of 9 years. Company C transfers the entire loans to an entity and the transfer is accounted for as a sale. Company C receives as proceeds \$1,000 cash, a beneficial interest to receive ~~1% percent~~ on the contractual interest on the loans (an interest-only strip receivable), and an additional ~~1% percent~~ of the contractual interest as compensation for servicing the loans. The fair values of the servicing asset and the interest-only strip receivable are \$40 and \$60, respectively.

Illustration 4 – Facts

Transferor's carrying amount and fair value of security loaned	\$1,000
Cash "collateral"	1,020
Transferor's return from investing cash collateral at a 5% percent annual rate	5
Transferor's rebate to the securities borrower at a 4% percent annual rate	4

SSAP No. 104R—Share-Based Payments

117.a.ii. Any purchase discount from the market price does not exceed the per-share amount of share issuance costs that would have been incurred to raise a significant amount of capital by a public offering. A purchase discount of ~~5% percent~~ or less from the market price shall be considered to comply with this condition without further justification. A purchase discount greater than ~~5% percent~~ that cannot be justified under this condition results in compensation cost for the entire amount of the discount. Note that an entity that justifies a purchase discount in excess of ~~5% percent~~ shall reassess at least annually, and no later than the first share purchase offer during the fiscal year, whether it can continue to justify that discount pursuant to this paragraph.

122. Changes in total employee withholdings during a purchase period that occur solely as a result of salary increases, commissions, or bonus payments are not plan modifications if they do not

represent changes to the terms of the award that was offered by the employer and initially agreed to by the employee at the grant (or measurement) date. Under those circumstances, the only incremental compensation cost is that which results from the additional shares that may be purchased with the additional amounts withheld (using the fair value calculated at the grant date). For example, an employee may elect to participate in the plan on the grant date by requesting that ~~5% percent~~ of the employee's annual salary be withheld for future purchases of stock. If the employee receives an increase in salary during the term of the award, the base salary on which the ~~5% percent~~ withholding amount is applied will increase, thus increasing the total amount withheld for future share purchases. That increase in withholdings as a result of the salary increase is not considered a plan modification and thus only increases the total compensation cost associated with the award by the grant date fair value associated with the incremental number of shares that may be purchased with the additional withholdings during the period. The incremental number of shares that may be purchased is calculated by dividing the incremental amount withheld by the exercise price as of the grant date (for example, ~~85% percent~~ of the grant date stock price).

SSAP No. 108—Derivatives Hedging Variable Annuity Guarantees

11. The term “highly effective” describes a fair value hedging relationship where the change in fair value of the derivative instrument is within 80 to 125% ~~percent~~ of the opposite change in fair value of the hedged item attributed to the hedged risk. It shall also apply when an R-squared of .80 or higher is achieved when using a regression analysis technique.

Status:

On March 22, 2023, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a SAP clarification, and exposed editorial revisions as illustrated within the agenda item.

On May 16, 2023, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed editorial revisions, as illustrated above, to the *Accounting Practices and Procedures Manual*.

<https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/NationalMeetings/A.NationalMeetingMaterials/2023/05-16-23/Adoptions/23-11EP-Spring2023.docx>

**Revisions to the
As of March 2023, Accounting Practices and Procedures Manual**

On **August 13, 2023**, the Statutory Accounting Principles (E) Working Group adopted the following revisions to the *As of March 2023 Accounting Practices and Procedures Manual*. Documents associated with these revisions are linked to the reference items in bold text.

Ref #	SSAP/ Appendix	Title	Summary
2019-21	SSAP No. 26R SSAP No. 43R Various SSAPs	Bond Definition <i>New SAP Concept</i> Effective January 1, 2025	Adoption revises <i>SSAP No. 26R—Bonds</i> and <i>SSAP No. 43R—Loan-Backed and Structured Securities</i> for the principles-based bond definition, the accounting for bonds (issuer credit obligations and asset-backed securities), as well as revisions to various SSAPs that have been updated to reflect the revised definition and/or SSAP references.
2022-01	SSAP No. 5R IP No. 168	Conceptual Framework <i>SAP Clarification</i> Effective Immediately (August 13, 2023)	Adoption revises the definition of a liability under statutory accounting to be more consistent with recent FASB revisions.
2022-19	INT 23-01	Negative IMR <i>New SAP Concept</i> Effective Immediately (August 13, 2023)	Adoption provides an optional, limited-time guidance, which allows the admittance of net negative (disallowed) interest maintenance reserve (IMR) up to 10% of adjusted capital and surplus. <i>INT 23-01: Net Negative (Disallowed) Interest Maintenance Reserve</i> will be automatically nullified on January 1, 2026.
2023-02	SSAP No. 43R	CLO Financial Modeling <i>SAP Clarification</i> Effective December 31, 2023	Adopted revisions incorporate changes to add collateralized loan obligations (CLOs) to the financial modeling guidance and to clarify that CLOs are not captured as legacy securities.
2023-05	INT 20-01	<i>ASUs 2020-04, 2021-01 & 2022-06 - Reference Rate Reform</i> <i>SAP Clarification</i> Effective Immediately (August 13, 2023)	Adoption provides a temporary (optional) expedient and exception interpretative guidance to revise the expiration date of the guidance in <i>INT 20-01: ASUs 2020-04 & 2021-01 – Reference Rate Reform</i> to December 31, 2024.

Ref #	SSAP/ Appendix	Title	Summary
2023-06	SSAP No. 24	Additional Updates on <i>ASU 2021-10, Government Assistance</i> <i>SAP Clarification</i> Effective Immediately (August 13, 2023)	Adoption clarifies <i>SSAP No. 24—Discontinued Operations and Unusual or Infrequent Items</i> for the rejection of <i>ASU No. 2021-10</i> while incorporating certain disclosures regarding government assistance.
2023-07	SSAP No. 47 SSAP No. 95 SSAP No. 104R	<i>ASU 2019-08 on Stock Compensation and Revenue Recognition</i> <i>SAP Clarification</i> Effective Immediately (August 13, 2023)	Revisions adopt with modification <i>ASU 2019-08</i> to include share-based consideration payable to customers in the scope of <i>SSAP No. 47—Uninsured Plans</i> , <i>SSAP No. 95—Nonmonetary Transactions</i> , and <i>SSAP No. 104R—Share-Based Payments</i> .
2023-08	Appendix D	<i>ASU 2019-07, Codification Updates to SEC Sections...</i> <i>SAP Clarification</i> Effective May 1, 2023	Adoption rejects <i>ASU 2019-07</i> as not applicable for statutory accounting.
2023-09	Appendix D	<i>ASU 2020-09, Amendments to SEC Paragraphs...</i> <i>SAP Clarification</i> Effective Immediately (August 13, 2023)	Adoption rejects <i>ASU 2020-09</i> as not applicable for statutory accounting.
2023-10	Appendix D	<i>ASU 2022-05, Transition for Sold Contracts</i> <i>SAP Clarification</i> Effective Immediately (August 13, 2023)	Adoption rejects <i>ASU 2022-05</i> as not applicable for statutory accounting.
2023-13	SSAP No. 34	PIK Interest Disclosure <i>SAP Clarification</i> Effective for year-end 2023 disclosures	Adopted revisions clarify and incorporate a practical expedient to the paid-in-kind (PIK) interest aggregate disclosure for <i>SSAP No. 34—Investment Income Due and Accrued</i> and proposed annual statement instructions.

Statement of Statutory Accounting Principles No. 26

Bonds

STATUS

Type of Issue.....	Common Area
Issued	August 13, 2023
Effective Date	January 1, 2025
Affects	Replaces SSAP No. 26R on January 1, 2025
Affected by.....	No other pronouncements
Interpreted by	INT 01-25; INT 06-02; INT 06-07; INT 07-01
Relevant Appendix A Guidance.....	None

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SCOPE OF STATEMENT

1. The principles-based definition of a bond within this statement shall be utilized to identify whether security structures should be reported as bonds. Investments that qualify within the principles-based definition as an issuer credit obligation shall follow the accounting guidance within this statement. Investments that qualify within the principles-based definition as an asset-backed security (ABS) shall follow the accounting guidance in *SSAP No. 43R—Asset-Backed Securities*.
2. In addition to security investments that qualify under the principles-based definition as issuer credit obligations, certain specific instruments are also captured in scope of this statement:
 - a. Certificates of deposit that have a fixed schedule of payments and a maturity date in excess of one year from the date of acquisition;
 - b. Bank loans that are obligations of operating entities issued directly by a reporting entity or acquired through a participation, syndication or assignment¹;
 - c. Debt instruments in a certified capital company (CAPCO) ^(INT 06-02)
 - d. Exchange Traded Funds (ETFs) that qualify for bond treatment as identified in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* and included in the ‘SVO-Identified Bond ETF List’ published on the SVO’s webpage. (These instruments are referred to as SVO-Identified Bond ETFs.)
 - e. Mortgage loans in scope of *SSAP No. 37—Mortgage Loans* that qualify under an SVO structural assessment and are identified as SVO-Identified Credit Tenant Loans.
3. Securities that qualify as issuer credit obligations with a maturity date of one year or less from date of acquisition that qualify as cash equivalents or short-term investments shall follow the accounting requirements of this statement. These investments are also captured in *SSAP No. 2R—Cash, Cash*

¹ **Bank Loan** – Fixed-income instruments, representing indebtedness of a borrower, made by a financial institution. Bank loans can be issued directly by a reporting entity or acquired through an assignment, participation or syndication:

- **Assignment** – A bank loan assignment is defined as a fixed-income instrument in which there is the sale and transfer of the rights and obligations of a lender (as assignor) under an existing loan agreement to a new lender (and as assignee) pursuant to an Assignment and Acceptance Agreement (or similar agreement) which effects a novation under contract law, so the new lender becomes the direct creditor of and is in contractual privity with the borrower having the sole right to enforce rights under the loan agreement.
- **Participation** – A bank loan participation is defined as a fixed-income investment in which a single lender makes a large loan to a borrower and subsequently transfers (sells) undivided interests in the loan to other entities. Transfers by the originating lender may take the legal form of either assignments or participations. The transfers are usually on a nonrecourse basis, and the originating lender continues to service the loan. The participating entity may or may not have the right to sell or transfer its participation during the term of the loan, depending on the terms of the participation agreement. Loan Participations can be made on a parri-passu basis (where each participant shares equally) or a senior subordinated basis (senior lenders get paid first and the subordinated participant gets paid if there are sufficient funds left to make a payment).
- **Syndication** – A bank loan syndication is defined as a fixed-income investment in which several lenders share in lending to a single borrower. Each lender loans a specific amount to the borrower and has the right to repayment from the borrower. Separate debt instruments exist between the debtor and the individual creditors participating in the syndication. Each lender in a syndication shall account for the amounts it is owed by the borrower. Repayments by the borrower may be made to a lead lender that then distributes the collections to the other lenders of the syndicate. In those circumstances, the lead lender is simply functioning as a servicer and shall not recognize the aggregate loan as an asset. A loan syndication arrangement may result in multiple loans to the same borrower by different lenders. Each of those loans is considered a separate instrument.

Equivalents, Drafts and Short-Term Investments and shall follow the reporting and disclosure requirements of that statement.

4. This statement excludes:
- a. Mortgage loans and other real estate lending activities made in the ordinary course of business. These investments are addressed in *SSAP No. 37—Mortgage Loans* and *SSAP No. 39—Reverse Mortgages*.
 - b. Investments that qualify within the principles-based definition as an ABS. These investments shall follow the guidance in *SSAP No. 43R—Asset-Backed Securities*
 - c. Securities that provide varying principal or interest based on underlying equity appreciation or depreciation, an equity-based derivative, real estate or other non-debt variable, as described in paragraph 6.d.
 - d. Securities that do not qualify as bonds pursuant to the principles-based bond definition, including first loss positions that lack contractual payments or substantive credit enhancement. These investments shall follow the appropriate guidance in *SSAP No. 21R—Other Admitted Assets*.
 - e. Replication (synthetic asset) transactions addressed in *SSAP No. 86—Derivatives*. The admissibility, classification and measurement of a replication (synthetic asset) transactions are not preemptively determined by the principles-based bond definition and should be evaluated in accordance with the guidance on replication (synthetic asset) transactions within SSAP No. 86.
 - f. Investments that are captured specifically within other SSAPs. For example, reporting entity acquired structured settlements are captured in scope of *SSAP No. 21R—Other Admitted Assets*, held surplus notes are captured in scope of *SSAP No. 41R—Surplus Notes* and working capital finance investments are captured in scope of *SSAP No. 105—Working Capital Finance Investments*. Investments captured in scope of other SSAPs are subject to the measurement and admittance provisions of those SSAPs. Furthermore, investments that have specific reporting lines on dedicated schedules (such as with both surplus notes and WCFI) shall be reported on their dedicated lines.

SUMMARY CONCLUSION

Principles-Based Bond Definition

5. A bond shall be defined as any security² representing a creditor relationship, whereby there is a fixed schedule for one or more future payments, and which qualifies as either an issuer credit obligation or an asset-backed security as described in this statement.

² This statement adopts the GAAP definition of a security as it is used in FASB Accounting Standards Codification Topics 320 and 860. Evaluation of an investment under this definition should consider the substance of the instrument rather than solely its legal form.

Security: A share, participation, or other interest in property or in an entity of the issuer or an obligation of the issuer that has all of the following characteristics:

- a. It is either represented by an instrument issued in bearer or registered form or, if not represented by an instrument, is registered in books maintained to record transfers by or on behalf of the issuer.
- b. It is of a type commonly dealt in on securities exchanges or markets or, when represented by an instrument, is commonly recognized in any area in which it is issued or dealt in as a medium for investment.
- c. It is either one of a class or series or by its terms is divisible into a class or series of shares, participations, interests or obligations.

6. Determining whether a security represents a creditor relationship should consider its substance, rather than solely the legal form of the instrument. The analysis of whether a security represents a creditor relationship should consider all other investments the reporting entity owns in the investee as well as any other contractual arrangements. A security that in substance possesses equity-like characteristics or represents an ownership interest in the issuer does not represent a creditor relationship. While not intended to be all-inclusive, paragraphs 6.a.-6.d. discuss specific elements that may introduce equity-like characteristics:

- a. Determining whether a debt instrument represents a creditor relationship in substance when the source of cash flows for repayment is derived from underlying equity interests inherently requires significant judgment and analysis. Unlike a debt instrument collateralized by assets with contractual cash flows, debt instruments collateralized by equity interests are dependent on cash flow distributions that are not contractually required to be made and are not controlled by the issuer of the debt. As a result, there is a rebuttable presumption that a debt instrument collateralized by equity interests does not represent a creditor relationship in substance. Notwithstanding this rebuttable presumption, it is possible for such a debt instrument to represent a creditor relationship if the characteristics of the underlying equity interests lend themselves to the production of predictable cash flows and the underlying equity risks have been sufficiently redistributed through the capital structure of the issuer. Factors to consider in making this determination include but are not limited to:
 - i. Number and diversification of the underlying equity interests
 - ii. Characteristics of the underlying equity interests (vintage, asset-types, etc.)
 - iii. Liquidity facilities
 - iv. Overcollateralization
 - v. Waiting period for distributions/paydowns to begin
 - vi. Capitalization of interest
 - vii. Covenants (e.g., loan-to-value trigger provisions)
 - viii. Reliance on ongoing sponsor commitments
- b. While reliance of the debt instrument on sale of underlying equity interests or refinancing at maturity does not preclude the rebuttable presumption from being overcome, it does require that the other characteristics mitigate the inherent reliance on equity valuation risk to support the transformation of underlying equity risk to bond risk. As reliance on sale or refinancing increases, the more compelling the other factors needed to overcome the rebuttable presumption become.
- c. Analysis of whether the rebuttable presumption for underlying equity interests is overcome shall be conducted and documented by a reporting entity at the time such an investment is acquired. The level of documentation and analysis required will vary based on the characteristics of the individual debt instrument, as well as the level of third-party and/or non-insurance company market validation to which the issuance has been subjected. For example, a debt instrument collateralized by fewer, less diversified equity interests would require more extensive and persuasive documented analysis than one collateralized by a larger diversified portfolio of equity interests. Likewise, a debt instrument that has been successfully marketed to unrelated and/or non-insurance company investors, may provide enhanced market validation of the structure compared to one held only by related party and/or insurance company investors where capital relief may be the primary motivation for the securitization.
- d. In order for a debt instrument to represent a creditor relationship in accordance with

Paragraph 6, it must have pre-determined principal and interest payments (whether fixed interest or variable interest) with contractual amounts that do not vary based on the appreciation or depreciation (i.e., performance) of any underlying collateral value or other non-debt variable. For example, an issued security that has varying principal and interest payments based on the appreciation of referenced equity, real estate or other non-debt variable is precluded from bond treatment. This exclusion is not intended to restrict variables that are commonly related to debt instruments such as, but not limited to, plain-vanilla³ inflation or benchmark interest rate adjustments (such as with U.S. TIPs or SOFR-linked coupons, respectively), scheduled interest rate step-ups, or credit-quality related interest rate adjustments. This exclusion is also not intended to encompass nominal interest rate adjustments⁴. For clarification purposes, all returns from a debt instrument in excess of principal are required to be considered as interest. Therefore, investments with “stated” interest and then “additional returns” to which the holder of the debt instrument is entitled are collectively considered as interest and shall be assessed together in determining whether the investment has variable principal or interest due to underlying referenced non-debt variables. Examples of securities excluded from the bond definition under this guidance:

- i. Structured Notes, which are securities that otherwise meet the definition of a bond, but for which the contractual amount of the instrument to be paid at maturity (or the original investment) is at risk for other than the failure of the borrower to pay the principal amount due, are excluded from the bond definition. These investments, although in the form of a debt instrument, incorporate the risk of an underlying variable in the terms of the agreement, and the issuer obligation to return the full principal is contingent on the performance of the underlying variable. These investments are addressed in *SSAP No. 86—Derivatives*. Mortgage-referenced securities issued by a government sponsored enterprise are explicit inclusions in scope of SSAP No. 43. Foreign-denominated bonds subject to variation as a result of foreign currency fluctuations are not structured notes.
- ii. Principal-protected securities, as defined in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* are excluded from the bond definition as they have a performance component whose payments originate from, or are determined by, non-fixed income securities. These investments shall follow the guidance for non-bond securities in *SSAP No. 21—Other Admitted Assets*.

³ Inflation or benchmark interest rate adjustment mechanisms are considered plain-vanilla if based on widely recognized measures of inflation or interest rate benchmarks and excludes those that involve either leverage (such as a multiplier) or an inverse adjustment relationship.

⁴ Nominal interest rate adjustments are those that are too small to be taken into consideration when assessing the investment’s substance as a bond. Nominal adjustments are not typically influential factors in an investors’ evaluation of investment return and are often included to incentivize certain behavior of the issuer. An example would include sustainability-linked bonds where failure to achieve performance metrics could cause interest rate adjustments. In general, interest rate adjustments that adjust the total return from interest by more than 10% (e.g., >0.4% for a 4% yielding bond), would not be considered nominal. Further, any such adjustments that cause an investment to meet the definition of a structured note would not be considered nominal.

7. An issuer credit obligation is a bond, for which the general creditworthiness of an operating entity or entities through direct or indirect recourse, is the primary⁵ source of repayment. Operating entity or entities includes holding companies with operating entity subsidiaries where the holding company has the ability to access the operating subsidiaries' cash flows through its ownership rights. An operating entity may be any sort of business entity, not-for-profit organization, governmental unit, or other provider of goods or services, but not a natural person or "ABS Issuer" (as defined in paragraph 8). Examples of issuer credit obligations include, but are not limited to:

- a. U.S. Treasury securities, including U.S. Treasury Inflation-Indexed Securities;^(INT 01-25)
- b. U.S. government agency securities;
- c. Municipal securities issued by the municipality or supported by cash flows generated by a municipally-owned asset or entity that provides goods or services (e.g., airport, toll roads, etc.);
- d. Corporate bonds issued by operating entities, including Yankee bonds and zero-coupon bonds;
- e. Corporate bonds, issued by holding companies that own operating entities;
- f. Project finance bonds issued by operating entities;
- g. Investments in the form of securities for which repayment is fully supported by an underlying contractual obligation of a single operating entity (e.g., Credit Tenant Loans (CTLs), Equipment trust certificates (ETCs), other lease backed securities, Funding Agreement Backed Notes (FABNs), etc.). For purposes of applying this principal concept, repayment is fully-supported by the underlying operating entity obligation if it provides cash flows for the repayment of all interest and at least 95% of the principal of the security.
- h. Bonds issued by real estate investment trusts (REITs) or similar property trusts;
- i. Bonds issued by business development corporations, closed-end funds, or similar operating entities, in each case registered under the 1940 Act.
- j. Convertible bonds issued by operating entities, including mandatory convertible bonds as defined in paragraph 20.b.

⁵ "Primary" refers to the first in order of repayment source, not to a majority of the sources of repayment. For example, an issuer obligation may have secondary recourse to collateral upon default of the operating entity but would otherwise be expected to be fully repaid with cash flows of the operating entity. This differs from an asset-backed security for which the primary source of repayment is from cash flows of the collateral.

8. An asset-backed security⁶ is a bond issued by an entity (an “ABS Issuer”) created for the primary purpose of raising debt capital backed by financial assets⁷ or cash generating non-financial assets owned by the ABS Issuer, for which the primary source of repayment is derived from the cash flows associated with the underlying defined collateral rather than the cash flows of an operating entity⁸. In most instances, the ABS Issuer is not expected to continue functioning beyond the final maturity of the debt initially raised by the ABS Issuer. Also, many ABS Issuers are in the form of a trust or special purpose vehicle (“SPV”), although the presence or lack of a trust or SPV is not a definitive criterion for determining that a security meets the definition of an asset-backed security. The provisions in paragraphs 9-10 detail the two defining characteristics that must be present for a security to meet the definition of an asset-backed security.

9. The assets owned by the ABS Issuer are either financial assets or cash-generating non-financial assets. Cash-generating non-financial assets are defined as assets that are expected to generate a meaningful level of cash flows toward repayment of the bond through use, licensing, leasing, servicing or management fees, or other similar cash flow generation. For the avoidance of doubt, there must be a meaningful level of cash flows to service the debt, other than through the sale or refinancing of the underlying assets held by the ABS Issuer. Reliance on cash flows from the sale or refinancing of cash generating non-financial assets does not preclude a security from being classified as an asset-backed security so long as the conditions in this paragraph are met.

- a. *Meaningful Level of Cash Flows:* Determining what constitutes a “meaningful” level of cash flows generated to service the debt from sources other than the sale or refinancing of the underlying collateral pursuant to paragraph 9 is specific to each transaction, determined at origination, and shall consider the following factors:
 - i. The price volatility in the principal market for the underlying collateral;
 - ii. The liquidity in the principal market for the underlying collateral;
 - iii. The diversification characteristics of the underlying collateral (i.e., types of collateral, geographic location(s), source(s) of cash flows within the structure, etc.);
 - iv. The overcollateralization of the underlying collateral relative to the debt obligation; and
 - v. The variability of cash flows, from sources other than sale or refinancing, expected to be generated from the underlying collateral.

⁶ The underlying collateral supporting an asset-backed security shall meet the definition of an asset by the ABS Issuer. Certain forms of collateral, such as rights to future cash flows, may not be recognized as assets by the selling entity but may be recognized as assets when sold to an ABS Issuer. These assets are permitted as the collateral supporting an asset-backed security, although they may not represent an asset that can be liquidated to provide payment toward the issued debt obligations (i.e., if the future cash flows do not materialize). The limited ability to liquidate the underlying collateral supporting an asset-backed security does not impact the structural determination of whether an issued security meets the definition of an asset-backed security but may impact the recoverability of the investment, as well as the consideration of whether there is sufficient credit enhancement.

⁷ SSAP No. 103R—*Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* defines a financial asset as cash, evidence of an ownership interest in an entity, or a contract that conveys to one entity a right (a) to receive cash or another financial instrument from a second entity or (b) to exchange other financial instruments on potentially favorable terms with the second entity. As a point of clarity, for the purposes of this standard, financial assets do not include assets for which the realization of the benefits conveyed by the above rights depends on the completion of a performance obligation (e.g., leases, mortgage servicing rights, royalty rights, etc.). These assets represent non-financial assets, or a means through which non-financial assets produce cash flows, until the performance obligation has been satisfied.

⁸ Dedicated cash flows from an operating entity can form the underlying defined collateral in an asset-backed security. This dynamic, perhaps noted in a whole-business securitization, still reflects an asset-backed security and is not an issuer credit obligation.

The factors for price variability and the variability of cash flows are directly related to the “meaningful” requirement. That is, as price volatility or variability of cash flows increase, the required percentage of cash flows generated to service the debt from sources other than the sale or refinancing of the underlying collateral must also increase. The factors for liquidity, diversification and overcollateralization are inversely related to the “meaningful” concept. That is, as liquidity, diversification or overcollateralization increase, the required percentage of cash flows generated to service the debt from sources other than the sale or refinancing of the underlying collateral may decrease.

- b. As a practical expedient to determining whether a cash generating non-financial asset is expected to produce meaningful cash flows, a reporting entity may consider an asset for which less than 50% of the original principal relies on sale or refinancing to meet the meaningful criteria. In applying this practical expedient, only contractual cash flows of the non-financial assets may be considered. This practical expedient should not be construed to mean that assets cannot meet the meaningful criteria if they rely on sale or refinancing to service greater than 50% of the original principal or if they rely on cash flows that are not contracted at origination. Rather, such instances would require a complete analysis of the considerations described within the meaningful level of cash flows definition in [paragraph 9](#).

10. The holder of a debt instrument issued by an ABS Issuer is in a different economic position than if the holder owned the ABS Issuer’s assets directly. The holder of the debt instrument is in a different economic position if such debt instrument benefits from substantive credit enhancement through guarantees (or other similar forms of recourse), subordination and/or overcollateralization.

- a. *Substantive Credit Enhancement:* The intent of the criteria requiring the holder to be in a different economic position is to distinguish qualifying bonds from instruments with equity-like characteristics or where the substance of the transaction is more closely aligned with that of the underlying collateral. To qualify as an ABS under this standard, there is a requirement that there are substantive credit enhancements within the structure that absorb losses before the debt instrument being evaluated would be expected to absorb losses. This is inherent in the context of an issuer credit obligation in scope of SSAP No. 26R as the owners of the equity in the operating entity are the first to absorb any variability in performance of the operating entity. The same concept applies to asset-backed securities. If substantive credit enhancement did not exist, the substance of the debt instrument being evaluated would be more closely aligned with that of the underlying collateral than that of a bond. Credit enhancement that is merely nominal or lacks economic substance does not put a holder in a different economic position. The substantive credit enhancement required to be in a different economic position is specific to each transaction; determined at origination; and refers to the level of credit enhancement a market participant (i.e., knowledgeable investor transacting at arm’s length) would conclude is substantive.
- b. The first loss position may be issued as part of a securitization in the form of a debt or equity interest, or it may be retained by the sponsor and not issued as part of the securitization. If the first loss position (or a more senior position(s), if the first loss position(s) lacks contractual payments along with a substantive credit enhancement) is issued as part of the securitization, and does not have contractual principal and interest payments along with substantive credit enhancement and is held by a reporting entity, the investment(s) does not qualify for reporting as a bond and shall be reported on Schedule BA: Other Long-Term Invested Assets at the lower of amortized cost or fair value consistent with the treatment for residuals. (These items are further addressed in *SSAP No. 21R—Other Admitted Assets*.)

11. Whether an issuer of debt represents an operating entity or ABS Issuer is unambiguous in most instances, but certain instances may be less clear. For example, an entity may operate a single asset such as a toll road or power generation facility (e.g., project finance) which serves to collateralize a debt issuance, and the cash flows produced by the operation of the assets are pledged to service the debt. In many such instances, the entity is structured as a bankruptcy-remote entity that is separate from the municipality or project sponsor. Such entities have characteristics of operating entities as the operation of the asset constitutes a stand-alone business. They also have many common characteristics of ABS Issuers as they are formed for the purpose of raising debt capital backed by the cash flows from collateral held by a bankruptcy-remote entity. When viewed more holistically, these issuing entities are typically being used to facilitate the financing of an operating component of a project sponsor or municipality. The use of a bankruptcy-remote entity facilitates the efficient raising of debt to finance the operating project, but the primary purpose is to finance an operating project. Therefore, structures in which the issuing entity represents a stand-alone business producing its own operating revenues and expenses, where the primary purpose is to finance an operating project, shall be considered operating entities despite certain characteristics they may share with ABS Issuers.

12. The definition of a creditor relationship, per paragraph 6, does not include equity/fund investments (such as mutual funds or exchanged-traded funds), or securities that possess equity-like characteristics or that represent an ownership interest in the issuer. However, as identified in paragraph 2, exchange traded funds (ETFs), which qualify for bond treatment, as identified in Part Three of the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* and included in the ‘SVO-Identified Bond ETF List’ published on the SVO’s webpage 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 issuer credit obligations, unless different treatment is specifically identified in paragraphs 32-38.

13. Investments within the scope of this statement issued by a related party, or acquired through a related party transaction, are also subject to the provisions, admittance assessments and disclosure requirements of *SSAP No. 25—Affiliates and Other Related Parties*.

14. Investments within the 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 and *SSAP No. 25*.

Accounting and Reporting Guidance for Investments that Qualify as Issuer Credit Obligations⁹

Acquisitions, Disposals and Changes in Unrealized Gains and Losses

15. A bond acquisition or disposal shall be recorded on the trade date (not the settlement date) except for the acquisition of private placement bonds which shall be recorded on the funding date. At acquisition, bonds shall be reported at their cost, including brokerage and other related fees. The reported cost of a bond received as a property dividend or capital contribution shall be the initial recognized value. *SSAP No. 25* shall be used to determine whether a transfer is economic or noneconomic for initial recognition.

16. For reporting entities required to maintain an interest maintenance reserve (IMR), the accounting for realized capital gains and losses on sales of bonds shall be in accordance with *SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve*. For reporting entities required to maintain an asset valuation reserve (AVR), the accounting for unrealized gains and losses shall be in accordance with *SSAP No. 7*.

⁹ For all references to “bond” investments beginning in paragraph 15, this term intends to refer to investments that are permitted accounting and reporting treatment within scope of this standard.

17. For reporting entities not required to maintain an IMR, realized gains and losses on sales of bonds 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).

Amortized Cost

18. Amortization of bond premium or discount shall be calculated using the scientific (constant yield) interest method taking into consideration specified interest and principal provisions over the life of the bond.¹⁰ (INT 07-01) Bonds containing call provisions (where the issuer can be called away from the reporting entity at the issuer's discretion), except "make-whole" call provisions, shall be amortized to the call or maturity value/date which produces the lowest asset value (yield-to-worst). Although the concept for yield-to-worst shall be followed for all callable bonds, make-whole call provisions, which allow the bond to be callable at any time, shall not be considered in determining the timeframe for amortizing bond premium or discount unless information is known by the reporting entity indicating that the issuer is expected to invoke the make-whole call provision.

Application of Yield-to-Worst

19. For callable bonds¹¹, the first call date after the lockout period (or the date of acquisition if no lockout period exists) shall be used as the "effective date of maturity." Depending on the characteristics of the callable bonds, the yield-to-worst concept in [paragraph 18](#) shall be applied as follows:

- a. For callable bonds with a lockout period, premium in excess of the next call price¹² (subsequent to acquisition¹³ and lockout period) shall be amortized proportionally over the length of the lockout period. After each lockout period (if more than one), remaining premium shall be amortized to the call or maturity value/date which produces the lowest asset value.
- b. For callable bonds without a lockout period, the book adjusted carrying value (at the time of acquisition) of the callable bonds shall equal the lesser of the next call price (subsequent to acquisition) or cost. Remaining premium shall then be amortized to the call or maturity value/date which produces the lowest asset value.
- c. For callable bonds that do not have a stated call price, all premiums over par shall be immediately expensed. For callable bonds with a call price at par in advance of the maturity date, all premiums shall be amortized to the call date.

¹⁰ For perpetual bonds with an effective call option, any applicable premium shall be amortized utilizing the yield-to-worst method.

¹¹ Callable bonds within the scope of [paragraph 19](#) excludes bonds with make-whole call provisions unless information is known by the reporting entity indicating that the issuer is expected to invoke the make-whole call provision. [Exhibit C](#) includes illustrations for the amortization of callable bonds.

¹² Reference to the "next call price" indicates that the reporting entity shall continuously review the call dates/prices to ensure that the amortization (and resulting BACV) follows the yield-to-worst concept throughout the time the reporting entity holds the bond.

¹³ The reporting entity shall only consider call dates/prices that occur after the reporting entity acquires the bond. If all of the call dates had expired prior to the reporting entity acquiring the bond, the reporting entity would consider the bond continuously callable without a lockout period.

Balance Sheet Amount

20. Bonds 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 prepared by the NAIC Securities Valuation Office (SVO).

- a. Bonds, except for mandatory convertible bonds: For reporting entities that maintain an asset valuation reserve (AVR), the bonds shall be reported at amortized cost, except for those with an NAIC designation of 6, which shall be reported at the lower of amortized cost or fair value. For reporting entities that do not maintain an AVR, bonds that are designated highest-quality and high-quality (NAIC designations 1 and 2, respectively) shall be reported at amortized cost; all other bonds (NAIC designations 3 to 6) shall be reported at the lower of amortized cost or fair value. For perpetual bonds which do not possess or no longer possess an effective call option, the bond shall be reported at fair value regardless of NAIC designation.
- b. Mandatory convertible bonds: Mandatory convertible bonds are subject to special reporting instructions and are not assigned NAIC designations or unit prices by the SVO. The balance sheet amount for mandatory convertible bonds shall be reported at the lower of amortized cost or fair value during the period prior to conversion. This reporting method is not impacted by NAIC designation or information received from credit rating providers (CRPs). Upon conversion, these securities will be subject to the accounting guidance of the statement that reflects their revised characteristics. (For example, if converted to common stock, the security will be in scope of *SSAP No. 30R—Unaffiliated Common Stock*, if converted to preferred stock, the security will be in scope of *SSAP No. 32R—Preferred Stocks*.)

21. The premium paid on a zero coupon convertible bond that produces a negative yield as a result of the value of a warrant exceeding the bond discount shall be written off immediately so that a negative yield is not produced. The full amount of the premium should be recorded as amortization within investment income on the date of purchase.

Impairment

22. An other-than-temporary^(INT 06-07) impairment 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 debt security in effect at the date of acquisition.¹⁴ A decline in fair value which is other-than-temporary includes situations where a reporting entity has made a decision to sell a security prior to its maturity at an amount below its carrying value. If it is determined that a decline in the fair value of a bond is other-than-temporary, an impairment loss shall be recognized as a realized loss equal to the entire difference between the bond’s carrying value and its fair value at the balance sheet date of the reporting period for which the assessment is made. The measurement of the impairment loss shall not include partial recoveries of fair value subsequent to the balance sheet date. For reporting entities required to maintain an AVR/IMR, the accounting for the entire amount of the realized capital loss shall be in accordance with SSAP No. 7. The other-than-temporary impairment loss shall be recorded entirely to either AVR or IMR (and not bifurcated between credit and non-credit components) in accordance with the annual statement instructions.

¹⁴ If a bond has been modified from original acquisition, the guidance in *SSAP No. 36—Troubled Debt Restructuring* and paragraph 22 of *SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* shall be followed, as applicable. After modification of original terms, future assessments to determine other-than-temporary impairment shall be based on the modified contractual terms of the debt instrument.

23. In periods subsequent to the recognition of an other-than-temporary impairment loss for a bond, the reporting entity shall account for the other-than-temporarily impaired security as if the security had been purchased on the measurement date of the other-than-temporary impairment. The fair value of the bond on the measurement date shall become the new cost basis of the bond and the new cost basis shall not be adjusted for subsequent recoveries in fair value. The discount or reduced premium recorded for the security, based on the new cost basis, shall be amortized over the remaining life of the security in the prospective manner based on the amount and timing of future estimated cash flows. The security shall continue to be subject to impairment analysis for each subsequent reporting period. Future declines in fair value which are determined to be other-than temporary shall be recorded as realized losses.

Income

24. Interest income for any period consists of interest collected during the period, the change in the due and accrued interest between the beginning and end of the period as well as reductions for premium amortization and interest paid on acquisition of bonds, and the addition of discount accrual. In accordance with *SSAP No. 34—Investment Income Due and Accrued*, investment income shall be reduced for amounts which have been determined to be uncollectible. Contingent interest may be accrued if the applicable provisions of the underlying contract and the prerequisite conditions have been met.

25. A bond may provide for a prepayment penalty or acceleration fee in the event the bond is liquidated prior to its scheduled termination date. Such fees shall be reported as investment income when received.

26. The amount of prepayment penalty and/or acceleration fee to be reported as investment income or loss shall be calculated as follows:

- a. For called or tendered bonds in which the total proceeds (consideration) received exceeds par:
 - i. The amount of investment income reported is equal to the consideration received less the par value of the investment; and
 - ii. Any difference between the book adjusted carrying value (BACV) and the par value at the time of disposal shall be reported as realized capital gains and losses, subject to the authoritative literature in SSAP No. 7.
- b. For called or tendered bonds in which the consideration received is less than par¹⁵:
 - i. To the extent an entity has in place a process to identify an explicit prepayment penalty or acceleration fee, these should be reported as investment income. (An entity shall consistently apply their process. Once a process is in place, an entity is required to maintain a process to identify prepayment penalties for called bonds in which consideration received is less than par.)
 - ii. After determining any explicit prepayment penalty or acceleration fee, the reporting entity shall calculate the resulting realized gain as the difference between

¹⁵ This guidance applies to situations in which consideration received is less than par but greater than the book adjusted carrying value (BACV). Pursuant to the yield-to-worst concept, bonds shall be amortized to the call or maturity date that produces the lowest asset value. In the event a bond has not been amortized to the lowest value prior to the call, or in cases of an accepted tender bond offer (BACV is greater than the consideration received), the entire difference between consideration received and the BACV shall be reported to investment income.

the remaining consideration and the BACV, which shall be reported as realized capital gain, subject to the authoritative literature in SSAP No. 7.

Origination Fees

27. Origination fees represent fees charged to the borrower in connection with the process of originating or restructuring a transaction such as the private placement of bonds. The fees include, but are not limited to, points, management, arrangement, placement, application, underwriting and other fees pursuant to such a transaction. Origination fees shall not be recorded until received in cash. Origination fees intended to compensate the reporting entity for interest rate risks (e.g., points) shall be amortized into income over the term of the bond consistent with paragraph 18 of this statement. Other origination fees shall be recorded as income upon receipt.

Origination, Acquisition and Commitment Costs

28. Costs related to origination when paid in the form of brokerage and other related fees shall be capitalized as part of the cost of the bond, consistent with paragraph 15 of this statement. All other costs, including internal costs or costs paid to an affiliated entity related to origination, purchase or commitment to purchase bonds shall be charged to expense when incurred.

Commitment Fees

29. Commitment fees are fees paid to the reporting entity that obligate the reporting entity to make available funds for future borrowing under a specified condition. A fee paid to the reporting entity to obtain a commitment to make funds available at some time in the future, generally, is refundable only if the bond is issued. If the bond is not issued, then the fees shall be recorded as investment income by the reporting entity when the commitment expires.

30. A fee paid to the reporting entity to obtain a commitment to be able to borrow funds at a specified rate and with specified terms quoted in the commitment agreement, generally, is not refundable unless the commitment is refused by the reporting entity. This type of fee shall be deferred, and amortization shall depend on whether or not the commitment is exercised. If the commitment is exercised, then the fee shall be amortized in accordance with paragraph 18 of this statement over the life of the bond as an adjustment to the investment income on the bond. If the commitment expires unexercised, the commitment fee shall be recognized in income on the commitment expiration date.

Exchanges and Conversions

31. If a bond is exchanged or converted into other securities (including conversions of mandatory convertible securities addressed in paragraph 20.b.), the fair value of the bond surrendered at the date of the exchange or conversion shall become the cost basis for the new securities with any gain or loss realized at the time of the exchange or conversion. However, if the fair value of the securities received in an exchange or conversion is more clearly evident than the fair value of the bond surrendered, then it shall become the cost basis for the new securities.

SVO-Identified Bond Exchange –Traded Funds

32. SVO-identified bond exchange-traded fund (ETF) investments, as discussed in paragraph 2.d., are captured within the scope of this statement for accounting and reporting¹⁶ purposes only. The inclusion of these investments within this statement is not intended to contradict state law regarding the classification

¹⁶ With the inclusion of these SVO-identified investments as bonds, specific guidelines are detailed in the annual statement instructions for reporting purposes.

of these investments and does not intend to provide exceptions to state investment limitations involving types of financial instruments (e.g., equity/fund interests), or with regards to concentration risk (e.g., issuer).

33. SVO-identified bond ETF investments shall be initially reported at cost, including brokerage and other related fees. Subsequently, SVO-identified bond ETF investments shall be reported at fair value,¹⁷ with changes in fair value recorded as unrealized gains or losses) unless the reporting entity has elected use¹⁸ of a documented systematic approach to amortize or accrete the investment in a manner that represents the expected cash flows from the underlying bond holdings. This special measurement approach is referred to as the “systematic value” measurement method and shall only be used for the SVO-identified bond ETF investments within the scope of this statement.

34. Use of the systematic value for SVO-identified bond ETF investments is limited as follows:

- a. Systematic value is only permitted to be designated as the measurement method for AVR filers acquiring qualifying investments that have an NAIC designation of 1 to 5, and for non-AVR filers acquiring qualifying investments with an NAIC designation of 1 or 2. SVO-identified investments that have an NAIC designation of 6 for AVR filers or 3-6 for non AVR filers shall be measured at fair value.
- b. Designated use of a systematic value is an irrevocable election per qualifying investment (by CUSIP) at the time investment is originally acquired¹⁹. Investments owned prior to being identified by the SVO as a qualifying SSAP No. 26R investment are permitted to be subsequently designated to the systematic value measurement method. This designation shall be applied as a change in accounting principle pursuant to *SSAP No. 3—Accounting Changes and Corrections of Errors*, which requires the reporting entity to recognize a cumulative effect to adjust capital and surplus as if the systematic value measurement method had been applied retroactively for all prior periods in which the investment was held. The election to use systematic value for investments shall be made before the year-end reporting of the investment in the year in which the SVO first identifies the investment as a qualifying SSAP No. 26R investment.
- c. Once designated for a particular investment, the systematic value measurement method must be retained as long as the qualifying investment is held by the reporting entity and the investment remains within the scope of this statement with an allowable NAIC designation per paragraph 34.a. Upon a full sale/disposal of an SVO-identified investment (elimination of the entire CUSIP investment), after 90 days the reporting entity can reacquire the SVO-identified investment and designate a different measurement method. If the reporting entity was to reacquire the same investment within 90 days after it was sold/disposed, the reporting entity must utilize the measurement method previously designated for the investment. Subsequent/additional purchases of the same SVO-identified investment (same CUSIP) already held by a reporting entity must follow the election previously made by the reporting entity. If an investment no longer qualifies for a systematic value

¹⁷ For these investments, net asset value (NAV) is allowed as a practical expedient to fair value.

¹⁸ The election to use systematic value is not a permitted or prescribed practice as it is an accounting provision allowed within this SSAP. Similarly, this election does not override state statutes, and if a state does not permit reporting entities the election to use systematic value as the measurement method, this is also not considered a permitted or prescribed practice. SVO-identified investments reported at fair value (NAV) or systematic value, if in accordance with the provisions of this standard, are considered in line with SSAP No. 26R and do not require permitted or prescribed disclosures under *SSAP No. 1—Accounting Policies, Risks & Uncertainties and Other Disclosures*.

¹⁹ This guidance requires investments purchased in lots to follow the measurement method established at the time the investment was first acquired.

measurement because the NAIC designation has declined, then the security must be subsequently reported at the lower of “systematic value” or fair value. If the security has been removed from the SVO-identified listings, and is no longer in scope of this statement, then the security shall be measured and reported in accordance with the applicable SSAP.

- d. Determination of the designated systematic value must follow the established²⁰ approach, which is consistently applied for all SVO-identified bond ETF investments designated for a systematic value. In all situations, an approach that continuously reflects “original” or “historical cost” is not an acceptable measurement method. The designated approach shall result with systematic amortization or accretion of the equity/fund investment in a manner that represents the expected cash flows from the underlying bond holdings.

35. Income distributions received from SVO-identified bond ETF investments (cash or shares) shall be reported as interest income in the period in which it is earned. For those SVO-identified bond ETF investments where the systematic value method is applied, interest income shall be recognized based on the book yield applied to the carrying value each period, similar to bonds.

36. For reporting entities required to hold an IMR and AVR reserve, realized and unrealized gains and losses for the SVO-identified bond ETF investments shall be consistent with bonds within the scope of this standard. With this guidance, recognition of gains/losses (and corresponding AVR/IMR impacts) will be based on the ETF, and not activity that occurs within the ETF (e.g., such as changes in the underlying bonds held within the ETF). Also consistent with the guidance for bonds, recognized losses from other-than-temporary impairments shall be recorded entirely to either AVR or IMR (and not bifurcated between credit and non-credit components) in accordance with the annual statement instructions.

37. SVO-identified bond ETF investments reported at systematic value shall recognize other-than-temporary impairments in accordance with the following guidance:

- a. A decision to sell an SVO-identified bond ETF investment that has a fair value less than systematic value results in an other-than-temporary impairment that shall be recognized.
- b. In situations in which an SVO-identified bond ETF investment has a fair value that is less than systematic value, the reporting entity must assess for other-than-temporary impairment. For these investments, a key determinant, along with other impairment indicators in *INT 06-07: Definition of Phrase “Other Than Temporary,”* shall be whether the net present value of the projected cash flows for the underlying bonds in the SVO-identified investment have materially²¹ declined from the prior reporting period (most recent issued financial statements) or from the date of acquisition. In calculating the net present value of the projected cash flows for each reporting period, entities shall discount cash flows using a constant purchase yield, which is the initial book yield at acquisition. Consistent with INT 06-07, a predefined threshold to determine whether the decline in projected cash flows (e.g., percentage change) shall result in an other than temporary impairment has not been set, as exclusive reliance on such thresholds removes the ability of management to apply its judgement.
- c. Upon identification of an SVO-identified investment as OTTI, the reporting entity shall recognize a realized loss equal to the difference between systematic value and the current

²⁰ Exhibit B details the established systematic value approach.

²¹ The net present value of cash flows will decline in a declining interest rate environment. Reporting entities shall use judgment when assessing whether the decline in cash flows is related to a decline in interest rates or the result of a non-interest related decline, and determine whether the decline represents an OTTI pursuant to INT 06-07.

fair value. (Although the determination of OTTI is likely based on projected cash flows, the realized loss recognized for the OTTI is based on the difference between systematic value and fair value.) The fair value of the SVO-identified investment on the date of the OTTI shall become the new cost basis of the investment.

- d. Subsequent to recognition of an OTTI, the SVO-identified bond ETF investment is required to be reported at the lower of the then-current period systematic value or fair value. As the underlying bonds can be replaced within an ETF, it is possible for a subsequent period systematic value and fair value to recover above the fair value that existed at the time an OTTI was recognized. As such, the requirement for subsequent reporting at the lower of systematic value or fair value is intended to be a current period assessment. For example, in reporting periods after an OTTI, the systematic value for an SVO-identified investment may exceed the fair value at the time of the OTTI, but in no event shall the reported systematic value exceed the then-current period fair value. If current calculated systematic value is lower than the current fair value, systematic value is required.

38. Impairment guidance for SVO-identified bond ETF investments reported at fair value is consistent with impairment guidance for investments captured under SSAP No. 30R. Pursuant to this guidance, realized losses are required to be recognized when a decline in fair value is considered to be other-than-temporary. 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 decision to sell an impaired security results with an other-than-temporary impairment that shall be recognized.

Disclosures

39. The financial statements shall include the following disclosures:

- a. Fair value in accordance with *SSAP No. 100R—Fair Value*;
- b. Concentrations of credit risk in accordance with *SSAP No. 27—Off-Balance-Sheet and Credit Risk Disclosures*;
- c. The basis at which the bonds, mandatory convertible securities, and SVO-identified bond ETF investments identified in paragraph 2.d., are stated;
- d. Amortization method for bonds and mandatory convertible securities, and if elected by the reporting entity, the approach for determining the systematic value for SVO-identified securities per paragraph 33. If utilizing systematic value measurement method approach for SVO-identified investments, the reporting entity must include the following information:
 - i. Whether the reporting entity consistently utilizes the same measurement method for all SVO-identified investments²² (e.g., fair value or systematic value). If different measurement methods are used²³, information on why the reporting entity

²² As identified in paragraph 34.d., a consistent approach must be followed for all investments designated to use the systematic value method. As such, this disclosure is limited to situations in which a reporting entity uses both fair value and systematic value for reported SVO-identified investments.

²³ The guidance in this statement allows different measurement methods by qualifying investment (CUSIP), but it is anticipated that companies will generally utilize a consistent approach for all qualifying investments.

has elected to use fair value for some SVO-identified investments and systematic value for others.

- ii. Whether SVO-identified investments are being reported at a different measurement method from what was used in an earlier current-year interim and/or in a prior annual statement. (For example, if reported at systematic value prior to the sale, and then reacquired and reported at fair value.) This disclosure is required in all interim reporting periods and in the year-end financial statements for the year in which an SVO-identified investment has been reacquired and reported using a different measurement method from what was previously used for the investment. (This disclosure is required regardless of the length of time between the sale/reacquisition of the investments, but is only required in the year in which the investment is reacquired.)
 - iii. Identification of securities still held that no longer qualify for the systematic value method. This should separately identify those securities that are still within the scope of SSAP No. 26R and those that are being reported under a different SSAP.
- e. For each balance sheet presented, the book/adjusted carrying values, fair values, excess of book/carrying value over fair value or fair value over book/adjusted carrying values for each pertinent bond or assets in scope of this statement.
 - f. For the most recent balance sheet, the book/adjusted carrying values and the fair values of bonds and assets in scope of this statement, reported in statutory Annual Statement Schedule D – **Part 1A** due:
 - i. In one year or less (including items without a maturity date which are payable on demand and in good standing);
 - ii. After one year through five years;
 - iii. After five years through ten years;
 - iv. After ten years (including items without a maturity date which are either not payable on demand or not in good standing).
 - g. For each period for which results of operations are presented, the proceeds from sales of bonds and assets in scope of this Statement and gross realized gains and gross realized losses on such sales.
 - h. For each balance sheet presented, all items in scope of this Statement 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 bonds with unrealized losses.
 - i. The disclosures in **paragraphs 39.h.i. and 39.h.ii.** should be segregated by items 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.

SSAP No. 26R

Statement of Statutory Accounting Principles

- j. As of the most recent balance sheet date 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.
- k. When it is not practicable to estimate fair value in accordance with SSAP No. 100R, 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.
- l. For securities sold, redeemed or otherwise disposed as a result of a call or tender offer feature (including make-whole call provisions), disclose the number of CUSIPs sold, disposed or otherwise redeemed and the aggregate amount of investment income generated as a result of a prepayment penalty and/or acceleration fee.

40. Refer to the Preamble for further discussion regarding disclosure requirements. The disclosures in paragraphs 39.b., 39.e., 39.f., 39.g., 39.h., 39.i., 39.j. and 39.k. shall be included in the annual audited statutory financial reports only.

Relevant Literature

41. This statement adopts *AICPA Statement of Position 90-11, Disclosure of Certain Information by Financial Institutions About Debt Securities Held as Assets*, and *AICPA Practice Bulletin No. 4, Accounting for Foreign Debt/Equity Swaps*. This statement also adopts *FASB Staff Position 115-1/124-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*, paragraph 16, with modification to be consistent with statutory language in the respective statutory accounting statements. This statement adopts the GAAP definition of “security” as it is used in FASB Codification Topic 320 and 860. This statement refers to the definition of “financial assets” captured in SSAP No. 103R adopted from U.S. GAAP. As noted in footnote 7, for purposes of this statement, and in applying the principles-based bond definition, financial assets do not include assets that depend on the completion of a performance obligation. When there is a performance obligation, the asset represents non-financial assets, or a means through which non-financial assets produce cash flows, until the performance obligation has been satisfied.

42. This statement rejects the GAAP guidance for debt securities, which is contained in *ASU 2020-08, Codification Improvements to Subtopic 310-20, Receivables – Nonrefundable Fees and Other Costs*, *ASU 2018-03, Recognition and Measurement of Financial Assets and Financial Liabilities*, *ASU 2017-08, Premium Amortization on Purchased Callable Debt Securities*, *ASU 2016-01, Financial Instruments – Overall*, *FASB Statement No. 115, Accounting for Certain Investments in Debt and Equity Securities*, *FASB Statement No. 91, Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases*, *FASB Emerging Issues Task Force No. 89-18, Divestitures of Certain Investment Securities to an Unregulated Commonly Controlled Entity under FIRREA*, and *FASB Emerging Issues Task Force No. 96-10, Impact of Certain Transactions on Held-to-Maturity Classifications Under FASB Statement No. 115*.

Effective Date and Transition

43. Revisions to SSAP No. 26R, adopted August 2023, to incorporate the principle-based bond concepts are effective January 1, 2025. These revisions incorporate principle concepts on what should be reported as a long-term bond. Securities that qualify as issuer credit obligations within the principle concepts are captured within scope of SSAP No. 26R. Securities that qualify as asset-backed securities within the principle concepts are captured within scope of SSAP No. 43R. Securities that do not qualify as

issuer credit obligations or ABS, unless specifically permitted in scope of these statements, are not permitted to be reported as a bond.

44. At the time of transition, reporting entities shall make their best efforts to assess investments to determine whether they qualify within the bond definition for reporting on Schedule D-1. The bond definition requires assessments at the time of acquisition (as of the origination date), and it is recognized that reporting entities may not have the means to complete historical assessments for securities held at the time of transition. For these instances, if information is not readily available for reporting entities to assess a security as of the date at origination, reporting entities may utilize current or acquisition information in concluding that a security qualifies for reporting as a bond as either an issuer obligation or asset-backed security.

45. Investments that were reported as a bond on Schedule D-1: Long-Term Bonds as of December 31, 2024, that do not qualify under the principle-based bond concepts shall be reported as a disposal from that schedule, with a reacquisition on the appropriate reporting schedule as of January 1, 2025. These investments shall be accounted for in accordance with the resulting SSAP that addresses the specific investment structure. For securities that are reported at the lower of amortized cost or fair value under the new applicable guidance, this could result with an unrealized loss in the measurement of the investment at the time of the reclassification. Although the adoption of this guidance is considered a change in accounting principle under SSAP No. 3, the following transition guidance shall be applied on January 1, 2025, to ensure consistency in reporting and to allow investment schedules to roll appropriately:

- a. Securities reclassified from Schedule D-1 as they no longer qualify under the bond definition shall be reported as a disposal from Schedule D-1 at amortized cost. Although no proceeds are received, amortized cost at the time of disposal shall be reported as consideration on Schedule D-4.
 - i. For securities held at amortized cost at the time of disposal, book adjusted carrying value and amortized cost shall agree, preventing gain or loss recognition at the time of reclassification.
 - ii. For securities held at fair value under the lower of amortized cost or fair value measurement method, previously reported unrealized losses shall be reversed on Jan. 1, 2025, prior to disposal, resulting with a reported value that mirrors amortized cost at the time of disposal. This action prevents realized loss recognition at time of reclassification.
- b. Securities reclassified from Schedule D-1 shall be recognized on the subsequent schedule (e.g., Schedule BA) with an actual cost that agrees to the disposal value (amortized cost). Immediately subsequent to recognition on the resulting schedule, the securities shall be reported in accordance with the measurement method prescribed by the applicable SSAP:
 - i. For securities previously reported at fair value on Schedule D-1 (under a lower of amortized cost or fair value measurement method), the reporting entity will recognize an unrealized loss to match the previously reported book adjusted carrying value. Subsequently, the security will continue to reflect a lower of amortized cost or fair value measurement method.
 - ii. For securities previously reported at amortized cost on Schedule D-1, if the subsequent statement requires a lower of amortized cost or fair value measurement

method, then the reporting entity shall recognize an unrealized loss to the extent fair value is less than amortized cost.

- iii. After application of paragraph 45.b.i. and 45.b.ii. all securities shall reflect either the same reported value as of December 31, 2024 (amortized cost or fair value) or a lower reported value (if the security is subject to the lower of amortized cost or fair value measurement method). There should be no instances that result with a security having a greater reported value than what was presented on December 31, 2024. Subsequent to transition, securities reported at fair value may incur unrealized gains or losses due to fair value fluctuations, but should never have unrealized gains that result with a book adjusted carrying value that exceeds amortized cost.

46. With this transition guidance, changes in measurement for securities reclassified under the bond definition will be reported as a change in unrealized capital gains (losses) in the first quarter 2025 financial statements (unless sold in the interim with a realized gain or loss) and not as a change in accounting principle. To enable regulators the ability to identify the impact of securities reclassified under the bond definition, the following disclosure for the 2025 first quarter financial statement is required:

- a. Aggregate book adjusted carrying value for all securities reclassified off Schedule D-1.
- b. Aggregate book adjusted carrying value after transition for all securities reclassified off Schedule D-1 that resulted with a change in measurement basis. (This shall be a subset of paragraph 46.a. and captures the securities that moved from an amortized cost to a fair value measurement method under the lower of amortized cost or fair value approach.)
- c. Aggregate surplus impact for securities reclassified off Schedule D-1. This shall include the difference between book adjusted carrying value as of December 31, 2024, and book adjusted carrying value after transition for those securities that moved from an amortized cost to a fair value measurement method under the lower of amortized cost or fair value approach.

47. For clarification purposes, the transition guidance shall be applied prospectively beginning with the first year of adoption (Jan. 1, 2025). For disclosures that provide comparative information, reporting entities shall not restate the prior year's information in the 2025 disclosure.

Historical Adoption and Revisions to Original SSAP No. 26R

48. For historical reference, the original adoption, and subsequent revisions to SSAP No. 26R prior to the adoption of the principles-based bond definition are detailed below:

- a. SSAP No. 26R was originally effective for years beginning January 1, 2001.
- b. Guidance for the accounting of securities subsequent to other than temporary impairments was originally effective for reporting periods beginning on January 1, 2009, with early adoption permitted. This guidance was incorporated from *SSAP No. 99—Accounting for Securities Subsequent to an Other-Than-Temporary Impairment* in 2010. The original impairment guidance included in this standard, and the substantive revisions reflected in SSAP No. 99 are retained for historical purposes in Issue Paper No. 131.

Bonds

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- c. Guidance pertaining to the accounting for zero-coupon convertible bonds was originally effective December 8, 2002, and was subsequently incorporated into this statement from *INT 02-05: Accounting for Zero Coupon Convertible Bonds*.
- d. Guidance adopted in December 2013 clarifying the ‘yield-to-worst’ concept for bonds with make-whole call provisions was initially effective January 1, 2014, unless the company had previously been following the guidance. (Companies that have previously been following the original intent, as clarified in the revisions, were not impacted by these changes.)
- e. The guidance on the calculation of investment income for prepayment penalties and/or acceleration fees was effective January 1, 2017, on a prospective basis and was required for interim and annual reporting periods thereafter, with early application permitted.
- f. In April 2017, revisions were incorporated in accordance with the investment classification project. These revisions are detailed in Issue Paper No. 156 and were effective December 31, 2017. These revisions clarified the scope of the bond definition as well as incorporated new guidance for SVO-Identified Bond ETFs identified in scope of this statement. Retained transition / application guidance is captured as follows:
 - i. For situations in which there is an interval of time between when a company purchases an investment and when the investment is designated as an SVO-identified investment eligible for systematic value, the book yield should be calculated by equating the book/adjusted carrying value at that time to the portfolio’s aggregate cash flows (ACF). For these situations, the ETF shall be reported as a disposed security on the prior reporting schedule and reported as an acquisition.
 - ii. In accordance with the systematic value methodology, at the next reporting period date, the reporting entity shall amortize or accrete the carrying value by the difference between the effective interest using the initial book yield, and the distributions received, and shall recalculate the new effective book yield using the new carrying value and ACF as of the last day of the reporting period.
 - iii. As the necessary historical ACF data is not available for calculating the initial book yield at acquisition for the net present value constant purchase yield (NPV-CPY) method for impairment recognition, reporting entities shall use recently published yield-to-maturity (YTM) as their constant purchase yield to be applied for NPV-CPY impairment recognition.
 - iv. If the investment no longer qualifies as an SVO-Identified Bond ETF in scope of statement, this change shall be reflected prospectively from the effective date. Investments previously captured in this statement, that will move within the scope of another SSAP and reporting schedule shall be shown as dispositions on and shown as an acquisition on the schedule for which it will be subsequently reported.
- g. The guidance to explicitly exclude securities for which the contract amount of the instrument to be paid at maturity (or the original investment) is at risk for other than failure of the borrower to pay the contractual amount due, were effective December 31, 2019.
- h. Revisions to clarify existing guidance that all prepayment penalties and acceleration fees for when a bond is liquidated prior to its scheduled maturity date, including those from tendered bonds, shall follow the guidance in SSAP No. 26R was effective January 1, 2021.

Reporting entities that have historically applied this guidance shall not change historical practices, but the effective date of January 1, 2021, with early application permitted, was allowed for reporting entities to make systems changes to capture tendered bonds in scope of this guidance.

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. 26—Bonds, Excluding Loan-Backed and Structured Securities*
- *Issue Paper No. 131—Accounting for Certain Securities Subsequent to an Other-Than-Temporary Impairment*
- *Issue Paper No. 156—Bonds*
- *Issue Paper No. XX—Principles-Based Bond Definition*

EXHIBIT A - EXAMPLES OF ANALYSIS FOR ASSET-BACKED SECURITIES

1. As detailed in paragraphs 9-10, the holder of an asset-backed securities is 1) required to be in a different economic position than if the holder owned the ABS Issuer's assets directly, and 2) if the assets owned by the ABS Issuer are cash generating non-financial assets, then the assets are expected to generate a meaningful level of cash flows towards repayment of the bond through use, licensing, leasing servicing or management fees, or other similar cash flow generation. (This guidance requires a meaningful level of cash flows to service the debt other than through the sale or refinancing of the assets.) This appendix details example analysis for these meaningful cash flow and substantive credit enhancements.

2. **Example 1:** A reporting entity invests in debt instruments issued from a SPV sponsored by the Government National Mortgage Association (GNMA), the Federal National Mortgage Association (FNMA) and the Federal Home Loan Mortgage Corporation (Freddie Mac) (collectively, "Agency or Agencies"). These debt instruments pass through principal and interest payments received from underlying mortgage loans held by the SPV to the debtholders proportionally, with principal and interest guaranteed by the Agencies. While there is prepayment and extension risk associated with the repayment of the underlying mortgage loans, the credit risk associated with the mortgage loans is assumed by the Agencies.

3. **Example 1 Rationale:** Although the reporting entity participates on a proportional basis in the cash flows from the underlying mortgage loans held by the SPV, the reporting entity is in a different economic position than if it owned the underlying mortgage loans directly because the credit risk has been redistributed and assumed by the Agencies. This is a substantive credit enhancement because a market participant (i.e., a knowledgeable investor transacting at arm's length) would conclude the Agency guarantee is expected to absorb all losses before the debt instrument being evaluated. Therefore, the holder of the debt instrument is in a substantively different economic position than if the holder owned the ABS Issuer's unguaranteed assets directly, in accordance with the requirements in paragraph 10. When guarantees do not cover 100% of principal and interest as the Agency guarantees do in this example, it is still appropriate to determine if the guarantee is substantive in accordance with the requirements in paragraph 10, to determine if the holder is in a substantively different economic position that if the holder held the ABS Issuer's assets directly.

4. **Example 2:** A reporting entity invested in a debt instrument issued by a SPV. Payments under the instrument are secured by a note, a legal assignment from the borrower of a lease for real property and an assignment of the lease payments from an operating entity tenant. Additional security is provided by a mortgage on the leased property (the "underlying collateral"). The leased property is owned by the borrower under the note -- the SPV does not have any ownership interest in the underlying collateral, though it has legal recourse to it through the mortgage. The tenant makes contractually-fixed payments over the life of the lease to the borrower, who has assigned both the lease and the lease payments to the SPV as security for the debt. While the debt is outstanding, the lease, the lease payments, and the mortgage all serve as security for the debtholders. Should a default occur, the debtholders can foreclose on and liquidate the real property as well as submit an unsecured lease claim in the lessee's bankruptcy for all or a portion of the defaulted lease payments. The loan-to-value (as a percentage of property value) at origination is 100%.

5. The existing lease payments are sufficient to cover all interest payments and all scheduled debt amortization payments over the life of the debt instrument. However, at debt maturity, there is a balloon payment due, totaling 50% of the original outstanding debt principal amount. The corresponding lease has no balloon payment due at lease maturity, so the SPV will either need to refinance the debt or sell the underlying collateral to service the final debt balloon payment. The property has a high probability of appreciating in value over the term, however ignoring any potential for appreciation, the 50% loan-to-value at maturity is the expected figure at the end of the debt term based solely on scheduled amortization payments. The real property is expected to be subject to some market value volatility and periods of lower

liquidity at certain points in time but has a predictable value range and ready market over a longer period of time, such that the property could be liquidated over a reasonable period of time, if necessary.

6. **Example 2 Rationale:** The reporting entity determined that the debtholder was in a fundamentally different position than if the real estate was owned directly. The lease is a cash generating non-financial asset which is expected to generate a meaningful level of cash flows for the repayment of the bonds which covers all interest payments and 50% of the principal payments. The level of reliance on the collateral value for sale or refinancing is just over the cutoff for using the practical expedient (<50%), so a full analysis is required. In reaching its determination, the reporting entity considered the predictable nature of the cash flows, which are contractually fixed for the life of the debt instrument, as well as the ability of the underlying collateral value to provide for the balloon payment through sale or refinancing in light of its characteristics. While the real property may have some market value volatility and periods of lower liquidity at points in time, the cash flows produced by the lease were concluded to reduce the loan balance to a level (50% loan-to-value) that would be able to be recovered by sale or refinancing at the maturity of the loan.

7. The reporting entity also determined that the structure provides substantive credit enhancement in the form of overcollateralization to conclude that investors are in a different economic position than holding the real property directly, in accordance with the requirements in [paragraph 10](#). In reaching this conclusion, the reporting entity noted that although the debt instrument starts with a 100% loan-to-value (not including the value of the contractually required lease payments), contractual fixed payments from the lease provide additional security such that the reporting entity is in a different economic position than owning the property directly. Lease cash flows are sufficient to cover the payment of all interest and 50% of the outstanding principal over the term of the lease. In the context of the predictable nature of the cash flows and collateral value range over time, the reporting entity concluded that a market participant (i.e., knowledgeable investor transacting at arm's length) would consider this level of overcollateralization to put the investor in a substantively different economic position than owning the underlying property directly.

8. For the purposes of determining whether there is substantive overcollateralization, it is appropriate to consider any expected economic depreciation, if it is reasonably expected, but it is not appropriate to consider any expected economic appreciation. Note that a debt instrument with a loan-to-value that is expected to decrease over time is not necessarily deemed to have substantive overcollateralization.

9. **Example 3:** A reporting entity invested in a debt instrument with the same characteristics as described in Example 2, except that the existing lease at the time of origination has a contractual term that is shorter than that of the debt instrument. It is expected with a high degree of probability that the lease will be renewed, and a substantial leasing market exists to replace the lessee should they not renew. However, in the unlikely circumstance that the property cannot be re-leased, there would not be enough cash flows to service the scheduled principal and interest payments, and the property would have to be liquidated to pay off the debt upon default.

10. **Example 3 Rationale:** All details of Example 3, including the expected collateral cash flows, are consistent with those in Example 2, except that the cash flows in Example 2 are contractually fixed for the duration of the debt while the cash flows in Example 3 are subject to re-leasing risk. Notwithstanding the involvement of re-leasing risk, the reporting entity concluded that the ability to re-lease the property was highly predictable and supported the conclusion that the underlying collateral was expected to produce meaningful cash flows to service the debt.

11. This distinction is to highlight that the expected cash flows of a cash-generating non-financial asset may or may not be contractually fixed for the term of the bond. Certain securitized cash flow streams may not by their nature lend themselves to long-term contracts (e.g., single-family home rentals), but may nevertheless lend themselves to the production of predictable cash flows. While the non-contractual nature of the cash flows is an important consideration in determining whether a non-financial asset is expected to

produce meaningful cash flows to service the debt, it does not, in and of itself, preclude a reporting entity from concluding that the assets are expected to produce meaningful cash flows.

12. **Example 4:** A reporting entity invested in a debt instrument issued by a SPV that owns equipment which is leased to an equipment operator. The equipment operator makes lease payments to the SPV, which are passed through to service the SPV's debt obligation. While the debt is outstanding, the equipment and lease are held in trust and pledged as collateral for the debtholders. Should a default occur, the debtholders can foreclose on and liquidate the equipment as well as submit an unsecured lease claim in the lessee's bankruptcy for any defaulted lease payments. The loan-to-value at origination is 70%.

13. The existing lease payments are sufficient to cover all interest payments and all scheduled debt amortization payments over the life of the debt instrument. However, at maturity, there is a balloon payment due, totaling 80% of the original outstanding principal amount. The corresponding lease has no balloon payment due at lease maturity, so the SPV will either need to refinance the debt or sell the underlying equipment to service the final debt balloon payment. The loan-to-value at maturity is expected to increase to 95% considering the scheduled principal amortization payments net of the expected economic depreciation in the equipment value over the term of the debt. The equipment is expected to be subject to some market value volatility and periods of lower liquidity at certain points in time, but has a predictable value range and ready market over a longer period of time, such that the equipment could be liquidated over a reasonable period of time, if necessary.

14. **Example 4 Rationale:** The equipment is a cash generating non-financial asset which is not expected to generate a meaningful level of cash flows for the repayment of the bonds via the existing lease that covers all interest payments and 20% of principal payments. In reaching this determination, the reporting entity considered that, while the cash flows being produced are predictable, the ability to recover the principal of the debt investment is almost entirely reliant on the equipment retaining sufficient value to sell or refinance to satisfy the debt.

15. The reporting entity also determined that the structure lacks substantive credit enhancement to conclude that investors are in a different economic position than holding the equipment directly, in accordance with the requirements in [paragraph 10](#). In reaching this conclusion, the reporting entity noted that the debt starts with a 70% loan-to-value, but the overcollateralization is expected to deteriorate over the term of the debt as the equipment economically depreciates more quickly than the debt amortizes. This results in a high loan-to-value (i.e., 95%) at maturity, relative to the market value volatility of the underlying collateral. Despite the predictable nature of the cash flows, the reporting entity concluded that the debt instrument lacked a substantive level of overcollateralization to conclude that the investor is in a different economic position than owning the underlying equipment directly. It was determined that the level of overcollateralization, as determined by a market participant (i.e., a knowledgeable investor transacting at arm's length), is nominal. Therefore, the reporting entity concluded that it was in a substantively similar position as if it owned the equipment directly.

16. For the purposes of determining whether there is substantive overcollateralization, it is appropriate to consider any expected economic depreciation, if it is reasonably expected, but it is not appropriate to factor in any expected economic appreciation. Note that a debt instrument with a loan-to-value that is expected to increase over time is not necessarily deemed to have nominal overcollateralization.

EXHIBIT B – SYSTEMATIC VALUE CALCULATION

The established systematic value method is considered an “aggregated cash flow” (ACF) method in which the cash flow streams from the individual bond holdings are aggregated into a single cash flow stream. These cash flows are scaled such that, when equated with the market price at which the ETF was purchased or sold, an internal rate of return is calculated, representing the investor’s initial book yield for the ETF. Although the initial book yield is utilized to determine the current period effective yield, and the resulting adjustments to the ETF’s reported (systematic) value, the book yield is recalculated at least quarterly in order to adjust the investor’s book yield to reflect current cash flow projections of the current bond holdings within the ETF.

The following calculation shall be followed by reporting entities electing systematic value:

1. Download **cash flows** file from ETF provider website.

NAV:	\$115.07	(Official end-of-day NAV found on <u>ETF provider website</u>)	<p>All formulas on the left are at a per share level (excepting “Par Value” which represents the number of shares purchased for this lot).</p> <p>The resulting values calculated on the left are aggregated to reflect the total number of shares held on the previous tabs reflecting how one might populate the reporting schedule with these values.</p> <p>Additionally, the cash flows in the data file are based on 1 million shares. This was done in order to make the cash flows easier to observe and work with (i.e., at a single share level, cash flows would be at fractional dollar levels). Therefore, in order to calculate the yield, investors must multiply the price of the ETF by 1 million shares and then use that value as a cash outflow against the positive cash inflows from the bond portfolio in order to calculate the IRR.</p>
Maturity:	12/8/2027	= SUMPRODUCT (CASHFLOW_DATE column, PRINCIPAL column)/SUM (PRINCIPAL column)	
When Paid:	Monthly		
Par Value:	2,500	# shares purchased	
Monthly Effective Interest:	\$0.40	= (Recalculated Effective Book Yield from prior month x Prior Month Ending Book Value /12)	
Distribution:	\$0.34	Found on <u>provider website</u>	
Net Amortization/Accretion:	\$0.06	= (Monthly Effective Interest) – (Distribution)	
Prior Month Ending Book Value:	\$115.35		
NPV Constant Yield Method:	\$117.10	= XNPV (Initial Book Yield, CASHFLOW column, CASHFLOW_DATE column) / 1000000	
Initial Book Yield:	4.15%		
Book (Systematic) Value:	\$115.41	= (Prior Period Ending Book Value) + (Net “amortization/ accretion”)	
Expense Ratio:	0.1500%		
Recalculated Effective Book Yield:	4.1639%	=XIRR(CASHFLOW column, CASHFLOW_DATE column, 0.05)	

CUSIP	ASOF_DATE	CALL_TYPE	CASHFLOW_DATE	INTEREST	PRINCIPAL	CASHFLOW
2. Insert a row in between the column headings and the cash flow data.		3. Filter for “Call Type” is WORST. (Click “Data” at the top of Excel sheet, then click “Filter” and click the new dropdown box in the “Call Type” cell and select only “WORST.”)	4. Enter the date of the cash flow data file underneath cash flow date.			5. Under the column “CASHFLOW” enter the following formula in Excel: =(-Ending Book Value)*1000000
			8/31/20X1			(115,414,059.56)
“Ticker”	8/31/20X1	WORST	9/8/20X1	136,538.564	81,472.372	218,010.937
“Ticker”	8/31/20X1	WORST	9/9/20X1	5,990.106	0	5,990.106
“Ticker”	8/31/20X1	WORST	9/10/20X1	9,706.324	0	9,706.324

EXHIBIT C – AMORTIZATION TREATMENT FOR CALLABLE BONDS

Example 1: Call Price Less Than BACV Throughout the Life of the Bond

12/31/2008 – Issuance of Bond. Par = 100/10-Year Bond (Matures 12/31/2018)

01/01/2009 – Call Date/Call Price 107

12/15/2010 – Reporting Entity Acquires Bond. Cost = 106

01/01/2012 – Scheduled Call Date Subsequent to Reporting Entity Acquisition. Call Price 104

01/01/2014 – Scheduled Call Date Subsequent to Reporting Entity Acquisition. Call Price 103

01/01/2016 – Scheduled Call Date Subsequent to Reporting Entity Acquisition. Call Price 102

General Note for Examples: The reporting entity purchased the bond at a premium (cost was greater than par). The 1/1/2009 call date and price is ignored as it occurred prior to the reporting entity acquiring the bond. The bolded numbers represent the lowest asset value at each reporting period. The bond is amortized to the lowest asset value, which in this scenario is amortizing to the call dates and prices. (The standard amortization to the maturity date is shown as it should be compared to the amortization to the call date/price to verify that the BACV at any given reporting date reflects the lowest asset value.)

Date	Action	Cost	Call Price	BACV (Under Call Date/Price)	Amortization to the Lowest Value	BACV Under Standard Amortization
12/15/2010	Acquired	106		106		106
12/31/2011	Lockout Period			104	2	105.25
01/01/2012	Call Date		104	104		
12/31/2012	Year-End Reporting			103.5	0.5	104.50
12/31/2013	Year-End Reporting			103	0.5	103.75
01/01/2014	Call Date		103	103		
12/31/2014	Year-End Reporting			102.5	0.5	103
12/31/2015	Year-End Reporting			102	0.5	102.25
01/01/2016	Call Date Exercised		102	102		

Standard Amortization								
This table shows the amortization with a purchase date of 12/15/2010 at \$106 through the maturity date of 12/31/2018.								
12/15/2010	12/31/2011	12/31/2012	12/31/2013	12/31/2014	12/31/2015	12/31/2016	12/31/2017	12/31/2018
Amortization	.75	.75	.75	.75	.75	.75	.75	.75
BACV	105.25	104.50	103.75	103	102.25	101.50	100.75	100

	Consideration	Par Value	BACV at Disposal Date	Realized Gain/Loss*
01/01/2016 Call Exercised	102	100	102	(2)

* Per paragraph 26, the entity would recognize a \$(2) loss (BACV less par), and investment income of \$2 (consideration less par).

Example 2: Call Price Could be Greater Than BACV

12/31/2008 – Issuance of Bond. Par = 100/10-Year Bond (Matures 12/31/2018)

01/01/2009 – Call Date/Call Price 107

12/15/2010 – Reporting Entity Acquires Bond. Cost = 104

01/01/2012 – Scheduled Call Date Subsequent to Reporting Entity Acquisition. Call Price 106

01/01/2014 – Scheduled Call Date Subsequent to Reporting Entity Acquisition. Call Price 103

01/01/2016 – Scheduled Call Date Subsequent to Reporting Entity Acquisition. Call Price 102

The bolded numbers represent the lowest asset value:

Date	Action	Cost	Call Price	BACV (Under Call Date / Price)	Amortization To the Lowest Asset Value	BACV Under Standard Amortization
12/15/2010	Acquired	104		104		104
12/31/2011	Lockout Period		106	104	0.5	103.50
01/01/2012	Call Date		106	104		103.50
12/31/2012	Year-End Reporting			103.5	0.5	103
12/31/2013	Year-End Reporting			103	0.5	102.50
01/01/2014	Call Date		103	103		102.50
12/31/2014	Year-End Reporting			102.5	0.5	102
12/31/2015	Year-End Reporting			102	0.5	101.50
01/01/2016	Call Date Exercised		102	102		101.50

Standard Amortization

This table shows the amortization with a purchase date of 12/15/2010 at \$104 through the maturity date of 12/31/2018.

	12/31/2011	12/31/2012	12/31/2013	12/31/2014	12/31/2015	12/31/2016	12/31/2017	12/31/2018
Amortization	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
BACV	103.50	103	102.50	102	101.50	101	100.50	100

	Consideration	Par Value	BACV at Disposal Date	Realized Gain/Loss*
01/01/2016 Call Exercised	102	100	101.50	(1.50)

* Per paragraph 26, the entity would recognize a \$(1.50) loss (BACV less par), and investment income of \$2 (consideration less par).

Example 3: Call Price Could be Greater Than BACV

12/31/2008 – Issuance of Bond. Par = 100/10-Year Bond (Matures 12/31/2018)

01/01/2009 – Call Date/Call Price 107

12/15/2010 – Reporting Entity Acquires Bond. Cost = 104

01/01/2012 – Scheduled Call Date Subsequent to Reporting Entity Acquisition. Call Price 106

01/01/2014 – Scheduled Call Date Subsequent to Reporting Entity Acquisition. Call Price 102

01/01/2016 – Scheduled Call Date Subsequent to Reporting Entity Acquisition. Call Price 101

Note – This illustration shows that the evaluation of whether standard amortization (to the maturity date) or the call date price may change over the time. The bolded numbers represent the lowest asset value:

Date	Action	Cost	Call Price	BACV (Under Call Date / Price)	Amortization To the Lowest Asset Value	BACV Under Standard Amortization
12/15/2010	Acquired	104		104		
12/31/2011	Lockout Period		106	104	0.5	103.50
01/01/2012	Call Date		106	104		103.50
12/31/2012	Year-End Reporting			103	0.5	103
12/31/2013	Year-End Reporting			102	1	102.50
01/01/2014	Call Date		102	102		102.50
12/31/2014	Year-End Reporting			101.5	0.5	102
12/31/2015	Year-End Reporting			101	0.5	101.50
01/01/2016	Call Date Exercised		101	101		101.50

Standard Amortization								
This table shows the amortization with a purchase date of 12/15/2010 at \$104 through the maturity date of 12/31/2018.								
12/15/2010	12/31/2011	12/31/2012	12/31/2013	12/31/2014	12/31/2015	12/31/2016	12/31/2017	12/31/2018
Amortization	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
BACV	103.50	103	102.50	102	101.50	101	100.50	100

	Consideration	Par Value	BACV at Disposal Date	Realized Gain/Loss*
01/01/2016 Call Exercised	101	100	101	(1)

* Per paragraph 26, the entity would recognize a \$(1) loss (BACV less par), and investment income of \$1 (consideration less par).

Example 4: Continuously Callable Bond – Callable at Par After Initial Lockout Period

12/31/2008 – Issuance of Bond. Par = 100/10-Year Bond (Matures 12/31/2018)
 01/01/2009 – Call Date / Call Price 107 – Continuously Callable Thereafter at Par
 12/15/2010 – Reporting Entity Acquires Bond. Cost = 104

The bolded numbers represent the lowest asset value:

Date	Action	Cost	Call Price	BACV (Under Call Date/Price)	Amortization To the Lowest Asset Value	BACV Under Standard Amortization
12/15/2010	Acquired	104		100	4	
12/31/2010	Year-End Reporting		100	100	There is no subsequent amortization as the premium was fully expensed at acquisition.	104
12/31/2011	Year-End Reporting		100	100		103.50
12/31/2012	Year-End Reporting		100	100		103
12/31/2013	Year-End Reporting		100	100		102.50
12/31/2014	Year-End Reporting		100	100		102
12/31/2015	Year-End Reporting		100	100		101.50
01/01/2016	Year-End Reporting		100	100		101.50

Standard Amortization								
This table shows the amortization with a purchase date of 12/15/2010 at \$104 through the maturity date of 12/31/2018.								
12/15/2010	12/31/2011	12/31/2012	12/31/2013	12/31/2014	12/31/2015	12/31/2016	12/31/2017	12/31/2018
Amortization	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
BACV	103.50	103	102.50	102	101.50	101	100.50	100

	Consideration	Par Value	BACV at Disposal Date	Realized Gain/Loss*
01/01/2016 Call Exercised	100	100	100	0

* Since the call price is par and could occur immediately after acquisition, the premium is immediately expensed. When the bond is called, there is no gain or loss as the consideration received equals the BACV.

Example 5: Determination of Prepayment Penalty When Call Price is Less Than Par

Call Price Less than Par				
Entity 1			Entity 2	
Par	100		Par	100
BACV	24		BACV	25
Consideration	26		Consideration	26
Explicit fee	1		Explicit fee	1
Remaining consideration	25		Remaining consideration	25
Gain	2		Gain	0
Income*	0		Income**	1

*Entity 1 does not have in place a process to identify an explicit prepayment penalty or acceleration fee.

**Entity 2 has in place a process to identify an explicit prepayment penalty or acceleration fee.

<https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/NationalMeetings/A.NationalMeetingMaterials/2023/8-13-23SummerNationalMeeting/Adoptions/19-21a-SSAP26R-8-13-23.docx>

Statement of Statutory Accounting Principles No. 43

Asset-Backed Securities

STATUS

Type of Issue.....	Common Area
Issued	August 13, 2023
Effective Date	January 1, 2025
Affects.....	Replaces SSAP No. 43R on January 1, 2025
Affected by	No other pronouncements
Interpreted by.....	INT 06-07; INT 07-01; INT 22-01
Relevant Appendix A Guidance	None

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SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for each security investment that qualifies as an asset-backed security (ABS) under the principles-based bond definition detailed in *SSAP No. 26R—Bonds*. Each security shall be individually assessed under the bond definition to determine applicability as an asset-backed security and reported separately regardless of whether the security was issued in combination or as a unit with other investments. Items captured in scope of this statement are collectively referred to as asset-backed securities.

2. In addition to security investments that qualify under the principles-based definition as an asset-backed security, certain specific investments are also captured in scope of this statement:

- a. Mortgage Referenced Securities that do not meet the definition of an asset-backed security. In order to qualify as a mortgage-referenced security, the security must be issued by a government sponsored enterprise¹ or by a special purpose trust in a transaction sponsored by a government sponsored enterprise in the form of a “credit risk transfer.” In these situations, the issued security is tied to a referenced pool of mortgages and the payments received are linked to the credit and principal payment risk of the underlying mortgage loan borrowers captured in the referenced pool of mortgages. For these instruments, reporting entity holders may not receive a return of their full principal as principal repayment is contingent on repayment by the mortgage loan borrowers in the referenced pool of mortgages. Unless specifically noted, the provisions within this standard apply to mortgage-referenced securities.
 - b. Freddie-Mac When Issued K-Deal (WI Trust) Certificates fully guaranteed by Freddie Mac are included in scope of this statement from original acquisition, and not initially reported as a derivative forward contract.^(INT 22-01)
3. Securities captured in scope of this statement are not permitted to be reported as cash equivalents or short-term investments in scope of *SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments* even if acquired within one year or less from the maturity date. Investments captured in scope of *SSAP No. 2R* are intended to reflect situations in which limited risk remains, either from changes in credit quality or interest rates, due to the short-duration until maturity. As ultimate cash flows from asset-backed securities may have other risks beyond default risk or interest rate risk (such as performance factors, balloon payments, collateral quality) reporting as a cash equivalent or short-term investment is not permitted to prevent inappropriate assumptions of the investment’s remaining potential risk.
4. This statement excludes:
- a. Securities captured in scope of *SSAP No. 26R—Bonds*.
 - b. Mortgage loans in scope of *SSAP No. 37—Mortgage Loans* that qualify under an SVO structural assessment as SVO-Identified Credit Tenant Loans. These investments are excluded as these are captured as issuer credit obligations under *SSAP No. 26R*.
 - c. Securities that do not qualify as Asset-Backed Securities per the bond definition in *SSAP No. 26R—Bonds*. This exclusion includes residual or interests, as well as first loss positions, that do not have contractual payments or substantive credit enhancement. Debt securities that do not qualify and residual interests shall follow guidance in *SSAP No. 21R—Other Admitted Assets*.

SUMMARY CONCLUSION

Principles-Based Bond Definition - Asset-Backed Security

5. Investments within the scope of this statement issued by a related party or acquired through a related party transaction or arrangement are also subject to the provisions, admittance assessments and disclosure requirements of *SSAP No. 25—Affiliates and Other Related Parties*. In determining whether a security is a related party investment, consideration should be given to the substance of the transaction, and the parties whose action or performance materially impacts the insurance reporting entity holding the security. Asset-

¹ Currently, only Fannie Mae and Freddie Mac are the government sponsored entities that either directly issue qualifying mortgage-referenced securities or sponsor transactions in which a special purpose trust issues qualifying mortgage-reference securities. However, this guidance would apply to mortgage-referenced securities issued by any other government sponsored entity that subsequently engages in the transfer of mortgage credit risk.

backed securities 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 and SSAP No. 25.

- a. Although an asset-backed security may be acquired from a non-related issuer, if the assets held in trust predominantly² reflect assets issued by affiliates of the insurance reporting entity, and the insurance reporting entity only has direct recourse to the assets held in trust, the transaction shall be considered an affiliated investment. In such situations where the underlying collateral assets are issued by related parties that do not qualify as affiliates, these securities shall be identified as related party investments in the investment schedules.
- b. An asset-backed security may involve a relationship with a related party but not be considered an affiliated investment. This may be because the relationship does not result in direct or indirect control of the issuer or because there is an approved disclaimer of control or affiliation. Regardless of whether investments involving a related party relationship are captured in the affiliated investment reporting lines, these securities shall be identified as related party investments in the investment schedules. Examples of related party relationships would include involvement of a related party in sponsoring or originating the asset-backed security or any type of underlying servicing arrangement. For the avoidance of doubt, investments from any arrangement that results in direct or indirect control, including control through a servicer or other controlling arrangement, shall be reported as affiliated in accordance with *SSAP No. 25—Affiliates and Other Related Parties*.

Initial Reporting Value and Recognition of Origination and Commitment Fees & Costs

6. Items in scope of this statement shall initially be reported at cost, including brokerage and related fees, unless otherwise detailed in paragraph 8. Acquisitions and dispositions shall be recorded on the trade date, not the settlement date, except for the acquisition of private placement asset-backed securities which shall be recorded on the funding date. For securities where all information is not known as of the trade date (e.g., actual payment factors and specific pools), a reporting entity shall make its best estimate based on known facts.

7. For assets that qualify in scope of this statement that result from a securitization or transfer of assets by the reporting entity captured in SSAP No. 103R, the guidance in that SSAP determines the initial reporting value:

- a. For asset-backed securities resulting from transfers of participating interests that qualify as a sale, the participating interests in financial assets that continue to be held by the reporting entity transferor shall be measured and reported at the date of transfer by allocating the previous carrying amount between the participating interests transferred and sold, and the participating interests that are not transferred and continue to be held by the reporting entity, based on their relative fair values.

² In applying this guidance, a reporting entity is not required to complete a detailed review of the assets held in trust to determine the extent, if any, the assets were issued by related parties. Rather, this guidance is a principle concept intended to prevent situations in which related party transactions (particularly those involving affiliates) is knowingly captured in a SSAP No. 43R structure and not identified as a related party transaction (or not reported as an affiliated investment on the investment schedule) because of the involvement of a non-related trustee or SSAP No. 43R security issuer. As identified in *SSAP No. 25—Affiliates and Other Related Parties*, it is erroneous to conclude that the inclusion of a non-related intermediary, or the presence of non-related assets in a structure predominantly comprised of related party investments, eliminates the requirement to identify and assess the investment transaction as a related party arrangement.

- b. For asset-backed securities resulting from transfers of an entire financial asset or group of entire financial assets that qualify as a sale, assets obtained, including beneficial interests, shall be initially recognized at fair value.
 - c. For asset-backed securities resulting from the transfer of assets that do not qualify as sales, the reporting entity transferor shall continue to report the transferred financial assets with no change in measurement.
8. Costs related to origination when paid in the form of brokerage and other related fees shall be capitalized as part of the cost of the asset-backed security. All other costs, including internal costs or costs paid to an affiliated entity related to origination, purchase, or commitment to purchase asset-backed securities, shall be charged to expense when incurred.
9. Origination fees represent fees charged to the borrower (paid to the reporting entity) in connection with the process of originating or restructuring a transaction. The fees include, but are not limited to, points, management, arrangement, placement, application, underwriting, and other fees pursuant to such a transaction. Origination fees shall not be recorded until received in cash. Origination fees intended to compensate the reporting entity for interest rate risks (e.g., points), shall be amortized into income over the term of the asset-backed security consistent with [paragraph 12](#) of this statement. Other origination fees shall be recorded as income upon receipt.
10. Commitment fees are fees paid to the reporting entity that obligate the reporting entity to make available funds for future borrowing under a specified condition:
- a. A fee paid to the reporting entity to obtain a commitment to make funds available at some time in the future is generally refundable only if the asset-backed security is issued. If the security is not issued, then the fees shall be recorded as investment income by the reporting entity when the commitment expires.
 - b. A fee paid to the reporting entity to obtain a commitment to borrow funds at a specified rate and with specified terms quoted in the commitment agreement is generally not refundable unless the commitment is refused by the reporting entity. This type of fee shall be deferred, and amortization shall depend on whether or not the commitment is exercised. If the commitment is exercised, then the fee shall be amortized in accordance with [paragraph 12](#) of this statement over the life of the asset-backed security as an adjustment to the investment income on the security. If the commitment expires unexercised, the commitment fee shall be recognized in income on the commitment expiration date.

Subsequent Carrying Value Method, Amortization, Accruals and Prepayment Penalties

11. After initial recognition, the carrying value shall be determined in accordance with the reported NAIC designation. The determination of NAIC designations shall be in accordance with the requirements detailed in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office (P&P Manual)*³:
- a. For reporting entities that maintain an Asset Valuation Reserve (AVR), asset-backed securities, excluding residual tranches or interests, shall be reported at amortized cost, except for those with an NAIC designation of 6, which shall be reported at the lower of amortized cost or fair value.

³ [Paragraphs 39-40](#) provide guidance on the NAIC financial modeling approach applicable to certain securities in determining NAIC designations.

- b. For reporting entities that do not maintain an AVR, asset-backed securities designated highest-quality and high-quality (NAIC designations 1 and 2, respectively), excluding residual tranches or interests, shall be reported at amortized cost; loan-backed and structured securities that are designated medium quality, low quality, lowest quality and in or near default (NAIC designations 3 to 6, respectively) shall be reported at the lower of amortized cost or fair value.
 - c. For residual tranches or interests⁴, all reporting entities shall report the item on Schedule BA: Other Long-Term Invested Assets at the lower of amortized cost or fair value. Changes in the reported value from the prior period shall be recorded as unrealized gains or losses. For reporting entities that maintain an AVR, the accounting for unrealized gains and losses shall be in accordance with *SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve*. These items are captured in *SSAP No. 21R—Other Admitted Assets* and subject to admittance restrictions detailed in that statement.
12. Amortization of premium or discount shall be calculated using the scientific (constant yield) interest method and shall be recorded as an adjustment to investment income.^(INT 07-01) The interest method results in a constant effective yield equal to the prevailing rate at the time of purchase or at the time of subsequent adjustments to book value. The amortization period shall reflect estimates of the period over which repayment of principal of the asset-backed securities is expected to occur, not the stated maturity period. (P9)
13. Interest shall be accrued using the effective-yield method using the redemption prices and redemption dates used for amortizing premiums and discounts. Interest income consists of interest collected during the period, the change in the due and accrued interest between the beginning and end of the period as well as reductions for premium amortization and interest paid on acquisition of asset-backed securities, and the addition of discount accrual. Contingent interest may be accrued if the applicable provisions of the underlying contract and the prerequisite conditions have been met.
14. An asset-backed security may provide for a prepayment penalty or acceleration fee in the event the investment is liquidated prior to its scheduled termination date. These fees shall be reported as investment income when received.
15. The amount of prepayment penalty and/or acceleration fees to be reported as investment income shall be calculated as follows:
- a. The amount of investment income reported is equal to the total proceeds (consideration) received less the par value of the investment; and
 - b. Any difference between the book adjusted carrying value (BACV) and the par value at the time of disposal shall be reported as realized capital gains and losses subject to the authoritative literature in *SSAP No. 7*.

⁴ Reference to “residual tranches or interests” intends to capture securitization tranches and beneficial interests as well as other structures that reflect loss layers without any contractual payments, whether principal or interest, or both. Payments to holders of these investments occur after contractual interest and principal payments have been made to other tranches or interests and are based on the remaining available funds. Although payments to holders can occur throughout an investment’s duration (and not just at maturity), such instances still reflect the residual amount permitted to be distributed after other holders have received contractual interest and principal payments.

Assessment of Cash Flows and Impact of Prepayments

16. Prepayments can be a significant variable element in the cash flows received from asset-backed securities because they may affect the yield and determine the expected maturity against which the yield is evaluated. For example, with a mortgage-backed security, falling interest rates generate faster prepayment of the mortgages underlying the security, shortening its duration. This causes the reporting entity to reinvest assets sooner than expected at potentially less advantageous rates. This is called prepayment risk. Extension risk is created when rising interest rates slow repayment and can significantly lengthen the duration of the security. In addition to interest rate risk, other factors can influence the cash flows generated from an asset-backed securities. These factors include, but are not limited to, defaults of the underlying payors as well as performance requirements that must occur before cash flows can be generated from the underlying assets (such as with leases or royalty rights). If the underlying assets are delinquent or otherwise not generating expected cash flows, such items should be reflected in the cash flow analysis through diminishing security cash flows. Updated cash flow assessments shall continue to occur even if the underlying assets have not been liquidated and regardless of whether an other-than-temporary loss has been recognized.

17. Changes in currently estimated cash flows, including the effect of prepayment assumptions, on all asset-backed securities shall be reviewed periodically, at least quarterly. The prepayment rates of the underlying assets shall be used to determine prepayment assumptions. Prepayment assumptions shall be applied consistently across portfolios to all asset-backed securities backed by similar collateral (similar with respect to coupon, issuer, and age of collateral). Reporting entities shall use consistent assumptions across portfolios for similar collateral within controlled affiliated groups. Since each reporting entity may have a unique method for determining the prepayment assumptions, it is impractical to set standard assumptions for the industry. Relevant sources and rationale used to determine each prepayment assumption shall be documented by the reporting entity.

18. Asset-backed securities shall be revalued using the currently estimated cash flows, including new prepayment assumptions. Reporting entities may utilize the prospective adjustment method for all asset-backed securities, or they may elect to utilize the retrospective adjustment methodology to specific asset-backed securities that are reported with NAIC designations that are of high credit quality⁵ at the time of acquisition by the reporting entity. That is, the reporting entity shall determine if it will apply the retrospective or prospective method at the time of acquisition depending on the NAIC designation at that time and can only apply retrospective (as a policy election) to securities that of high credit. Subsequently, if an investment is downgraded below high credit quality, the reporting entity may continue to apply the retrospective method unless the security is other-than-temporarily impaired.

19. The prospective approach recognizes, through the recalculation of the effective yield to be applied to future periods, the effects of all cash flows whose amounts differ from those estimated earlier and the effects and changes in projected cash flows. Under the prospective method, the recalculated effective yield will equate the amortized cost of the investment to the present value of the anticipated future cash flows. The recalculated yield is then used to accrue income on the investment balance for subsequent accounting periods. There are no accounting changes in the current period unless the security is determined to be other than temporarily impaired.

20. The retrospective methodology changes both the yield and the amortized cost so that expected future cash flows produce a return on the investment equal to the return now expected over the life of the investment as measured from the date of acquisition. Under the retrospective method, the recalculated effective yield will equate the present value of the actual and anticipated cash flows with the original cost

⁵ Under U.S. GAAP, application of the retrospective method for beneficial interests in securitized financial assets, which would generally encompass most asset backed securities defined within SSAP 43R, is limited to “high quality” investments. This has been interpreted to be investments with AA or better ratings.

of the investment. The current amortized cost basis for the asset-backed security is then increased or decreased to the amount that would have resulted had the revised yield been applied since inception, and investment income is correspondingly decreased or increased.

Accretable Yield and Changes to Effective Yield for Application of Prospective Method

21. At initial acquisition of an asset-backed security, the reporting entity shall determine the accretable yield. The accretable yield is the excess of cash flows expected to be collected over the reporting entity's initial investment in the asset-backed security. The accretable yield shall be recognized as interest income on an effective-yield basis over the life of the asset-backed security⁶. The nonaccretable difference is the contractually required payments in excess of the cash flows expected to be collected. The nonaccretable difference shall not be recognized as an adjustment to yield, a loss accrual or a valuation allowance for credit risk. For transactions initially captured in SSAP No. 103R resulting from a reporting entity's transfer of assets, all cash flows estimated at the transaction date are defined as the holder's estimate of the amount and timing of estimated future principal and interest cash flows used in determining the purchase price or the holder's fair value for purposes of determining a gain or loss under SSAP No. 103R.

22. After the transaction date, cash flows expected to be collected are defined as the holder's estimate of the amount and timing of the estimated principal and interest cash flows based on the holder's best estimate of current considerations and reasonable and supportable forecasts. Expected cash flows are re-evaluated each quarter to determine if there has been a favorable (or an adverse) change in cash flows versus the previous estimate.

23. If upon evaluation there is a favorable (or an adverse) change in cash flows expected to be collected from the cash flows previously projected, the reporting entity shall recalculate the amount of accretable yield for the asset-backed security on the date of evaluation as the excess of cash flows expected to be collected over the asset-backed security's current amortized cost. The amortized cost is equal to the initial investment minus cash received to date, minus write-offs of the amortized cost basis (e.g., recognized other than temporary impairments) plus the yield accreted to date. If the security is in an impaired state (meaning, fair value is less than amortized cost, regardless if an unrealized loss has been recognized because the security is reported at amortized cost) and there is an adverse change in cash flows expected to be collected, an other-than-temporary impairment shall be considered to have occurred as described in paragraph 30 and requires recognition of a realized loss pursuant to paragraph 35. However, an adverse change in cash flows due solely to changes in the interest rate of a "plain-vanilla", variable-rate asset-backed security generally shall not result in the recognition of an other-than-temporary impairment (a plain-vanilla, variable-rate asset-backed investment does not include those variable-rate investments with interest rate reset formulas that involve either leverage or an inverse floater).

24. A favorable (or an adverse) change in cash flows expected to be collected is considered in the context of both timing and amount of the cash flows expected to be collected. Based on cash flows expected to be collected, interest income may be recognized on an asset-backed security even if the net investment in the asset-backed security is accreted to an amount greater than the amount at which the asset-backed security could be settled if prepaid immediately in its entirety. The adjustment shall be accounted for prospectively as a change in estimate in conformity with SSAP No. 3, with the amount of periodic accretion adjusted over the remaining life of the asset-backed security.

25. Determining whether there has been a favorable (or an adverse) change in cash flows expected to be collected from the cash flows previously projected (taking into consideration both the timing and amount

⁶ An asset-backed security may be acquired at a discount because of a change in credit quality or rate or both. When a security is acquired at a discount that relates, at least in part, to the security's credit quality, the effective interest rate is the discount rate that equates the present value of the investor's estimate of the security's future cash flows with the purchase price of the security.

of the cash flows expected to be collected) involves comparing the present value of the remaining cash flows expected to be collected at the initial transaction date (or at the last date previously revised) against the present value of the cash flows expected to be collected at the current financial reporting date. Both the current and previous sets of cash flows shall be discounted at a rate equal to the current yield used to accrete the asset-backed security.

Recognition of Realized and Unrealized Gains and Losses and Impairment Guidance

26. Asset-backed securities required to be reported at the lower of amortized cost or fair value shall report changes from the prior reporting period as unrealized gains or losses unless an other-than-temporary impairment has occurred. For reporting entities required to maintain an AVR, the accounting for unrealized gains and losses shall be reported through the AVR. 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). (P29)

27. Assessment of an other-than-temporary impairment is required for all asset-backed securities when fair value is less than the amortized cost basis. The amortized cost basis includes adjustments made to the cost of an investment for accretion, amortization, collection of cash, and previous other-than-temporary impairments recognized as a realized loss. Reporting a security at the lower of amortized cost or fair value is not a substitute for other-than-temporary impairment recognition. For securities reported at fair value where an other-than-temporary impairment has been determined, the loss recognized reflects the realization of unrealized losses previously recorded from fluctuations in fair value. (The extent to which unrealized losses are realized depends on whether the other-than-temporary impairment is considered a full impairment or a bifurcated impairment pursuant to paragraphs 34 and 35.) After the recognition of an other-than-temporary impairment, securities reported at the lower of amortized cost or fair value shall continue to report unrealized gains and losses from fluctuations in fair value.

28. If an entity intends to sell the asset-backed security (that is, it has decided to sell the security), an other-than-temporary impairment shall be considered to have occurred.

29. If an entity does not intend to sell the asset-backed security, the entity shall assess whether it has the intent and ability⁷ to retain the investment in the security for a period of time sufficient to recover the amortized cost basis. If the entity does not have the intent and ability to retain the investment for the time sufficient to recover the amortized cost basis, an other-than-temporary impairment shall be considered to have occurred.

30. If the entity does not expect to recover the entire amortized cost basis of the security, the entity would be unable to assert that it will recover its amortized cost basis even if it does not intend to sell the security and the entity has the intent and ability to hold. (This includes situations in which an entity has an adverse change in cash flows expected to be collected for a security that is an impaired position (meaning, fair value is less than amortized cost, regardless of if an unrealized loss has been recognized.) In such situations, an other-than temporary impairment shall be considered to have occurred. (For mortgage-referenced securities, an OTTI is considered to have occurred when there has been a delinquency or other credit event in the referenced pool of mortgages such that the entity does not expect to recover the entire amortized cost basis of the security.) In assessing whether the entire amortized cost basis of the security will be recovered, an entity shall compare the present value of cash flows expected to be collected from the security with the amortized cost basis of the security. If present value of cash flows expected to be collected is less than the amortized cost basis of the security, the entire amortized cost basis of the security will not be recovered, and an other-than-temporary impairment shall be considered to have occurred. A decrease in

⁷ This assessment shall be considered a high standard due to the accounting measurement method established for the securities within the scope of this statement (amortized cost).

the present value of cashflows expected to be collected on an asset-backed security that results from an increase or decrease in expected prepayments on the underlying assets shall be considered in the estimate of the present value of cashflows expected to be collected.

31. In determining whether an other than-temporary impairment has occurred, an entity shall calculate the present value of cash flows expected to be collected based on an estimate of the expected future cash flows of the impaired asset-backed security, discounted at the security's effective interest rate. For securities in which there was no nonaccretable yield and for which there has been no changes to estimated cash flows since acquisition, the effective interest rate is the rate of return implicit in the security (that is, the contractual interest rate adjusted for any net deferred fees or costs, premium, or discount existing at the origination or acquisition of the security).⁸ For all other securities, the effective interest rate is the rate implicit immediately prior to the recognition of the other-than-temporary impairment. (Meaning, the effective interest rate as adjusted to reflect the last revised assessment of expected cash flows.)

32. It is inappropriate to automatically conclude that a security is not other-than-temporarily impaired because all of the scheduled payments to date have been received. However, it also is inappropriate to automatically conclude that every decline in fair value represents an other-than-temporary impairment. Further analysis and judgment are required to assess whether a decline in fair value indicates that it is probable that the holder will not collect all of the contractual or estimated cash flows from the security. In addition, the length of time and extent to which the fair value has been less than cost can indicate a decline is other than temporary. The longer and/or the more severe the decline in fair value, the more persuasive the evidence that is needed to overcome the premise that it is probable that the holder will not collect all of the contractual or estimated cash flows from the issuer of the security.

33. In making its other-than-temporary impairment assessment, the holder shall consider all available information relevant to the collectibility of the security, including information about past events, current conditions, and reasonable and supportable forecasts, when developing the estimate of future cash flows. Such information generally shall include the remaining payment terms of the security, prepayment speeds, the financial condition of the issuer(s), expected defaults, and the value of any underlying collateral. To achieve that objective, the holder shall consider, for example, industry analyst reports and forecasts, sector credit ratings, and other market data that are relevant to the collectibility of the security. The holder also shall consider how other credit enhancements affect the expected performance of the security, including consideration of the current financial condition of the guarantor of a security (if the guarantee is not a separate contract) and/or whether any subordinated interests are capable of absorbing estimated losses on the loans underlying the security. The remaining payment terms of the security could be significantly different from the payment terms in prior periods (such as for some securities backed by "nontraditional loans"⁹). Thus, the holder shall consider whether a security backed by currently performing loans will continue to perform when required payments increase in the future (including "balloon" payments). The holder also shall consider how the value of any collateral would affect the expected performance of the

⁸ An asset-backed security may be acquired at a discount because of a change in credit quality or rate or both. When a security is acquired at a discount that relates, at least in part, to the security's credit quality, the effective interest rate is the discount rate that equates the present value of the investor's estimate of the security's future cash flows with the purchase price of the security.

⁹ A nontraditional loan may have features such as (a) terms that permit principal payment deferral or payments smaller than interest accruals (negative amortization), (b) a high loan-to-value ratio, (c) multiple loans on the same collateral that when combined result in a high loan-to value ratio, (d) option adjustable-rate mortgages (option ARMs) or similar products that may expose the borrower to future increases in repayments in excess of increases that result solely from increases in the market interest rate (for example, once negative amortization results in the loan reaching a maximum principal accrual limit), (e) an initial interest rate that is below the market interest rate for the initial period of the loan term and that may increase significantly when that period ends, and (f) interest-only loans that should be considered in developing an estimate of future cash flows.

security. If the fair value of the collateral has declined, the holder needs to assess the effect of that decline on the ability of the holder to collect the balloon payment.

34. When an other-than-temporary impairment has occurred because the entity intends to sell the security or has assessed that they do not have the intent and ability to retain the investments in the security for a period of time sufficient to recover the amortized cost basis, the amount of the other-than-temporary impairment recognized in earnings as a realized loss shall equal the entire difference between the investment's amortized cost basis and its fair value at the balance sheet date (full impairment). For asset-backed securities held at lower of amortized cost or fair value, upon recognition of an other-than-temporary impairment, all unrealized losses would be considered realized and the current fair value becomes the new cost basis.)

35. When an other-than-temporary impairment has occurred because the entity does not expect to recover the entire amortized cost basis of the security even if the entity has no intent to sell and the entity has the intent and ability to hold, the amount of the other-than-temporary impairment recognized as a realized loss shall equal the difference between the investment's amortized cost basis and the present value of cash flows expected to be collected, discounted at the security's effective interest rate in accordance with paragraph 31 (bifurcated impairment). For asset-backed securities held at lower of cost or fair value, unrealized losses would be realized for the non-interest related decline. Hence, unrealized losses could continue to be reflected for these securities based on the difference between the current fair value and the present value of cash flows expected to be collected. (After recognizing an OTTI in these situations, the present value of cash flows expected to be collected becomes the new cost basis of the security.)

36. For reporting entities required to maintain an AVR or IMR, all unrealized gains and losses shall be reported through the AVR. For realized gains and losses, an analysis is required on whether the realized loss reflects an interest or non-interest related decline¹⁰. The analysis required is the same regardless of whether a realized loss results from an impairment write-down or whether there was a gain or loss upon sale. Guidance on specific scenarios resulting in realized gains and losses are as follows:

- a. Unrealized Gains and Losses – Record all unrealized gains and losses through AVR. At the time an unrealized gain or loss is realized, allocation between AVR or IMR will depend on the analysis and bifurcation between interest or non-interest related declines Unrealized gains or losses that are realized shall be reversed from AVR before the recognition of the realized gain or loss within AVR and IMR.
- b. Other-Than-Temporary Impairment – Non-interest related other-than-temporary impairment losses shall be recorded through the AVR and interest-related OTTI losses shall be recorded through the IMR. If the reporting entity wrote the security down to fair value due to the intent to sell or because the entity does not have the intent and ability to retain the investment for a period of time sufficient to recover the amortized cost basis, the entity shall bifurcate the realized loss between non-interest related (AVR) and interest related (IMR). The analysis for bifurcating impairment losses between AVR and IMR shall be completed as of the date when the other-than-temporary impairment is determined. Entities that recognized an OTTI based on the difference between amortized cost and the present value of expected cash flows shall recognize the full realized loss through AVR.

¹⁰ Pursuant to INT 06-07, the term interest-related includes a declining value due to both increases in the risk free interest rate and general credit spread widening. Credit spreads can widen or contract for a variety of reasons, including supply/demand imbalances in the marketplace or the perceived higher/lower risk of an entire sector. If the declining value is caused, in whole or in part, due to credit spreads widening, but not due to fundamental credit problems of the issuer, the change in credit spreads is deemed to be interest-related.

- c. Security Sold at a Loss Without Prior OTTI – An entity shall bifurcate the loss into AVR and IMR portions depending on interest and non-interest related declines in accordance with the analysis performed as of the date of sale.
- d. Security Sold at a Loss With Prior OTTI – An entity shall bifurcate the current realized loss into AVR and IMR portions depending on interest and non-interest related declines in accordance with the analysis performed as of the date of sale. An entity shall not adjust previous allocations to AVR and IMR that resulted from previous recognition of other-than-temporary impairments.
- e. Security Sold at a Gain With Prior OTTI – An entity shall bifurcate the gain into AVR and IMR portions depending on interest and non-interest factors in accordance with the analysis performed as of the date of sale. The bifurcation between AVR and IMR that occurs as of the date of sale may be different from the AVR and IMR allocation that occurred at the time of previous other-than-temporary impairments. An entity shall not adjust previous allocations to AVR and IMR that resulted from previous recognition of other-than-temporary impairments.
- f. Security Sold at a Gain Without Prior OTTI – An entity shall bifurcate the gain into AVR and IMR portions depending on interest and non-interest factors in accordance with the analysis performed as of the date of sale.

37. This statement does not permit reversals of recognized other-than-temporary impairments based on subsequent recoveries of fair value. If there are subsequent changes to the cash flows expected to be collected, the prospective adjustment method shall be used to adjust the effective yield in future periods to reflect those changes.

38. In periods subsequent to the recognition of an other than temporary impairment loss for an asset-backed security, the reporting entity shall account for the other-than-temporarily impaired security as if the security had been purchased on the measurement date of the other-than-temporary impairment at an amortized cost basis equal to the previous amortized cost basis less the other-than-temporary impairment recognized as a realized loss. The difference between the new amortized cost basis and the cash flows expected to be collected shall be accreted as interest income. A reporting entity shall continue to estimate the present value of cash flows expected to be collected over the life of the asset-backed security.

Designation Guidance

39. For Residential Mortgage-Backed Securities (RMBS), Commercial Mortgage-Backed Securities (CMBS) and Collateralized Loan Obligations (CLOs) securities within the scope of this statement, the initial NAIC designation used to determine the carrying value method and the final NAIC designation for reporting purposes is determined using a multi-step process or the NAIC designation assigned by the NAIC Securities Valuation Office. The P&P Manual provides detailed guidance. A general description of the processes is as follows:

- a. Financial Modeling: Pursuant to the P&P Manual, the NAIC identifies select securities where financial modeling must be used to determine the NAIC designation. For a modeled RMBS/CMBS legacy security, meaning one which closed prior to January 1, 2013, the NAIC designation is based on financial modeling incorporating the insurers' carrying value. For a modeled RMBS/CMBS non-legacy security, meaning one which closed after December 31, 2012, or modeled CLO, the NAIC designation and NAIC designation category assigned by the NAIC Securities Valuation Office must be used. For those RMBS/CMBS legacy securities that are financially modeled, the insurer must use NAIC

CUSIP specific modeled breakpoints provided by the modelers in determining initial and final designation for these identified securities. As specified in the P&P Manual, a modeled legacy security RMBS or CMBS tranche that has no expected loss, as compiled and published by the NAIC Securities Valuation Office, under any of the selected modeling scenarios would be assigned an NAIC 1 designation and NAIC 1.A designation category regardless of the insurer's book/adjusted carrying value. The three-step process for modeled RMBS/CMBS legacy securities is as follows:

- i. Step 1: Determine Initial Designation – The current amortized cost (divided by remaining par amount) of an asset-backed security is compared to the modeled breakpoint values assigned to each NAIC designation and NAIC designation category for each CUSIP to establish the **initial** NAIC designation.
 - ii. Step 2: Determine Carrying Value Method – The carrying value method, either the amortized cost method or the lower of amortized cost or fair value method, is then determined as described in paragraph 11 based upon the initial NAIC designation from Step 1.
 - iii. Step 3: Determine Final Designation – The final NAIC designation is determined by comparing the carrying value (divided by remaining par amount) of a security (based on paragraph 39.a.ii.) to the NAIC CUSIP specific modeled breakpoint values assigned to the NAIC designation and NAIC designation category for each CUSIP or is mapped to an NAIC designation category, according to the instructions in the P&P Manual. This final NAIC designation shall be applicable for statutory accounting and reporting purposes and the NAIC designation category will be used for investment schedule reporting and establishing RBC and AVR charges. The final NAIC designation is not used for establishing the appropriate carrying value method in Step 2 (paragraph 39.a.ii.).
- b. All Other Asset-Backed Securities: For securities not subject to paragraph 39.a. (financial modeling) follow the established designation procedures according to the appropriate section of the P&P Manual. The NAIC designation shall be applicable for statutory accounting and reporting purposes (including determining the carrying value method and establishing the AVR charges). The carrying value method is established as described in paragraph 11.

40. For securities that will be financially modeled under paragraph 39, the guidance in this paragraph shall be applied in determining the reporting method for such securities acquired in the current year for quarterly financial statements. Securities reported as of the prior-year end shall continue to be reported under the prior-year end methodology for the current-year quarterly financial statements. For year-end reporting, securities shall be reported in accordance with paragraph 39, regardless of the quarterly methodology used. (P28)

- a. Reporting entities that acquired the entire financial modeling database for the prior-year end are required to follow the financial modeling methodology (paragraph 39.a.) for all securities acquired in the subsequent year that were included in the financial modeling data acquired for the prior year-end.
- b. Reporting entities that acquired identical securities (identical CUSIP) to those held and financially modeled for the prior year-end are required to follow the prior year-end financial modeling methodology (paragraph 39.a.) for these securities acquired subsequent to year-end.

- c. Reporting entities that do not acquire the prior-year financial modeling information for current-year acquired individual CUSIPs, and are not captured within paragraphs 40.a. or 40.b., are required to follow the analytical procedures for non-financially modeled securities (paragraph 39.b. as appropriate) until the current year financial modeling information becomes available and then follow the procedures for financially modeled securities (paragraph 27.a., as appropriate). Reporting entities that do acquire the individual CUSIP information from the prior-year financial modeling database shall use that information for interim reporting.
- d. Reporting entities that acquire securities not previously modeled at the prior year-end are required to follow the analytical procedures for non-financially modeled securities (paragraph 39.b. as appropriate) until the current year financial modeling information becomes available and then follow the procedures for financially modeled securities (paragraph 27.a., as appropriate).

Giantization/Megatization of FHLMC or FNMA Mortgage-Backed Securities

41. Giantization/megatization of mortgage-backed securities is defined as existing pools of FHLMC or FNMA mortgage-backed securities (MBS) with like coupon and prefix which are repooled together by the issuing agency creating a new larger security. The new Fannie Mae “Mega” or Freddie Mac “Giant” is a guaranteed MBS pass-through representing an undivided interest in the underlying pools of loans.

42. Repooled FHLMC and FNMA securities meet the definition of substantially the same as defined in *SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. The transaction shall not be considered a sale/purchase and no gain or loss shall be recognized. To properly document the repooling, the transaction shall be reported through Schedule D of the annual statement as a disposition and an acquisition.

43. Transaction fees charged by the issuing agencies shall be capitalized and amortized over the life of the repooled security.

Disclosures

44. In addition to the disclosures required for invested assets in general, the following disclosures regarding asset-backed securities shall be made in the financial statements. Regardless of the allowances within paragraph 63 of the Preamble, the disclosures in paragraph 44.f., 44.g. and 44.h. of this statement are required in separate, distinct notes to the financial statements:

- a. Fair values in accordance with *SSAP No. 100R—Fair Value*.
- b. Concentrations of credit risk in accordance with *SSAP No. 27*;
- c. Basis at which the asset-backed securities are stated;
- d. The adjustment methodology used for each type of security (prospective or retrospective);
- e. Descriptions of sources used to determine prepayment assumptions.
- f. All securities within the scope of this statement with a recognized other-than-temporary impairment, disclosed in the aggregate, classified on the basis for the other-than-temporary impairment: (1) intent to sell, (2) inability or lack of intent to retain the investment in the security for a period of time sufficient to recover the amortized cost basis, or (3) present

value of cash flows expected to be collected is less than the amortized cost basis of the security.

- g. For each security with an other-than-temporary impairment, recognized in the current reporting period by the reporting entity, as the present value of cash flows expected to be collected is less than the amortized cost basis of the securities:
 - i. The amortized cost basis, prior to any current-period other-than-temporary impairment.
 - ii. The other-than-temporary impairment recognized in earnings as a realized loss.
 - iii. The fair value of the security.
 - iv. The amortized cost basis after the current-period other-than-temporary impairment.
- h. All impaired securities (fair value is less than cost or amortized cost) for which an other-than-temporary impairment has not been recognized in earnings as a realized loss (including securities with a recognized other-than-temporary impairment for non-interest related declines when a non-recognized interest related impairment remains):
 - 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 securities with unrealized losses.
- i. The disclosures in (i) and (ii) above should be segregated by those securities 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.
- j. 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.
- k. When it is not practicable to estimate fair value, the investor should disclose the following additional information, if applicable:
 - 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.
- l. For securities sold, redeemed or otherwise disposed as a result of a callable feature (including make whole call provisions), disclose the number of CUSIPs sold, disposed or otherwise redeemed and the aggregate amount of investment income generated as a result of a prepayment penalty and/or acceleration fee.
- m. The items in the scope of this statement are also subject to the annual audited disclosures in *SSAP No. 26R—Bonds*, paragraphs 39.e., 39.f. and 39.g.

45. Refer to the Preamble for further discussion regarding disclosure requirements. All disclosures within this statement, except disclosures included in paragraphs 44.b., 44.k. and 44.m., shall be included

within the interim and annual statutory financial statements. Disclosure requirements in paragraphs 44.b., 44.k. and 44.m. are required in the annual audited statutory financial statements only.

Relevant Literature

46. This statement reflects specific statutory accounting guidance for assets that qualify as asset-backed securities under the statutory accounting principles-based bond definition. The classification of investments as ‘bonds’ for statutory accounting and reporting purposes differs from the U.S. GAAP determination of a “debt instrument” and this statement reflects statutory specific measurement and impairment guidance for investments captured in scope. This statement does incorporate limited U.S. GAAP concepts, particularly with the determination of accretible yield and consideration of changes in expected cash flows using the retrospective or prospective method. However, due to the statutory accounting specifications on scope, measurement method and impairment, no U.S. GAAP standards are considered adopted within this statement. Concepts that converge with U.S. GAAP are limited to the extent they are detailed in this statement.

Effective Date and Transition

47. This statement adopted August 13, 2023, is effective for years beginning January 1, 2025. The revisions to this statement, and *SSAP No. 26R—Bonds*, incorporate principal concepts on what should be reported as a long-term bond. Securities that qualify as issuer credit obligations within the principal concepts are captured within scope of SSAP No. 26R. Securities that qualify as asset-backed securities within the principal concepts are captured within scope of SSAP No. 43R. Securities that do not qualify as issuer credit obligations or ABS, unless specifically permitted in scope of these statements, are not permitted to be reported as a bond.

48. At the time of transition, reporting entities shall make their best efforts to assess investments to determine whether they qualify within the bond definition for reporting as issuer credit obligations on Schedule D-1-1 or asset-backed securities on Schedule D-1-2. The bond definition requires assessments at the time of acquisition (as of the origination date), and it is recognized that reporting entities may not have the means to complete historical assessments for securities held at the time of transition. For these instances, if information is not readily available for reporting entities to assess a security as of the date at origination, reporting entities may utilize current or acquisition information in concluding that a security qualifies for reporting as a bond as either an issuer obligation or asset-backed security.

49. Investments that were reported as a bond on Schedule D-1: Long-Term Bonds as of December 31, 2024, that do not qualify under the principle-based bond concepts shall be reported as a disposal from that schedule, with a reacquisition on the appropriate reporting schedule as of January 1, 2025. These investments shall be accounted for in accordance with the resulting SSAP that addresses the specific investment structure. For securities that are reported at the lower of amortized cost or fair value under the new applicable guidance, this could result with an unrealized loss in the measurement of the investment at the time of the reclassification. Although the adoption of this guidance is considered a change in accounting principle under SSAP No. 3, the following transition guidance shall be applied on January 1, 2025, to ensure consistency in reporting and to allow investment schedules to roll appropriately:

- a. Securities reclassified from Schedule D-1 as they no longer qualify under the bond definition shall be reported as a disposal from Schedule D-1 at amortized cost. Although no proceeds are received, amortized cost at the time of disposal shall be reported as consideration on Schedule D-4.

- i. For securities held at amortized cost at the time of disposal, book adjusted carrying value and amortized cost shall agree, preventing gain or loss recognition at the time of reclassification.
 - ii. For securities held at fair value under the lower of amortized cost or fair value measurement method, previously reported unrealized losses shall be reversed on Jan. 1, 2025, prior to disposal, resulting with a reported value that mirrors amortized cost at the time of disposal. This action prevents realized loss recognition at time of reclassification.
- b. Securities reclassified from Schedule D-1 shall be recognized on the subsequent schedule (e.g., Schedule BA) with an actual cost that agrees to the disposal value (amortized cost). Immediately subsequent to recognition on the resulting schedule, the securities shall be reported in accordance with the measurement method prescribed by the applicable SSAP:
- i. For securities previously reported at fair value on Schedule D-1 (under a lower of amortized cost or fair value measurement method), the reporting entity will recognize an unrealized loss to match the previously reported book adjusted carrying value. Subsequently, the security will continue to reflect a lower of amortized cost or fair value measurement method.
 - ii. For securities previously reported at amortized cost on Schedule D-1, if the subsequent statement requires a lower of amortized cost or fair value measurement method, then the reporting entity shall recognize an unrealized loss to the extent fair value is less than amortized cost.
 - iii. After application of paragraph 49.b.i. and 49.b.ii. all securities shall reflect either the same reported value as of December 31, 2024 (amortized cost or fair value) or a lower reported value (if the security is subject to the lower of amortized cost or fair value measurement method). There should be no instances that result with a security having a greater reported value than what was presented on December 31, 2024. Subsequent to transition, securities reported at fair value may incur unrealized gains or losses due to fair value fluctuations, but should never have unrealized gains that result with a book adjusted carrying value that exceeds amortized cost.

50. With this transition guidance, changes in measurement for securities reclassified under the bond definition will be reported as a change in unrealized capital gains (losses) in the first quarter 2025 financial statements (unless sold in the interim with a realized gain or loss) and not as a change in accounting principle. To enable regulators the ability to identify the impact of securities reclassified under the bond definition, the following disclosure for the 2025 first quarter financial statement is required:

- a. Aggregate book adjusted carrying value for all securities reclassified off Schedule D-1.
- b. Aggregate book adjusted carrying value after transition for all securities reclassified off Schedule D-1 that resulted with a change in measurement basis. (This shall be a subset of paragraph 50.a. and captures the securities that moved from an amortized cost to a fair value measurement method under the lower of amortized cost or fair value approach.)

- c. Aggregate surplus impact for securities reclassified off Schedule D-1. This shall include the difference between book adjusted carrying value as of December 31, 2024, and book adjusted carrying value after transition for those securities that moved from an amortized cost to a fair value measurement method under the lower of amortized cost or fair value approach.

51. Asset-backed securities that were previously reported as short-term (Schedule DA) or as a cash equivalent (Schedule E2) shall be reclassified to be reported on Schedule D-1-2 on Jan. 1, 2025. Similar to the process detailed in paragraph 49, the securities shall be removed from DA and E2 at amortized cost, with reversal of any unrealized loss prior to the reclassification. The amortized cost shall be reported as “consideration received on disposals” on Schedule DA – Verification Between Years or Schedule E-2 – Verification Between Years, as applicable based on the prior reporting location. The security shall be recognized as an ABS acquired on Schedule D-3 at amortized cost. Immediately after initial recognition, if the security was required to be held at fair value, under the lower of amortized cost or fair value measurement method, the reporting entity shall recognize an unrealized loss.

52. For clarification purposes, the transition guidance shall be applied prospectively beginning with the first year of adoption (Jan. 1, 2025). For disclosures that provide comparative information, reporting entities shall not restate the prior year’s information in the 2025 disclosure.

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. XX—Principles Based Bond Definition*

EXHIBIT A – QUESTION AND ANSWER IMPLEMENTATION GUIDE

This exhibit addresses common questions regarding the valuation and impairment guidance detailed in SSAP No. 43R.

Index to Questions

No.	Question
1	Are reporting entities permitted to establish an accounting policy to write down a SSAP No. 43R other-than-temporarily impaired security, for which a “non-interest” related decline exists, to fair-value regardless of whether the reporting entity intends to sell, or has the intent and ability to hold?
2	Can a reporting entity avoid completing a cash-flow assessment or testing for a specific other-than-temporarily impaired security when the entity believes there is a clear cash-flow shortage (i.e., non-interest related impairment) and elect to recognize a full impairment for the SSAP No. 43R security (no impairment bifurcation), with fair value becoming the new amortized cost basis, and recognition of the full other-than-temporary impairment as a realized loss?
3	Can reporting entities change their “intend to sell” or “unable to hold” assertions and recover previously recognized other-than-temporary impairments?
4	How do the regulators intend the phrase “intent and ability to hold” as used within SSAP No. 43R to be interpreted?
5	How do contractual prepayments affect the determination of credit losses?
6	Are the disclosure requirements within paragraphs 44.f. and 44.g. of SSAP No. 43R required to be completed for the current reporting quarter only, or as a year-to-date cumulative disclosure?
7	If an impairment loss is recognized based on the "present value of projected cash flows" in one period is the entity required to get new cash flows every reporting period subsequent or just in the periods where there has been a significant change in the actual cash flows from projected cash flows?
Questions 8-10 are specific to securities subject to the financial modeling process. (This process is limited to qualifying RMBS/CMBS securities reviewed by the NAIC Structured Securities Group.) The guidance in questions 8-10 shall not be inferred to other securities in scope of SSAP No. 43R.	
8	Do ABS purchased in different lots result in a different NAIC designation for the same CUSIP? Can reporting entities use a weighted average method determined on a legal entity basis?
9	The NAIC Designation process for ABS may incorporate loss expectations that differ from the reporting entity’s expectations related to OTTI conclusions. Should the reporting entities be required to incorporate recovery values obtained from data provided by the service provider used for the NAIC Designation process for impairment analysis as required by SSAP No. 43R?

No.	Question
10	For companies that have separate accounts, can the NAIC designation be assigned based upon the total legal entity or whether it needs to be calculated separately for the general account and the total separate account?

Questions 8-10 are specific to securities subject to the financial modeling process. (This process is limited to qualifying RMBS/CMBS securities reviewed by the NAIC Structured Securities Group.) The guidance in questions 8-10 shall not be inferred to other securities in scope of SSAP No. 43R.

1. Question - Are reporting entities permitted to establish an accounting policy to write down a SSAP No. 43R other-than-temporarily impaired security, for which a “non-interest” related decline exists, to fair value regardless of whether the reporting entity intends to sell, or has the intent and ability to hold?

1.1 Pursuant to the guidance in SSAP No. 43R, optionality is not permitted. As such, an accounting policy that differs from SSAP No. 43R would be considered a departure from statutory accounting principles as prescribed by the NAIC *Accounting Practices and Procedures Manual*.

2. Question – Can a reporting entity avoid completing a cash-flow assessment or testing for a specific other-than-temporarily impaired security when the entity believes there is a clear cash-flow shortage (i.e., non-interest related impairment) and elect to recognize a full impairment for the SSAP No. 43R security (no impairment bifurcation), with fair value becoming the new amortized cost basis, and recognition of the full other-than-temporary impairment as a realized loss?

2.1 Under the basis of SSAP No. 43R, an entity is not permitted to elect a write-down to fair value in lieu of assessing cash flows and bifurcating “interest” and “non-interest” impairment components. As noted in paragraph 30, if the entity does not have the intent to sell, and has the intent and ability to hold, but does not expect to recover the entire amortized cost basis of the security, the entity shall compare the present value of cash flows expected to be collected with the amortized cost basis of the security. If present value of cash flows expected to be collected is less than the amortized cost basis of the security, the entire amortized cost basis of the security will not be recovered (a non-interest decline exists) and an other-than-temporary impairment shall be considered to have occurred. Pursuant to paragraph 35, when an other-than-temporary impairment has occurred because the entity does not expect to recover the entire amortized cost basis of the security even if the entity has no intent to sell and the entity has the intent and ability to hold, the amount of the other-than-temporary impairment recognized as a realized loss shall equal the difference between the investment’s amortized cost basis and the present value of cash flows expected to be collected, discounted at the asset-backed security’s effective interest rate.

2.2 If the entity does not want to assess cash flows of an impaired security (fair value is less than amortized cost), the entity can designate the security as one the entity intends to sell, or one that the entity does not have the intent and ability to hold, providing it is reflective of the true intent and assessment of the ability of the entity. Once an impaired security has this designation, pursuant to paragraphs 28 or 29, an other-than-temporary impairment shall be considered to have occurred. As detailed in paragraph 34, the amount of the other-than-temporary impairment recognized in earnings as a realized loss shall equal the entire difference between the investment’s amortized cost basis and its fair value at the balance sheet date.

- 2.3 As addressed in question 3 of this Question and Answer Guide, reporting entities are not permitted to change assertions regarding their intent to sell or their lack of intent and ability to hold. Once the security has been identified as one the entity intends to sell, or as a security that the entity does not have the intent and ability to hold, that assertion shall not change as long as the entity continues to hold the security.

3. Question - Can reporting entities change their “intend to sell” or “unable to hold” assertions and recover previously recognized other-than-temporary impairments?

- 3.1 No, a reporting entity is not permitted to change assertions and reverse previously recognized SSAP No. 43R other-than-temporary impairments. Although an entity may elect to hold a security due to a favorable change in the security’s fair value, once the security has been identified as one the entity intends to sell, or as a security that the entity does not have the intent and ability to hold for purposes of initially recognizing an other-than-temporary impairment, that assertion shall not change as long as the entity continues to hold the security.

- 3.2 Reporting entities that have recognized an other-than-temporary impairment on a SSAP No. 43R security in a manner corresponding with an assertion on the intent to sell or the lack of the intent and ability to hold, for which a subsequent other-than-temporary impairment has been identified, shall recognize a realized loss for the difference between the current amortized cost (reflecting the previously recognized SSAP No. 43R other-than-temporary impairment) and the fair value at the balance sheet date of the subsequent impairment. Thus, bifurcation of impairment between interest and non-interest related declines is not permitted for securities in which an other-than-temporary impairment was previously recognized on the basis that the reporting entity had the intent to sell, or lacked the intent and ability to hold, regardless if the entity has subsequently decided to hold the security.

- 3.3 Reporting entities shall reclassify a security as one for which there is an intent to sell, or for which there is not an intent or ability to hold, regardless if a bifurcated other-than-temporary impairment had previously been recognized, as soon as the entity realizes that they can no longer support a previous assertion to hold the security. In making such reclassifications, if the security is impaired, the difference between the amortized cost (reflecting the initial non-interest other-than-temporary impairment recognized) and fair value at the balance sheet date of the reclassification shall be recognized as a realized loss, with fair value reflecting the new amortized cost basis. Once such a reclassification occurs, and the security is classified as one for which there is an intent to sell, or for which there is not an intent and ability to hold, the security must continue to carry that assertion until it is no longer held by the reporting entity.

4. Question – How do the regulators intend the phrase “intent and ability to hold” as used within SSAP No. 43R to be interpreted?

- 4.1 SSAP No. 43R paragraph 29 states in part “...the entity shall assess whether it has the intent and ability to retain the investment in the security for a period of time sufficient to recover the amortized cost basis. If the entity does not have the intent and ability to retain the investment for the time sufficient to recover the amortized cost basis, an other-than-temporary impairment shall be considered to have occurred.”

- 4.2 The intent of this language within SSAP No. 43R is focused on ensuring that, as of the balance sheet date, after considering the entity’s own cash or working capital requirements

and contractual or regulatory obligations and all known facts and circumstances related to the impaired security, the entity does not have the intention of selling the impaired security and has the current intent and ability to hold the security to recovery. Due to impairment bifurcation provisions provided within SSAP No. 43R, and the amortized cost measurement method generally permitted for asset-backed securities, the assessment of “intent and ability” is intended to be a high standard. Despite the intent of [paragraph 29](#), it is identified that information not known to the entity may become known in subsequent periods and/or facts and circumstances related to an individual holding or group of holdings may change thereby influencing the entity’s subsequent determination of intent and ability with respect to a security or securities.

- 4.3 If a reporting entity asserts that it has the intent and ability to hold a security, or group of securities, until recovery of the amortized cost, but sells or otherwise disposes the security or securities prior to such recovery, the reporting entity shall be prepared to justify this departure from their original assertion to examiners and auditors. SSAP No. 43R purposely does not identify specific circumstances in which a change in assertion would be justifiable, but requires judgment from management, examiners and auditors on whether future assertions warrant closer review.
- 4.4 Delaying recognition of other-than-temporary impairments is a cause of serious concern by the regulators, and entities that habitually delay such recognition through false assertions on the “intent and ability to hold” may face increased scrutiny and regulatory action by their domiciliary state. It is imperative that a reporting entity recognize the full other-than-temporary impairment as soon as the entity realizes that they will no longer be able to hold the security until recovery of the amortized cost basis. Greater scrutiny shall be placed on securities sold or otherwise disposed shortly after a financial statement reporting date if such securities had been excluded from the full other-than-temporary impairment recognition on the basis of the reporting entity’s intent and ability to hold.
- 4.5 As noted in [paragraph 3.3](#) of this question and answer guide, once a security is classified as one for which there is an intent to sell, or for which there is not an intent and ability to hold, the security must continue to carry that assertion until the security is no longer held by the reporting entity.

5. Question – How do contractual prepayments affect the determination of credit losses?

- 5.1 [Paragraph 30](#) of SSAP No. 43R states that "A decrease in cash flows expected to be collected on asset-backed security that results from an increase in prepayments on the underlying assets shall be considered in the estimate of present value of cash flows expected to be collected." [Paragraph 18](#) states that "Asset-backed securities shall be revalued using the currently estimated cash flows, including new prepayment assumptions. Reporting entities may utilize the prospective adjustment method for all asset-backed securities that are reported with NAIC designations that are of high credit at the of acquisition by the reporting entity."

6. Question – Are the disclosure requirements within [paragraphs 44.f. and 44.g.](#) of SSAP No. 43R required to be completed for the current reporting quarter only, or as a year-to-date cumulative disclosure?

- 6.1 The disclosures should reflect the year-to-date other-than-temporary impairments. The “fair value” reported within the disclosure is intended to reflect the fair value at the date of the other-than-temporary impairment and shall not be updated due to the fluctuations identified at subsequent reporting dates. If a security has more than one other-than-

temporary impairment identified during a fiscal reporting year, the security shall be included on the disclosure listing separately for each identified other-than-temporary impairment. Notation shall be included in the disclosure identifying the other-than-temporary impairments that were recognized for each respective reporting period.

7. Question – If an impairment loss is recognized based on the "present value of projected cash flows" in one period is the entity required to get new cash flows every reporting period subsequent or just in the periods where there has been a significant change in the actual cash flows from projected cash flows?

7.1 The guidance in **paragraph 38** of SSAP No. 43R indicates that a reporting entity shall continue to estimate the present value of cash flows expected to be collected over the life of the asset-backed security. This guidance is explicit that the reporting entity shall continue to estimate the present value of cash flows expected to be collected over the life of the loan-backed or structured security.

7.2 As provided in paragraph 2.2 of this Q&A, if the entity does not want to assess cash flows of an impaired security (fair value is less than amortized cost), the entity can designate the security as one the entity intends to sell, or one that the entity does not have the intent and ability to hold, providing it is reflective of the true intent and assessment of the ability of the entity. Reporting entities subject to the requirements of AVR and IMR should allocate the impairment loss between AVR and IMR accordingly.

8. Question – Do ABS purchased in different lots result in a different NAIC designation for the same CUSIP? Can reporting entities use a weighted average method determined on a legal entity basis?

8.1 Under the financial modeling process (applicable to qualifying RMBS/CMBS reviewed by the NAIC Structured Securities Group), the amortized cost of the security impacts the "final" NAIC designation used for reporting and RBC purposes. As such, securities subject to the financial modeling process acquired in different lots can result in a different NAIC designation for the same CUSIP. In accordance with the current instructions for calculating AVR and IMR, reporting entities are required to keep track of the different lots separately, which means reporting the different designations. For reporting purposes, if a SSAP No. 43R security (by CUSIP) has different NAIC designations by lot, the reporting entity shall either 1) report the aggregate investment with the lowest applicable NAIC designation or 2) report the investment separately by purchase lot on the investment schedule. If reporting separately, the investment may be aggregated by NAIC designation. (For example, all acquisitions of the identical CUSIP resulting with an NAIC 1 designation may be aggregated, and all acquisitions of the identical CUSIP resulting with an NAIC 3 designation may be aggregated.)

9. Question – The NAIC Designation process for ABS subject to the financial modeling process may incorporate loss expectations that differ from the reporting entity's expectations related to OTTI conclusions. Should the reporting entities be required to incorporate recovery values obtained from data provided by the service provider used for the NAIC Designation process for impairment analysis as required by SSAP No. 43R?

9.1 In accordance with *INT 06-07: Definition of Phrase "Other Than Temporary,"* reporting entities are expected to "consider all available evidence" at their disposal, including the information that can be derived from the NAIC designation.

10. Question - For companies that have separate accounts, can the NAIC designation be assigned based upon the total legal entity or whether it needs to be calculated separately for the general account and the total separate account?

10.1 The financial modeling process for qualifying RMBS/CMBS securities is required for applicable securities held in either the general or separate account.

[https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2023/8-13-23 Summer National Meeting/Adoptions/19-21b - 43R -8-13-23.docx](https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National%20Meetings/A.%20National%20Meeting%20Materials/2023/8-13-23%20Summer%20National%20Meeting/Adoptions/19-21b%20-%2043R%20-%208-13-23.docx)

Bond Definition - Revisions to other SSAPs Adopted Aug. 13, 2023

SSAP Reference Revisions

1. SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments

SSAP No. 26R: Updated reference in paragraph 18. No revisions needed to paragraph 7 or 15.

SSAP No. 43R: Adjusted title references in paragraphs 7 and 15.

2. SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve

SSAP No. 43R: Adjusted reference in paragraph 3.

3. SSAP No. 15—Debt and Holding Company Obligations

SSAP No. 26R: No revisions needed to paragraph 13.

4. SSAP No. 21—Other Admitted Assets

SSAP No. 26R: Updated footnote 1 and clarified guidance for GICs in paragraphs 14-17.

SSAP No. 43R: Adjusted reference in paragraph 6 to asset-backed securities that qualify.

5. SSAP No. 36—Troubled Debt Restructuring

SSAP No. 26R: No revisions needed to paragraph 29.

6. SSAP No. 43R—Asset-Backed Securities

SSAP No. 26R: Updated disclosure reference that link to SSAP No. 26R, paragraph 51.m.

7. SSAP No. 86—Derivatives

SSAP No. 26R and SSAP No. 43R: Updated the guidance for structured notes in paragraph 5.g. and replication (synthetic assets) in Footnote 5.

8. SSAP No. 95—Nonmonetary Transactions

SSAP No. 26R: No revisions needed to paragraph 6.

SSAP No. 43R: Adjusted the citation to SSAP No. 43R in paragraph 6.

9. SSAP No. 100R—Fair Value

SSAP No. 26R: No revisions needed to Footnote 3.

10. SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities

SSAP No. 43R: Revisions remove the direct pointer of beneficial interests as in scope of SSAP No. 43R and incorporate guidance for reporting under the applicable SSAP in paragraphs 2, 11 and 18.

11. INT 01-25: Accounting for U.S. Treasury Inflation-Indexed Securities

SSAP No. 26: No revisions needed.

12. 06-02: Accounting and Reporting for Investments in a Certified Capital Company (CAPCO)

SSAP No. 26: Updated paragraph reference in paragraph 5.a.

13. 06-07: Definition of Phrase “Other Than Temporary”

SSAP No. 26: No revisions needed.

SSAP No. 43R: Updated reference in list of applicable SSAPs.

14. INT 07-01: Application of the Scientific (Constant Yield) Method in Situations of Reverse Amortization

SSAP No. 26R: Removed quoted guidance.

SSAP No. 43R: Updated reference in list of applicable SSAPs and removed quoted guidance.

15. INT 19-02: Freddie Mac Single Security Initiative

SSAP No. 26R: No revisions needed.

SSAP No. 43R: Updated reference in list of applicable SSAPs and in paragraph 1.

16. INT 22-01: Freddie Mac When Issued K-Deal (WI Trust) Certificates

SSAP No. 43R: Updated reference in list of applicable SSAPs and in paragraph 1.

Summary of SAP Guidance Revisions

17. SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments

Revisions preclude asset-backed securities that are in scope of SSAP No. 43R from being reported as cash equivalents or short-term investments. The revisions also identify items captured on Schedule BA as non-bond securities. (These revisions also add reference to working capital finance investments, but that is not new guidance, but was not explicitly stated in SSAP No. 2R.)

Summary of SAP Reference Revisions:

SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments

7. Regardless of maturity date, related party or affiliated investments that would be in scope of *SSAP No. 26R—Bonds*, *SSAP No. 43R—~~Loan-Backed and Structured~~Asset-Backed Securities*, or that would be reported as “Other Invested Assets” shall be reported as long-term investments if any of the following conditions apply,¹ unless the reporting entity has re-underwritten the investment, maintained appropriate re-underwriting documentation, and each participating party had the ability to independently review the terms and can terminate the transaction prior to renewal.

- a. The reporting entity does not reasonably expect the investment to terminate on the maturity date. This provision includes investments that are expected to be renewed (or rolled) with a maturity date that ends subsequent to the initial 90-day timeframe.
- b. The investment was previously reported as a cash equivalent investment and the initial maturity timeframe has passed. If an investment is reported as a cash equivalent and it is unexpectedly renewed/rolled, the reporting entity is not permitted to continue to report the held security as a cash equivalent, regardless of the updated maturity date, and shall report the security as a long-term investment. An investment is only permitted to be reported as a cash equivalent for one quarter reporting period. Meaning, if an investment was reported as a cash equivalent in the first quarter, it is not permitted to be reported as a cash equivalent in the second quarter.
- c. The reporting entity reacquired the investment (or a substantially similar investment) within one year after the original security matured or was terminated. These reacquired securities shall be reported as long-term investments. (These securities are also not permitted to be reported as short-term investments, regardless of the maturity date of the reacquired investment.)

Footnote 1: Cash equivalents subject to the provisions of paragraph 7 are not permitted to be subsequently reported as short-term investments, even if the updated/reacquired maturity date is within one year. These investments shall be reported as long-term investments. To avoid changes in reporting schedules, reporting entities are permitted to report securities as long-term investments at initial acquisition, regardless of the initial maturity date.

15. Regardless of maturity date, related party or affiliated investments in scope of *SSAP No. 26R—Bonds*, *SSAP No. 43R—~~Loan-Backed and Structured~~Asset-Backed Securities*, or that would be reported as “Other Invested Assets” shall be reported as long-term investments if any of the following conditions apply,^{2, 3} unless the reporting entity has re-underwritten the investment, maintained appropriate re-underwriting documentation, and each participating party had the ability to independently review the terms and can terminate the transaction prior to renewal.

- a. The reporting entity does not reasonably expect the investment to terminate on the maturity date. This provision includes investments that are expected to be renewed (or rolled) with a maturity date that ends subsequent to the initial “less than one year” timeframe.
- b. The investment was previously reported as a short-term investment and the initial maturity timeframe has passed. If an investment is reported as a short-term investment and it is unexpectedly renewed/rolled, the reporting entity is not permitted to continue to report the held security as a short-term investment (or as a cash equivalent) regardless of the updated maturity date and shall report the security as a long-term investment. An investment is only permitted to be reported as a short-term investment for one annual reporting period. Meaning, if an investment was reported as a short-term investment as of December 31, 2018, it is not permitted to be reported as short-term investment as of December 31, 2019.

- c. The reporting entity reacquired the investment (or a substantially similar investment) within one year after the original security matured or was terminated. These reacquired securities shall be reported as long-term investments. (These securities are also not permitted to be reported as cash equivalent investments regardless of the maturity date of the reacquired investment.)

Footnote 2: Reverse repurchase transactions are excluded from these provisions if admitted in accordance with collateral requirements pursuant to *SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*.

Footnote 3: Short-term investments subject to the provisions of paragraph 15 are not permitted to be subsequently reported as cash equivalents, even if the updated/reacquired maturity date is within 90 days. These investments shall be reported as long-term investments. To avoid changes in reporting schedules, reporting entities are permitted to report securities as long-term investments at initial acquisition, regardless of the initial maturity date.

Disclosures

18. The following disclosures shall be made for short-term investments in the financial statements:
 - a. Fair values in accordance with *SSAP No. 100R—Fair Value*;
 - b. Concentrations of credit risk in accordance with *SSAP No. 27—Off-Balance-Sheet and Credit Risk Disclosures*;
 - c. Basis at which the short-term investments are stated.
 - d. The items in the scope of this statement are also subject to the annual audited disclosures in *SSAP No. 26R—Bonds*, paragraph ~~39.f.30.f.~~
 - e. Identification of cash equivalents (excluding money market mutual funds as detailed in paragraph 8) and short-term investments (or substantially similar investments), which remain on the same reporting schedule for more than one consecutive reporting period. This disclosure is satisfied by use of a designated code in the investment schedules of the statutory financial statements.

SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve

3. The IMR and AVR shall be calculated and reported as determined per guidance in the SSAP for the specific type of investment (e.g., SSAP No. 43R for ~~loan-backed and structured~~ asset-backed securities), or if not specifically stated in the respective SSAP, in accordance with the NAIC *Annual Statement Instructions* for Life and Accident and Health Insurance Companies.

SSAP No. 15—Debt and Holding Company Obligations - (No Changes)

13. Convertible debt securities and convertible preferred stock with beneficial conversion features are to be valued according to the appropriate statutory accounting statement; *SSAP No. 26R—Bonds* or *SSAP No. 32R—Preferred Stock*.

SSAP No. 21R—Other Admitted Assets

Collateral Loans

4. Collateral loans are unconditional obligations¹ for the payment of money secured by the pledge of an investment² and meet the definition of assets as defined in SSAP No. 4, and are admitted assets to the extent they conform to the requirements of this statement. The outstanding principal balance on the loan and any related accrued interest shall be recorded as an admitted asset subject to the following limitations:

Footnote 1: For purposes of determining a collateral loan in scope of this statement, a collateral loan does not include investments captured in scope of other statements. For example, *SSAP No. 26R—Bonds* includes securities [that qualify as issuer creditor obligations and SSAP No. 43—Asset-Backed Securities includes securities that qualify as asset-backed securities under the bond definition](#). ~~(as defined in that statement) representing a creditor relationship whereby there is a fixed schedule for one or more future payments.~~ Investments captured in SSAP No. 26R [or SSAP No. 43R](#) that are also secured with collateral shall continue to be captured within scope of ~~SSAP No. 26R~~[those statements](#).

Footnote 2: Investment defined as those assets listed in Section 3 of *Appendix A-001—Investments of Reporting Entities*.

6. A reporting entity that acquires (directly or indirectly) structured settlement payment rights³ through a factoring company, excluding securitizations [that qualify as asset-backed securities captured in scope of](#) SSAP No. 43R, shall report the acquisition as follows:

- a. Period-certain (non-life contingent) structured settlement income streams shall be reported as other long-term invested assets⁴, and are admitted assets if the rights to the future payments from a structured settlement have been legally acquired in accordance with all state and federal requirements. If the structured settlement has not met all legal requirements, including the court-approved transfer from the original recipient, then the reporting entity shall recognize the appropriate excise tax obligation and the structured settlement shall be nonadmitted.
- b. Life-contingent structured settlement income streams shall be reported as other long-term invested assets on Schedule BA and shall be nonadmitted. (Nonadmittance is required regardless if the right to future payments has been legally transferred.)

Footnote 3: This guidance is specific to acquired structured settlement income streams (legal right to receive future payments from a structured settlement) and does not capture accounting and reporting guidance for the acquisition of any insurance product (e.g., life settlement, annuities, etc.).

Footnote 4: Reporting entities that hold qualifying structured settlement payment rights shall report the security on Schedule BA either as an “any other class of asset” or as a “fixed or variable interest rate investment with underlying characteristics of other fixed income instruments” if the structured settlement payment right qualifies for reporting within that reporting line (e.g., NAIC designation).

Guaranteed Investment Contracts

14. Guaranteed Investment Contracts (GICs) purchased for investment purposes meet the definition of assets as defined in SSAP No. 4, and are admitted assets to the extent they conform to the requirements of this statement. [This includes an investment in a GIC payment stream which can be created when an intermediary purchases individual GICs, pools them, and sells the rights to the payment stream.](#)

[15. GICs acquired in a security structure that qualify under the bond definition as an issuer obligation or asset-backed security shall follow the accounting guidance within SSAP No. 26R or SSAP No. 43R as applicable.](#)

~~15.~~16. Purchases of GIC investments that do not meet the definition of a security, but for which all contractual rights and ownership of the GIC result in an investment similar to a corporate bond, shall be reported at amortized cost and ~~accounted for in accordance with the guidance in SSAP No. 26R—Bonds included on Schedule BA: Other Long-Term Invested Assets.~~ If, in accordance with SSAP No. 5R, it is probable that the carrying value of a GIC is not fully recoverable the investment shall be considered impaired. Accordingly, the cost basis of the investment shall be written down to the undiscounted estimated cash flows and the amount of the write down shall be accounted for as a realized loss. The new cost basis shall not be changed for subsequent recoveries in fair value.

~~16.—An investment in a GIC payment stream is created when an intermediary purchases individual GICs, pools them, and sells the rights to the payment stream. These investments shall be reported as other long-term invested assets and shall be carried at amortized cost.~~

~~17.—If, in accordance with SSAP No. 5R, it is probable that the carrying value of a GIC is not fully recoverable the investment shall be considered impaired. Accordingly, the cost basis of the investment shall be written down to the undiscounted estimated cash flows and the amount of the write down shall be accounted for as a capital loss. The new cost basis shall not be changed for subsequent recoveries in fair value.~~

SSAP No. 36—Troubled Debt Restructuring (No Changes)

29. Although FASB Statement No. 91, *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases* (FAS 91) was rejected in SSAP No. 26R—Bonds, this statement is consistent with paragraph 14 of FAS No. 91.

SSAP No. 43R—Asset-Backed Securities

Disclosures

51. In addition to the disclosures required for invested assets in general, the following disclosures regarding loan-backed and structured securities shall be made in the financial statements. Regardless of the allowances within paragraph 63 of the Preamble, the disclosures in paragraph 51.f., 51.g. and 51.h. of this statement are required in separate, distinct notes to the financial statements:

- m. The items in the scope of this statement are also subject to the annual audited disclosures in SSAP No. 26R—Bonds, paragraphs ~~39.e., 30.e., 39.f., 30.f.~~ and ~~39.g., 30.g.~~

SSAP No. 86—Derivatives

5. Derivative instruments include, but are not limited to; options, warrants used in a hedging transaction and not attached to another financial instrument, caps, floors, collars, swaps, forwards, futures, structured notes with risk of principal/original investment loss based on the terms of the agreement (in addition to default risk), and any other agreements or instruments substantially similar thereto or any series or combination thereof.

- g. “Structured Notes” ~~in scope of this statement are instruments defined in SSAP No. 26R—Bonds (often in the form of debt instruments),~~ in scope of this statement are instruments in which the amount of principal repayment or return of original investment is contingent on an underlying variable/interest⁵, where the terms of the agreement make it possible that the reporting entity could lose all or a portion of its original investment amount (for other than failure of the issuer to pay the contractual amounts due). ~~Structured notes that are “mMortgage-referenced securities”~~ issued by a government sponsored enterprise in the

form of credit-risk transfers where an issue security is tied to a referenced pool of mortgages are captured in *SSAP No. 43R—Loan-Backed and Structured Securities*.

Footnote 5 - ~~The “structured notes” captured within scope of this statement is specific to instruments in which the terms of the agreement make it possible that the reporting entity could lose all or a portion of its original investment amount (for other than failure of the issuer to pay the contractual amounts due).~~ These instruments incorporate both the credit risk of the issuer, as well as the risk of an underlying variable/interest (such as the performance of an equity index or the performance of an unrelated security). Securities that are labeled “principal-protected notes” are captured within scope of this statement if the “principal protection” involves only a portion of the principal and/or if the principal protection requires the reporting entity to meet qualifying conditions in order to be safeguarded from the risk of loss from the underlying linked variable. Securities that may have changing positive interest rates in response to a linked underlying variable or the passage of time, or that have the potential for increased principal repayments in response to a linked variable (such as U.S. Treasury Inflation-Indexed Securities) that do not incorporate risk of original investment/principal loss (outside of default risk) are not captured as structured notes in scope of this statement. A replication (synthetic asset) transaction addressed within this standard may reproduce the investment characteristics of an otherwise permissible investment that would not meet the principles-based bond definition (e.g., is distinct from a “structured note” as defined here); the admissibility, classification and measurement of a replication (synthetic asset) transaction are not preemptively determined by the principles-based bond definition, and should be evaluated in accordance with the guidance on replication (synthetic asset) transactions within this standard.

SSAP No. 95—Nonmonetary Transactions

6. Fair value of assets received or transferred in a nonreciprocal transfer shall be measured based on statutory accounting principles for the type of asset transferred. Accordingly, the value shall be determined in accordance with *SSAP No. 26R—Bonds*, *SSAP No. 30R—Unaffiliated Common Stock*, *SSAP No. 32R—Preferred Stock*, *SSAP No. 37—Mortgage Loans*, *SSAP No. 39—Reverse Mortgages*, *SSAP No. 40R—Real Estate Investments*, *SSAP No. 43R—~~Loan-Backed and Structured~~Asset-Backed Securities*, *SSAP No. 90—Impairment or Disposal of Real Estate Investments* or other applicable statements. The guidance provided in *SSAP No. 25* shall be followed in accounting for nonreciprocal transactions with affiliates and other related parties as defined in that statement.

SSAP No. 100—Fair Value (No Changes)

48. For each class of assets and liabilities measured and reported³ at fair value or NAV in the statement of financial position after initial recognition. The reporting entity shall determine appropriate classes of assets and liabilities in accordance with the annual statement instructions.

Footnote 3: The term “reported” is intended to reflect the measurement basis for which the asset or liability is classified within its underlying SSAP. For example, a bond with an NAIC designation of 2 is considered an amortized cost measurement and is not included within this disclosure even if the amortized cost and fair value measurement are the same. An example of when such a situation may occur includes a bond that is written down as other-than-temporarily impaired as of the date of financial position. The amortized cost of the bond after the recognition of the other-than-temporary impairment may agree to fair value, but under *SSAP No. 26R* this security is considered to still be reported at amortized cost.

SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities

2. This statement focuses on the issues of accounting for transfers and servicing of financial assets and extinguishments of liabilities. This statement establishes statutory accounting principles for transfers and servicing of financial assets, including asset securitizations and securitizations of policy acquisition costs, extinguishments of liabilities, repurchase agreements, repurchase financing and reverse repurchase agreements, including dollar repurchase and dollar reverse repurchase agreements that are consistent with the Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy (Statement of Concepts). This statement discusses generalized situations. Facts and circumstances and specific contracts need to be considered carefully in applying this statement. Securitizations of nonfinancial assets are outside the scope of this statement. Transfers of financial assets that are in substance real estate shall be accounted for in accordance with *SSAP No. 40R—Real Estate Investments*. Additionally, retained beneficial interests

from the sale of ~~loan-backed or structured~~ asset-backed securities are to be accounted for in accordance with the statutory accounting statement that is applicable to the investment retained ~~with SSAP No. 43R—Loan-Backed and Structured Securities, Revised~~. If the retained security does not qualify for reporting as a bond under the bond definition detailed in SSAP No. 26R, it shall be reported as a debt security that does not qualify as a bond in scope of SSAP No. 21R—Other Admitted Assets.

11. Upon completion of a transfer of an entire financial asset or a group of entire financial assets that satisfies the conditions to be accounted for as a sale (see paragraph 8), the transferor (seller) shall:
- a. Derecognize the transferred financial assets;
 - b. Recognize and initially measure at fair value servicing assets, servicing liabilities, and any other assets obtained (including a transferor's beneficial interest in the transferred financial assets) and liabilities incurred¹ in the sale (paragraphs 60 and 62-66).
 - c. For reporting entities required to maintain an Interest Maintenance Reserve (IMR), the accounting for realized and unrealized capital gains and losses shall be determined per the guidance in the SSAP for the specific type of investment ~~(e.g., SSAP No. 43R for loan-backed and structured securities)~~, or if not specifically stated in the related SSAP, in accordance with *SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve*. For reporting entities not required to maintain an IMR, realized capital gains and losses shall be reported as net realized capital gains or losses in the statement of income, and unrealized capital gains and losses shall be reported as net unrealized gains and losses in unassigned funds (surplus).

The transferee shall recognize all assets obtained and any liabilities incurred, and initially measure them at fair value.

Footnote 1: Some assets that might be obtained and liabilities that might be incurred include cash, put or call options that are held or written (for example, guarantee or recourse obligations), forward commitments (for example, commitments to deliver additional receivables during the revolving periods of some securitizations) and swaps (for example, provisions that convert interest rates from fixed to variable).

Financial Assets Subject to Prepayment

18. Financial assets, except for instruments that are within the scope of *SSAP No. 86—Derivatives*, that can contractually be prepaid or otherwise settled in such a way that the holder would not recover substantially all of its recorded investment shall be assessed in accordance with the bond definition captured in SSAP No. 26R—Bonds to determine appropriate accounting and reporting. Securities that do not qualify for bond reporting shall be captured as debt securities that do not qualify as bonds in scope of SSAP No. 21R—Other Admitted Assets. ~~subsequently measured in accordance with the statutory accounting statement that is applicable to the financial asset, subsequently measured like investments in debt securities and loan-backed and structured securities in accordance with SSAP No. 43R~~. ~~Examples of such financial assets include, but are not limited to, interest-only strips, other beneficial interests, loans, or other receivables.~~

INT 01-25: Accounting for U.S. Treasury Inflation-Indexed Securities

- No Change – Applies to SSAP No. 26R.

INT 06-02: Accounting and Reporting for Investments in a Certified Capital Company (CAPCO)

5. For Issue 1, the Working Group came to a consensus that reporting entities should account and report for investments in CAPCO's consistent with the agreement structure within the guidance provided below:

- h. Investment in a debt instrument of a CAPCO shall be reported as a bond in accordance with the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* and the designation assigned in the *NAIC Valuations of Securities* product prepared by the NAIC Securities Valuation Office (Valuations of Securities manual) as stated in SSAP No. 26R, paragraph ~~2011~~.
- i. Investment in an equity interest of a CAPCO shall be reported as common stock and reported at fair value as stated in SSAP No. 30R, paragraph 8.
- j. Investment in preferred stock interest of a CAPCO shall be reported as preferred stock in accordance with the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* and the designation assigned in the *NAIC Valuations of Securities* product prepared by the NAIC Securities Valuation Office (Valuations of Securities manual) as stated in SSAP No. 32R, paragraphs 19-22.
- k. Investment in a Joint Venture, Partnership and Limited Liability Company (LLC) shall be reported in accordance with SSAP No. 48, paragraphs 5-6. The reported value of the investment shall be decreased in proportion to the premium tax credits utilized.
- l. The tax credits shall be recognized as a reduction of the tax liabilities as they are utilized. Tax credits received are not to be included in investment income.

INT 06-07: Definition of Phrase "Other Than Temporary"

- Update interpreted SSAP list to reference to *SSAP No. 43R—Asset-Backed Securities*

INT 07-01: Application of the Scientific (Constant) Yield Method in Situations of Reverse Amortizations

1. SSAP No. 26R and SSAP No. 43R both reference the use of the scientific or constant yield method of amortization of a premium or a discount. ~~SSAP No. 26R—Bonds provides the following (bolding added for emphasis):~~

~~Amortized Cost~~

~~9. Amortization of bond premium or discount shall be calculated using the scientific (constant yield) interest method taking into consideration specified interest and principal provisions over the life of the bond. Bonds containing call provisions (where the issue can be called away from the reporting entity at the issuer's discretion) shall be amortized to the call or maturity value/date which produces the lowest asset value (yield to worst).~~

~~SSAP No. 43R—Loan Backed and Structured Securities provides the following (bolding added for emphasis):~~

~~Amortization~~

~~8.——Amortization of premium or discount shall be calculated using the scientific (constant yield) interest method and shall be recorded as an adjustment to investment income. The interest method results in a constant effective yield equal to the prevailing rate at the time of purchase or at the time of subsequent adjustments to book value. The amortization period shall reflect estimates of the period over which repayment of principal of the loan-backed securities is expected to occur, not the stated maturity period.~~

Collection of All Contractual Cashflows is Probable

~~12.——The following guidance applies to loan-backed and structured securities for which it is probable that the investor will be able to collect all contractually required payments receivable. (Paragraphs 17-19 provide guidance for securities in which collection of all contractual cash flows is not probable and paragraphs 20-24 provide guidance for beneficial interests.) Prepayments are a significant variable element in the cash flow of loan-backed securities because they affect the yield and determine the expected maturity against which the yield is evaluated. Falling interest rates generate faster prepayment of the mortgages underlying the security, shortening its duration. This causes the reporting entity to reinvest assets sooner than expected at potentially less advantageous rates. This is called prepayment risk. Extension risk is created by rising interest rates which slow repayment and can significantly lengthen the duration of the security. Differences in cash flows can also result from other changes in the cash flows from the underlying assets. If assets are delinquent or otherwise not generating cash flow, which should be reflected in the cash flow analysis through diminishing security cash flows, even if assets have not been liquidated and gain/losses have not been booked.~~

~~13.——Changes in currently estimated cash flows, including the effect of prepayment assumptions, on loan-backed securities shall be reviewed periodically, at least quarterly. The prepayment rates of the underlying loans shall be used to determine prepayment assumptions. Prepayment assumptions shall be applied consistently across portfolios to all securities backed by similar collateral (similar with respect to coupon, issuer, and age of collateral). Reporting entities shall use consistent assumptions across portfolios for similar collateral within controlled-affiliated groups. Since each reporting entity may have a unique method for determining the prepayment assumptions, it is impractical to set standard assumptions for the industry. Relevant sources and rationale used to determine each prepayment assumption shall be documented by the reporting entity.~~

~~14.——Loan-backed securities shall be revalued using the currently estimated cash flows, including new prepayment assumptions, using either the prospective or retrospective adjustment methodologies, consistently applied by type of securities. However, if at any time during the holding period, the reporting entity determines it is no longer probable that they will collect all contractual cashflows, the reporting entity shall apply the accounting requirements in paragraphs 17-19.~~

~~15.——The prospective approach recognizes, through the recalculation of the **effective yield** to be applied to future periods, the effects of all cash flows whose amounts differ from those estimated earlier and the effects and changes in projected cash flows. Under the prospective method, the recalculated effective yield will equate the carrying amount of the investment to the present value of the anticipated future cash flows. The recalculated yield is then used to accrue income on the investment balance for subsequent accounting periods. There are no accounting changes in the current period unless the security is determined to be other than temporarily impaired.~~

~~16.——The retrospective methodology changes both the yield and the asset balance so that expected future cash flows produce a return on the investment equal to the return now expected over the life of the investment as measured from the date of acquisition. Under the retrospective method, the recalculated **effective yield** will equate the present value of the actual and anticipated cash flows with the original cost of the investment. The current balance is then increased or decreased to the amount that would have resulted had the revised yield been applied since inception, and investment income is correspondingly decreased or increased.~~

2. This interpretation~~The following~~ identifies three situations where, using a constant yield methodology for determining amortization or accretion, changes in amortized value move in the opposite direction of what is expected. That is, if a security is purchased at a premium, the constant yield methodology will, in certain cases, cause the amortized value to move to a discount during the life of the security. Conversely, if the security were purchased at a discount, the constant yield methodology will, in certain cases, cause the amortized value to move to a premium during the life of the security.

INT 19-02: Freddie Mac Single Security Initiative

- Update interpreted SSAP list to reference to *SSAP No. 43R—Asset-Backed Securities*
 1. This interpretation has been issued to provide a limited-scope exception to the exchange and conversion guidance in *SSAP No. 26R—Bonds* as well as prescribe guidance in *SSAP No. 43R—Asset-Backed ~~Loan-Backed and Structured~~ Securities* (SSAP No. 43R) for instruments converted in accordance with the Freddie Mac Single Security Initiative. Under this initiative, reporting entities will be permitted to exchange “45-day securities” for “55-day securities” without any material change to the securities, or to the loans that back the securities. (With the exchange, there would be a 10-day delay in payment cycle.)

INT 22-01: Freddie Mac When Issued K-Deal (WI Trust) Certificates

- Update interpreted SSAP list to reference to *SSAP No. 43R—Asset-Backed Securities*
 1. This interpretation is to address questions on the accounting and reporting for Freddie Mac “When-Issued K-Deal (WI Trust) Certificates” (WI Program). Ultimately, the question is whether the structure should be initially captured in scope of *SSAP No. 43R—~~Loan-Backed and Structured~~Asset-Backed Securities* or as a forward contract in scope of *SSAP No. 86—Derivatives*.

Summary of SAP Guidance Revisions:

SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments

Cash Equivalents

6. Cash equivalents are short-term, highly liquid investments that are both (a) readily convertible to known amounts of cash, and (b) so near their maturity that they present insignificant risk of changes in value because of changes in interest rates. Only investments with original maturities¹ of three months or less can qualify under this definition, with the exception of money market mutual funds, as detailed in paragraph 8, and cash pooling, as detailed in paragraph 9. Regardless of maturity date, the following investments are not permitted to be reported as cash equivalents and shall be reported on the investment schedule that corresponds to the SSAP for which the investment is applicable:

a. Asset-backed securities captured in scope of SSAP No. 43R.

b. All debt securities that do not qualify as bonds which are in scope of SSAP No. 21R.

~~a.c. , d~~ Derivative instruments in scope of SSAP No. 86 or SSAP No. 108 shall not be reported as cash equivalents and shall be reported as derivatives on Schedule DB.

d. Working capital finance investments in scope of SSAP No. 105R.

~~b.e.~~ Securities with terms that are reset at predefined dates (e.g., an auction-rate security that has a long-term maturity and an interest rate that is regularly reset through a Dutch auction) or have other features an investor may believe results in a different term than the related contractual maturity shall be accounted for based on the contractual maturity at the date of acquisition, except where other specific rules within the statutory accounting framework currently exist.

Short-Term Investments

14. Short-term investments are investments that do not qualify as cash equivalents with remaining maturities (or repurchase dates under reverse repurchase agreements) of one year or less at the time of acquisition. Short-term investments can include, but are not limited to bonds, commercial paper, reverse repurchase agreements, and collateral and mortgage loans which meet the noted criteria. Short-term investments shall not include investments specifically classified as cash equivalents as defined in this statement, certificates of deposit, or derivatives. Regardless of maturity date, the following investments are not permitted to be reported as cash equivalents and shall be reported on the investment schedule that corresponds to the SSAP for which the investment is applicable:

a. Asset-backed securities captured in scope of SSAP No. 43R.

b. All debt securities that do not qualify as bonds which are in scope of SSAP No. 21R.

c. ~~d~~ Derivative instruments in scope of SSAP No. 86 or SSAP No. 108 shall not be reported as short term investments and shall be reported as derivatives on Schedule DB.

d. Working capital finance investments in scope of SSAP No. 105R.

¹ Original maturity means original maturity to the entity holding the investment. For example, both a three-month U.S. Treasury bill and a three-year Treasury note purchased three months from maturity qualify as cash equivalents. However, a Treasury note purchased three years ago does not become a cash equivalent when its remaining maturity is three months.

**Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A**

Issue: Conceptual Framework – Updates

Check (applicable entity):

	P/C	Life	Health
Modification of Existing SSAP	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
New Issue or SSAP	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Interpretation	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Description of Issue: In December 2021, the Financial Accounting Standards Board (FASB) issued two new chapters of its conceptual framework. The conceptual framework is a body of interrelated objectives and fundamentals that provides the FASB with a foundation for setting standards and concepts to consider when it resolves questions or develops/modifies accounting and reporting guidance.

It is important to note that the Statements of Financial Accounting Concepts are not authoritative and do not establish new or change existing U.S. GAAP. Per the FASB chair, these concepts are “a tool for the Board to use in setting standards that improve the understandability of information entities provide to existing and potential investors, lenders, donors, and other resource providers.”

This agenda item reviews and summarizes each of the two newly issued concept chapters and reviews their potential impact on statutory accounting. Again, while the conceptual framework statements are not authoritative, they are the guiding principles for standard setting and these new updates have superseded chapters currently referenced in the *Accounting Practices and Procedures Manual (AP&P Manual)*. In addition, and most notably, in the case of one of these chapters, FASB changed certain key fundamental definitions, specifically the definition of an asset and a liability, which have historically been mirrored by statutory accounting.

Update 1:

FASB Concepts Statement No. 8, *Conceptual Framework for Financial Reporting—Chapter 4, Elements of Financial Statements* introduced updated definitions of certain key elements used in financial reporting – the definition of an asset and liability. The chapter states that assets and liabilities have conceptual and definitional primacy because assets and liabilities (and changes in those elements) are foundational to all the other items reported in the financial statements. To correctly identify and represent an asset or liability is the beginning basis for all financial reporting and due to their importance, updates to both financial statement elements have been adopted. A summary of each, comparing the historical and current definitions, is provided below:

Changes regarding the definition of an ASSET:

- **Historical definition:** a probable future economic benefit obtained or controlled by a particular entity as a result of past transactions or events.
- **Historical Characteristics: Three essential characteristics:**
 1. it embodies a probable future benefit that involves a capacity, singly or in combination with other assets, to contribute directly or indirectly to future net cash inflows,
 2. a particular enterprise can obtain the benefit and control others' access to it, and
 3. the transaction or other event giving rise to the enterprise's right to or control of the benefit has already occurred.
- **New Definition:** a present right of an entity to an economic benefit.

➤ **Current Characteristics: Two essential characteristics:**

1. it is a present right, and
2. the right is to an economic benefit.

The combination of these two characteristics allows an entity to obtain the economic benefit and control others' access to the benefit. A present right of an entity to an economic benefit entitles the entity to the economic benefit and the ability to restrict others' access to the benefit to which the entity is entitled. For clarity, an "economic benefit" represents services or other items of economic value and generally result in net cash inflows to the entity.

Commentary regarding definitional changes:

The current definition of an asset no longer includes the term *probable* or the phrases *future economic benefit* and *past transactions or events*. The FASB concluded that the term *probable* has historically been misunderstood as implying that a future benefit must be probable to a certain threshold before the definition of an asset was met. Thus, if the probability of a future benefit was low, an asset could not be recognized. FASB also struck the phrase *future economic benefit* as this phrase often was interpreted that the asset must represent a certain future economic benefit (such as eventual cash inflows), however with this update, FASB clarified that the asset represents the rights to the benefit, not the actual benefit itself – nor the probability of realization.

Finally, FASB struck the phrase as the result of *past transactions or events*. It was concluded that if the asset represents a *present right*, by default, the right must have occurred as the result of a past transaction or event and thus this phraseology was deemed redundant and unnecessary.

Changes regarding **the definition of a LIABILITY:**

- **Historical definition:** are [certain or] probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events.
- **Historical Characteristics: Three essential characteristics:**
 1. it embodies a present duty or responsibility to one or more other entities that entails settlement by probable future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand,
 2. the duty or responsibility obligates a particular enterprise, leaving it little or no discretion to avoid the future sacrifice, and
 3. the transaction or other event obligating the enterprise has already happened.
- **New Definition:** a present obligation of an entity to transfer an economic benefit.
- **Current Characteristics: Two essential characteristics:**
 1. it is a present obligation, and
 2. the obligation requires an entity to transfer or otherwise provide economic benefit to others. (For the purposes of this characteristic, *transfer* is typically used to describe obligations to pay cash or convey assets, while the term *provide* is used to describe obligations to provide services or stand by to do so).

Commentary regarding definitional changes:

The current definition of a liability no longer includes the term *probable* or the phrase *in the future as a result of past transactions or events*. The FASB concluded that the term *probable* has historically been understood as implying that a future obligation must meet a probability to a certain threshold before the definition of a liability was met. Thus, if the probability of a future transfer of an asset (or the requirement to provide a service) was low, a liability would likely not be recognized. In removing the term *probable* (and replacing it with "present

obligation”), FASB concluded that in almost all situations, the presence of an obligation will be apparent. It stated that most present obligations are legally enforceable, including obligations arising from binding contracts, agreements, statutes, or other legal or contractual means. Chapter 4 also discusses the prevalence of certain business risks and how to assess if they result in the recognition of a liability. It concluded that while certain businesses pose risk of future events occurring that will cause them to transfer an economic benefit (an asset), the risk itself does not represent a present obligation because exposure to a potential negative consequence does not constitute a present obligation.

However, FASB also stated situations lacking clear legal or contractual evidence of a present obligation may pose particular challenges that may make it difficult to discern whether a present obligation exists. In these settings, the FASB stated that constructive obligations or other noncontractual obligations are created by circumstance rather than by explicit agreement. In the absence of an explicit agreement, sufficient information to distinguish a present obligation is likely only available at the specific standards level. Thus, the FASB concluded that the specific facts and circumstances at the standards level (or in the case of statutory accounting, at the SAP level) must be utilized to determine whether the entity has created a constructive obligation and must recognize a liability.

FASB also struck the phrase as the result of *past transactions or events*. It was concluded that if the liability represents a *present right*, by default, the right must have occurred as the result of a past transaction or event and thus this phraseology was deemed redundant and unnecessary.

Update 2:

FASB Concepts Statement No. 8, *Conceptual Framework for Financial Reporting—Chapter 7, Presentation* identifies factors that the FASB will consider when deciding **how** items should be displayed on the financial statements. Chapter 7 describes the information to be included in the financial statements and how appropriate presentation can contribute to the objective of financial reporting – to communicate financial information about an entity that is useful to existing and potential investors, lenders, and other creditors in making decisions about providing resources (goods and services) to the entity. These decisions typically involve buying or selling of goods/services or holding equity and debt instruments as well as providing or settling loans or other forms of credit. This chapter articulates that the financial statements meet a “general purpose” and should not be considered to meet all purposes for possible users – and thus a common set of conceptual standards is appropriate.

Chapter 7 also describes the importance of financial statement notes, or supplementary information so that financial statement users are provided with a more complete picture of an entity’s accounting policy or any particular unique circumstance or event. In terms of general reporting, the conceptual statement relays that a distinction between nonhomogeneous items should be depicted in the financial statements with different reporting line items and subtotals and that the information should be provided based on recognition and measurement standards. In essence, reporting should be sufficiently aggregated, but not aggregated to a level in which the information is too consolidated for general use and understanding. Once reported, then any significant accounting policy or circumstance would further be defined with accompanying notes.

The chapter broadly states that to meet the objectives of financial reporting, line items should be distinct based on the information being provided – as the information should distinguish between various types of transactions/events and should assist users in their estimates in the amounts and timing of future cash flows or the entity’s ability to provide other economic value. The financial statements should depict the results of different types of transactions, including changes in events or other circumstances that may vary the frequency or predictability of performance based on many items, including changes in economic conditions.

In summary, while Chapter 7 does supersede sections of *Statement of Financial Accounting Concept 5*, it did not result in fundamental changes to the principal concepts of financial reporting. The chapter articulates the need for complete financial reporting, describes the interconnectedness of a ‘complete set of financial statements’ and relays the importance of these documents as the information in the financial statements is the primary (and typically the sole) source for analyzing current and potential future performance of an organization and its ability to meet its long-term financial objectives. At a high level, the chapter discusses what information should broadly be categorized

as revenues, expenses, gains, and losses and to the extent equity is impacted by operations as well as changes in owners' equity through investments or distributions.

In terms of the impact to statutory accounting, the updated concepts in this chapter are not expected to modify current guidance, other than to update references to superseded accounting concepts.

Existing Authoritative Literature:

NAIC Staff Note – the Preamble contains reference to certain concept statements in footnotes 2 and 4 and have been bolded below for ease of identification. It is important to note that while these footnotes currently reference superseded conceptual statements, the conceptual statements noted do not represent adopted guidance - they are noted as reference for overarching guiding principles regarding financial reporting.

Preamble

IV. Statutory Accounting Principles Statement of Concepts

25. This document states the fundamental concepts on which statutory financial accounting and reporting standards are based. These concepts provide a framework to guide the National Association of Insurance Commissioners (NAIC) in the continued development and maintenance of statutory accounting principles ("SAP" or "statutory basis") and, as such, these concepts and principles constitute an accounting basis for the preparation and issuance of statutory financial statements by insurance companies in the absence of state statutes and/or regulations.

26. The NAIC and state insurance departments are primarily concerned with statutory accounting principles that differ from GAAP reflective of the varying objectives of regulation. Recodification of areas where SAP and GAAP are parallel is an inefficient use of limited resources.

27. SAP utilizes the framework established by GAAP. **FN2** This document integrates that framework with objectives exclusive to statutory accounting. The NAIC's guidance on SAP is comprehensive for those principles that differ from GAAP based on the concepts of statutory accounting outlined herein. Those GAAP pronouncements that are not applicable to insurance companies will not be adopted by the NAIC. For those principles that do not differ from GAAP, the NAIC must specifically adopt those GAAP Pronouncements to be included in statutory accounting. GAAP Pronouncements do not become part of SAP until and unless adopted by the NAIC.

28. The body of statutory accounting principles is prescribed in the statutory hierarchy of accounting guidance. This hierarchy provides the framework for judging the presentation of statutory financial statements in conformance with statutory accounting principles.

29. Statutory requirements vary from state to state. While it is desirable to minimize these variations, to the extent that they exist it is the objective of NAIC statutory accounting principles to provide the standard against which the exceptions will be measured and disclosed if material.

FN 2 - The GAAP framework applicable to insurance accounting is set forth in *Statements of Financial Accounting Concepts One, Two, Five, and Six*. These documents, promulgated by the Financial Accounting Standards Board, set forth the objectives and concepts which are used in developing accounting and reporting standards.

V. Statutory Hierarchy

42. The following Hierarchy is not intended to preempt state legislative and regulatory authority.

Level 1

SSAPs, including U.S. GAAP reference material to the extent adopted by the NAIC from the FASB Accounting Standards Codification (FASB Codification or GAAP guidance)

Level 2

Consensus positions of the Emerging Accounting Issues (E) Working Group as adopted by the NAIC (INTs adopted before 2016)

Interpretations of existing SSAPs as adopted by the Statutory Accounting Principles (E) Working Group (INTs adopted in 2016 or beyond)

Level 3

NAIC Annual Statement Instructions

Purposes and Procedures Manual of the NAIC Investment Analysis Office

Level 4

*Statutory Accounting Principles Preamble and Statement of Concepts **FN4***

Level 5

Sources of nonauthoritative GAAP accounting guidance and literature, including: (a) practices that are widely recognized and prevalent either generally or in the industry, (b) FASB Concept Statements, (c) AICPA guidance not included in FASB Codification, (d) International Financial Reporting Standards, (e) Pronouncements of professional associations or regulatory agencies, (f) Technical Information Service Inquiries and Replies included in the AICPA Technical Practice Aids, and (g) Accounting textbooks, handbooks and articles

43. If the accounting treatment of a transaction or event is not specified by the SSAPs, preparers, regulators and auditors of statutory financial statements should consider whether the accounting treatment is specified by another source of established statutory accounting principles. If an established statutory accounting principle from one or more sources in Level 2 or 3 is relevant to the circumstances, the preparer, regulator or auditor should apply such principle. If there is a conflict between statutory accounting principles from one or more sources in Level 2 or 3, the preparer, regulator or auditor should follow the treatment specified by the source in the higher level—that is, follow Level 2 treatment over Level 3. Revisions to guidance in accordance with additions or revisions to the NAIC statutory hierarchy should be accounted for as a change in accounting principle in accordance with SSAP No. 3—*Accounting Changes and Corrections of Errors*.

44. Because of developments such as new legislation or the evolution of a new type of business transaction, there sometimes are no established statutory accounting principles for reporting a specific transaction or event. In those instances, it might be possible to report the event or transaction on the basis of its substance by selecting a statutory accounting principle that appears appropriate when applied in a manner similar to the application of an established statutory principle to an analogous transaction or event. In the absence of a SSAP or another source of established statutory accounting principles, the preparer, regulator or auditor of statutory financial statements may consider other accounting literature, depending on its relevance in the circumstances. Other accounting literature includes the Statutory Accounting Principles Statement of Concepts and GAAP reference material and accounting literature identified in Level 5. The appropriateness of other accounting literature depends on its relevance to the particular circumstances, the specificity of the guidance, and the general recognition of the issuer or author as an authority. For example, the Statutory Accounting Principles Statement of Concepts would be more authoritative than any other sources of accounting literature. Similarly, FASB Concepts Statements would normally be more influential than other sources of nonauthoritative GAAP pronouncements.

FN 4 - The Statutory Accounting Principles Statement of Concepts incorporates by reference FASB Concepts Statements One, Two, Five and Six to the extent they do not conflict with the concepts outlined in the statement. However, for purposes of applying this hierarchy the FASB Concepts Statements shall be included in Level 5 and only those concepts unique to statutory accounting as stated in the statement are included in Level 4.

SSAP No. 4—Assets and Nonadmitted Assets

NAIC Staff Note – this SAP contains the definition of the financial statement element of an **Asset**. Relevant items have been bolded below for ease of identification.

2. For purposes of statutory accounting, **an asset shall be defined as: probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events. An asset has three essential characteristics: (a) it embodies a probable future benefit that involves a capacity, singly or in combination with other assets, to contribute directly or indirectly to future net cash inflows, (b) a particular entity can obtain the benefit and control others' access to it, and (c) the transaction or other event giving rise to the entity's right to or control of the benefit has already occurred.** These assets shall then be evaluated to determine whether they are admitted. The criteria used is outlined in paragraph 3.

3. As stated in the Statement of Concepts, "The ability to meet policyholder obligations is predicated on the existence of readily marketable assets available when both current and future obligations are due. Assets having economic value other than those which can be used to fulfill policyholder obligations, or those assets which are unavailable due to encumbrances or other third-party interests should not be recognized on the balance sheet," and are, therefore, considered nonadmitted. For purposes of statutory accounting principles, a nonadmitted asset shall be defined as an asset meeting the criteria in paragraph 2, which is accorded limited or no value in statutory reporting, and is one which is:

- a. Specifically identified within the *Accounting Practices and Procedures Manual* as a nonadmitted asset; or
- b. Not specifically identified as an admitted asset within the *Accounting Practices and Procedures Manual*.

If an asset meets one of these criteria, the asset shall be reported as a nonadmitted asset and charged against surplus unless otherwise specifically addressed within the *Accounting Practices and Procedures Manual*. The asset shall be depreciated or amortized against net income as the estimated economic benefit expires. In accordance with the reporting entity's written capitalization policy, amounts less than a predefined threshold of furniture, fixtures, equipment, or supplies, shall be expensed when purchased.

4. Transactions which do not give rise to assets as defined in paragraph 2 shall be charged to operations in the period the transactions occur. Those transactions which result in amounts which may meet the definition of assets, but are specifically identified within the *Accounting Practices and Procedures Manual* as not giving rise to assets (e.g., policy acquisition costs), shall also be charged to operations in the period the transactions occur.

5. The reporting entity shall maintain a capitalization policy containing the predefined thresholds for each asset class to be made available for the department(s) of insurance.

FN1 - FASB Statement of Financial Accounting Concepts No. 6, Elements of Financial Statements, states: Probable is used with its usual general meaning, rather than in a specific accounting or technical sense (such as that in FASB Statement No. 5, Accounting for Contingencies, paragraph 3), and refers to that which can reasonably be expected or believed on the basis of available evidence or logic but is neither certain nor proved.

FN2 - If assets of an insurance entity are pledged or otherwise restricted by the action of a related party, the assets are not under the exclusive control of the insurance entity and are not available to satisfy policyholder obligations due to these encumbrances or other third-party interests. Thus, pursuant to paragraph 2(c), such assets shall not be recognized as an admitted asset on the balance sheet. Additional guidance for assets pledged as collateral is included in INT 01-31.

SSAP No. 5—Liabilities, Contingencies and Impairments of Assets

NAIC Staff Note – this SAP contains the definition of the financial statement element of a **Liability**. Relevant items have been bolded below for ease of identification.

2. **A liability is defined as certain or probable FN1 future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or to provide services to other entities in the future as a result of a past transaction(s) or event(s).**

3. **A liability has three essential characteristics: (a) it embodies a present duty or responsibility to one or more other entities that entails settlement by probable FN1 future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand, (b) the duty or responsibility obligates a particular entity, leaving it little or no discretion to avoid the future sacrifice, and (c) the transaction or other event obligating the entity has already happened.** This includes, but is not limited to, liabilities arising from policyholder obligations (e.g., policyholder benefits, reported claims and reserves for incurred but not reported claims). Liabilities shall be recorded on a reporting entity's financial statements when incurred.

4. Estimates (e.g., loss reserves) are required in financial statements for many ongoing and recurring activities of a reporting entity. The mere fact that an estimate is involved does not of itself constitute a loss contingency. For example, estimates of losses utilizing appropriate actuarial methodologies meet the definition of liabilities as outlined above and are not loss contingencies.

FN1 - FASB Statement of Financial Accounting Concepts No. 6, Elements of Financial Statements, states: Probable is used with its usual general meaning, rather than in a specific accounting or technical sense (such as that in FASB Statement 5, Accounting for Contingencies, paragraph 3), and refers to that which can reasonably be expected or believed on the basis of available evidence or logic but is neither certain nor proved.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): None.

Information or issues (included in *Description of Issue*) not previously contemplated by the Working Group: None

Convergence with International Financial Reporting Standards (IFRS): While slightly different, the updated FASB asset & liability definitions closely align with IFRS definitions. While IFRS retains the phrase “as a result of past events,” it also explicitly retains the term “control,” which is now implicit with the FASB updates. The elimination of the explicit term “control” was a deliberate action of the FASB as they noted that the notion of control has been historically misunderstood (control is to the right that gives rise to the economic benefit rather than to the economic benefits themselves). For reference *IFRS Chapter 4 – The Elements of Financial Statements*, defines an **asset** as a present economic resource controlled by the entity as a result of past events; with the economic resource representing a right that has the potential to produce economic benefits. Additionally, the chapter defines a **liability** as a present obligation of an entity to transfer an economic resource as a result of past events.

Staff Recommendation: NAIC staff recommends that the Working Group move this item to the active listing, categorized as a SAP clarification, and expose revisions to the Preamble, *SSAP No. 4—Assets and Nonadmitted Assets* and *SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets*, as illustrated below and in the issue papers, to incorporate updates from *Chapter 4, Elements of Financial Statements* and *Chapter 7, Presentation* of the FASB’s Conceptual Framework for Financial Reporting.

Proposed edits to the Preamble: proposed modifications reflect updates for superseded FASB Financial Accounting Concepts.

IV. Statutory Accounting Principles Statement of Concepts

25. This document states the fundamental concepts on which statutory financial accounting and reporting standards are based. These concepts provide a framework to guide the National Association of Insurance Commissioners (NAIC) in the continued development and maintenance of statutory accounting principles (“SAP” or “statutory basis”) and, as such, these concepts and principles constitute an accounting basis for the preparation and issuance of statutory financial statements by insurance companies in the absence of state statutes and/or regulations.

26. The NAIC and state insurance departments are primarily concerned with statutory accounting principles that differ from GAAP reflective of the varying objectives of regulation. Recodification of areas where SAP and GAAP are parallel is an inefficient use of limited resources.

27. SAP utilizes the framework established by GAAP. **FN2** This document integrates that framework with objectives exclusive to statutory accounting. The NAIC’s guidance on SAP is comprehensive for those principles that differ from GAAP based on the concepts of statutory accounting outlined herein. Those GAAP pronouncements that are not applicable to insurance companies will not be adopted by the NAIC. For those principles that do not differ from GAAP, the NAIC must specifically adopt those GAAP Pronouncements to be included in statutory accounting. GAAP Pronouncements do not become part of SAP until and unless adopted by the NAIC.

28. The body of statutory accounting principles is prescribed in the statutory hierarchy of accounting guidance. This hierarchy provides the framework for judging the presentation of statutory financial statements in conformance with statutory accounting principles.

29. Statutory requirements vary from state to state. While it is desirable to minimize these variations, to the extent that they exist it is the objective of NAIC statutory accounting principles to provide the standard against which the exceptions will be measured and disclosed if material.

FN 2 - The GAAP framework applicable to insurance accounting is set forth in *Statements of Financial Accounting Concepts* ~~One, Two, Five, and Six~~Eight. These documents, promulgated by the Financial Accounting Standards Board, set forth the objectives and concepts which are used in developing accounting and reporting standards.

V. Statutory Hierarchy

42. The following Hierarchy is not intended to preempt state legislative and regulatory authority.

Level 1

SSAPs, including U.S. GAAP reference material to the extent adopted by the NAIC from the FASB Accounting Standards Codification (FASB Codification or GAAP guidance)

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Statutory Accounting Principles Preamble and Statement of Concepts FN4

Level 5

Sources of nonauthoritative GAAP accounting guidance and literature, including: (a) practices that are widely recognized and prevalent either generally or in the industry, (b) FASB Concept Statements, (c) AICPA guidance not included in FASB Codification, (d) International Financial Reporting Standards, (e) Pronouncements of professional associations or regulatory agencies, (f) Technical Information Service Inquiries and Replies included in the AICPA Technical Practice Aids, and (g) Accounting textbooks, handbooks and articles

FN 4 - The Statutory Accounting Principles Statement of Concepts incorporates by reference FASB Concepts Statements ~~One, Two,~~ Five and ~~Six~~Eight to the extent they do not conflict with the concepts outlined in the statement. However, for purposes of applying this hierarchy the FASB Concepts Statements shall be included in Level 5 and only those concepts unique to statutory accounting as stated in the statement are included in Level 4.

Proposed edits SSAP No. 4—Assets and Nonadmitted Assets: proposed modifications reflect an updated definition of the term **Asset** – to match the newly issued definition in FASB Statement of Financial Accounting Concepts No. 8

2. For purposes of statutory accounting, an asset shall be defined as: a present right of an entity to an economic benefit. ~~probable FN1 future economic benefits obtained or controlled by a particular entity as a result of past transactions or events.~~ An asset has ~~two~~three essential characteristics: (a) it is a present right~~embodies a probable future benefit that involves a capacity, singly or in combination with other assets, to contribute directly or indirectly to future net cash inflows,~~ and (b) the right is to an economic benefit. ~~a particular entity can obtain the benefit and control others' access to it FN1 FN2, and (c) the transaction or other event giving rise to the entity's right to or control of the benefit has already occurred.~~ These assets shall then be evaluated to determine whether they are admitted. The criteria used is outlined in paragraph 3.

3. As stated in the Statement of Concepts, "The ability to meet policyholder obligations is predicated on the existence of readily marketable assets available when both current and future obligations are due. Assets having economic value other than those which can be used to fulfill policyholder obligations, or those assets which are unavailable due to encumbrances or other third-party interests should not be recognized on the balance sheet," and are, therefore, considered nonadmitted. For purposes of statutory accounting principles, a nonadmitted asset shall be defined as an asset meeting the criteria in paragraph 2, which is accorded limited or no value in statutory reporting, and is one which is:

- a. Specifically identified within the *Accounting Practices and Procedures Manual* as a nonadmitted asset; or
- b. Not specifically identified as an admitted asset within the *Accounting Practices and Procedures Manual*.

If an asset meets one of these criteria, the asset shall be reported as a nonadmitted asset and charged against surplus unless otherwise specifically addressed within the *Accounting Practices and Procedures Manual*. The asset shall be depreciated or amortized against net income as the estimated economic benefit expires. In accordance with the reporting entity's written capitalization policy, amounts less than a predefined threshold of furniture, fixtures, equipment, or supplies, shall be expensed when purchased.

4. Transactions which do not give rise to assets as defined in paragraph 2 shall be charged to operations in the period the transactions occur. Those transactions which result in amounts which may meet the definition of assets, but are specifically identified within the *Accounting Practices and Procedures Manual* as not giving rise to assets (e.g., policy acquisition costs), shall also be charged to operations in the period the transactions occur.

5. The reporting entity shall maintain a capitalization policy containing the predefined thresholds for each asset class to be made available for the department(s) of insurance.

FN1 - FASB Statement of Financial Accounting Concepts No. ~~86~~, *Elements of Financial Statements*, states that the combination of these two characteristics allows an entity to obtain the economic benefit and control others' access to the benefit. A present right of an entity to an economic benefit entitles the entity to the economic benefit and the ability to restrict others' access to the benefit to which the entity is entitled. ~~Probable is used with its usual general meaning, rather than in a specific accounting or technical sense (such as that in FASB Statement No. 5, Accounting for Contingencies, paragraph 3), and refers to that which can reasonably be expected or believed on the basis of available evidence or logic but is neither certain nor proved.~~

FN2 - If assets of an insurance entity are pledged or otherwise restricted by the action of a related party, the assets are not under the exclusive control of the insurance entity and are not available to satisfy policyholder obligations due to these encumbrances or other third-party interests. Thus, pursuant to paragraph 2(c), such assets shall not be recognized as an admitted asset on the balance sheet. Additional guidance for assets pledged as collateral is included in INT 01-31.

Relevant Literature

9. This statement incorporates the definition of an asset from ~~adopts~~ FASB Statement of Financial Accounting Concepts No. ~~86~~, *Chapter 4, Elements of Financial Statements*, paragraphs ~~E16-E18~~25-33.

References

Relevant Issue Papers

Issue Paper No. 4—Definition of Assets and Nonadmitted Assets

Issue Paper No. 119—Capitalization Policy, An Amendment to SSAP Nos. 4, 19, 29, 73, 79 and 82

Issue Paper No. 166—Updates to the Definition of an Asset

SSAP No. 5—Liabilities, Contingencies and Impairments of Assets: proposed modifications reflect an updated definition of the term **Liability** – to match the newly issued definition in FASB Statement of Financial Accounting Concepts No. 8

2. A liability is defined as a present obligation of an entity to transfer an economic benefit. ~~certain or probable FN1 future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or to provide services to other entities in the future as a result of a past transaction(s) or event(s).~~

3. A liability has ~~three~~two essential characteristics: (a) it is a present obligation ~~embodies a present duty or responsibility to one or more other entities that entails settlement by probable FN1 future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand, and (b) the obligation requires an entity to transfer or otherwise provide economic benefit to others ~~duty or responsibility obligates a particular entity, leaving it little or no discretion to avoid the future sacrifice, and~~ (c) ~~the transaction or other event obligating the entity has already happened.~~ This includes, but is not limited to, liabilities arising from policyholder obligations (e.g., policyholder benefits, reported claims and~~

reserves for incurred but not reported claims). Liabilities shall be recorded on a reporting entity's financial statements when incurred.

4. Estimates (e.g., loss reserves) are required in financial statements for many ongoing and recurring activities of a reporting entity. The mere fact that an estimate is involved does not of itself constitute a loss contingency. For example, estimates of losses utilizing appropriate actuarial methodologies meet the definition of liabilities as outlined above and are not loss contingencies.

~~FN1—FASB Statement of Financial Accounting Concepts No. 6, Elements of Financial Statements, states: Probable is used with its usual general meaning, rather than in a specific accounting or technical sense (such as that in FASB Statement 5, Accounting for Contingencies, paragraph 3), and refers to that which can reasonably be expected or believed on the basis of available evidence or logic but is neither certain nor proved.~~

Relevant Literature

39. This statement adopts *FASB Statement No. 5, Accounting for Contingencies* (FAS 5), *FASB Statement 114, Accounting by Creditors for Impairment of a Loan* only as it amends in part FAS 5 ~~and paragraphs 35 and 36 of FASB Statement of Financial Accounting Concepts No. 6—Elements of Financial Statements~~. *FASB Interpretation No. 14, Reasonable Estimation of the Amount of a Loss, An Interpretation of FASB Statement No. 5* (FIN No. 14) is adopted with the modification to accrue the loss amount as the midpoint of the range rather than the minimum as discussed in paragraph 3 of FIN No. 14. This statement adopts with modification *ASU 2013-04, Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation is Fixed at the Reporting Date* with the same statutory modification adopted for FIN 14. [This statement incorporates the definition of a liability from FASB Statement of Financial Accounting Concepts No. 8, Chapter 4, Elements of Financial Statements, paragraphs E37 and E38.](#)

References

Relevant Issue Papers

Issue Paper No. 5—Definition of Liabilities, Loss Contingencies and Impairments of Assets

Issue Paper No. 20—Gain Contingencies

Issue Paper No. 135—Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others

[*Issue Paper No. 166—Updates to the Definition of an Asset*](#)

Recommendation:

NAIC staff recommends that the Working Group move this item to the active listing, categorized as a SAP clarification, and expose revisions to the Preamble, SSAP No. 4—Assets and Nonadmitted Assets and SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets, as illustrated in the agenda item and in the draft issue papers, to incorporate updates from Chapter 4, Elements of Financial Statements and Chapter 7, Presentation of the FASB's Conceptual Framework for Financial Reporting.

Staff Review Completed by: Jim Pinegar— NAIC Staff, January – 2022; Robin Marcotte, NAIC Staff, December – 2022

Status:

On April 4, 2022, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a SAP clarification, and exposed revisions to the Preamble, SSAP No. 4—Assets and

Nonadmitted Assets and *SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets* to incorporate 1) updates from FASB Concepts Statement No. 8, *Conceptual Framework for Financial Reporting—Chapter 7, Presentation* which identifies factors to consider when deciding how items should be displayed on the financial statements, and 2) Concepts Statement No. 8, *Conceptual Framework for Financial Reporting—Chapter 4, Elements of Financial Statements*, which updates the definitions of an asset and a liability. The Working Group also exposed two draft issue papers for historical documentation of these SAP clarifications.

On August 10, 2022, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed revisions, as illustrated above, to the Preamble and *SSAP No. 4—Assets and Nonadmitted Assets*. The revisions incorporate updates from FASB Concepts Statement No. 8, *Conceptual Framework for Financial Reporting—Chapter 7, Presentation*, which identifies factors to consider when deciding how items should be displayed on the financial statements, and Concepts Statement No. 8, *Conceptual Framework for Financial Reporting—Chapter 4, Elements of Financial Statements*, which updates the definition of an asset. In addition, the Working Group adopted *Issue Paper No. 166—Updates to the Definition of an Asset*, which documents the revisions to *SSAP No. 4*.

Additionally, on August 10, 2022, the Working Group re-exposed the proposed revisions and draft issue paper related to the definition change of a liability in *SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets*. This exposure intends to provide additional time for industry to review the changes in accordance with statutory accounting statements. These revisions are also shown above under the *SSAP No. 5R* heading.

On December 13, 2022, the Working Group re-exposed the proposed revisions and draft *Issue Paper No. 16X—Updates to the Definition of a Liability* related to the definition change of a liability in *SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets*. This exposure intends to provide additional time for industry to review the changes in accordance with statutory accounting statements. NAIC staff were directed to collaborate with interested parties on proposed clarifying language.

On March 22, 2023, the Working Group exposed additional revisions to *Issue Paper No. 16X—Updates to the Definition of a Liability* related to the definition change of a liability in *SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets*. The revisions to: 1) add an additional footnote to the definition of a liability in *SSAP No. 5R* which defers to more topic specific contradictory guidance 2) revise the relevant literature section of *SSAP No. 5R* to note the modification and 3) note the additional exposure action in the Issue Paper paragraph 18.

These clarifications were because of the authoritative treatment that statutory accounting provides to the definition of an asset and a liability in *SSAP No. 4* and *SSAP No. 5R*. For GAAP, the FASB Conceptual statements definitions are not authoritative, but rather are concepts to consider when developing and applying guidance. The FASB basis for conclusions noted that some existing authoritative FASB literature regarding liabilities is inconsistent with the updates to Concepts Statement No. 8. Therefore, a modification regarding topic specific liabilities guidance was incorporated to address variations from the definition of a liability. Examples of existing SAP variations from the definition of a liability include but are not limited to:

- a. *SSAP No. 7—Asset Valuation Reserves and Interest Maintenance Reserves – AVR and IMR* establish liabilities for regulatory objectives.
- b. *SSAP No. 62R—Property and Casualty Reinsurance* – contains the provision for reinsurance liability guidance which results in a liability that is a regulatory valuation allowance for overdue and slow paying reinsurance and also enforces Credit for Reinsurance (Model No. 785) collateral requirements.
- c. *SSAP No. 92—Post Retirement Benefits Other than Pensions*, provides liability recognition, which adopts several GAA P standards with modifications.

The additional exposed revisions to *SSAP No. 168* and *SSAP No. 5R* are reflected in the Issue Paper and also shown below.

- **Exposed revisions – Topic Specific Footnote** - This language is proposed for incorporation as a footnote to the liability definition in SSAP No. 5R and its related and *Issue Paper No. 16X—Updates to the Definition of a Liability*.

New Footnote to paragraph 3 of SSAP No. 5R:

The guidance in this Statement regarding the definition of a liability is applicable unless another authoritative statement of statutory accounting principles (SSAP) provides more topic specific contradictory guidance. In such cases the topic specific guidance shall apply.

- Exposed revisions to *SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets* and *Issue Paper No. 16X—Updates to the Definition of a Liability* (New language shaded):

Relevant Literature

39. This statement adopts *FASB Statement No. 5, Accounting for Contingencies* (FAS 5), *FASB Statement 114, Accounting by Creditors for Impairment of a Loan* only as it amends in part FAS 5 ~~and paragraphs 35 and 36 of FASB Statement of Financial Accounting Concepts No. 6—Elements of Financial Statements~~. *FASB Interpretation No. 14, Reasonable Estimation of the Amount of a Loss, An Interpretation of FASB Statement No. 5* (FIN No. 14) is adopted with the modification to accrue the loss amount as the midpoint of the range rather than the minimum as discussed in paragraph 3 of FIN No. 14. This statement adopts with modification *ASU 2013-04, Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation is Fixed at the Reporting Date* with the same statutory modification adopted for FIN 14. This statement incorporates the definition of a liability from *FASB Statement of Financial Accounting Concepts No. 8, Chapter 4, Elements of Financial Statements, paragraphs E37 and E38* with modification reflected in this Statement regarding topic specific guidance.

On August 13, 2023, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed revisions, as illustrated in *Issue Paper No. 168—Updates to the Definition of a Liability*, to the Preamble and SSAP No. 5R which revises the definition of a liability under statutory accounting.

<https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/NationalMeetings/A.NationalMeetingMaterials/2023/8-13-23SummerNationalMeeting/Adoptions/21-22-01ConceptualFramework.docx>

Statutory Issue Paper No. 168

Updates to the Definition of a Liability

STATUS

Finalized August 13, 2023

Original and Current Authoritative Guidance: SSAP No. 5R

Type of Issue:

Common Area

SUMMARY OF ISSUE

1. This issue paper documents the SAP clarification revisions to *SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets*. The intent of the revisions is to align current statutory accounting guidance, specifically the definition of a “liability,” with the term utilized by the Financial Accounting Standards Board (FASB).

SUMMARY CONCLUSION

2. The statutory accounting principle clarifications to SSAP No. 5R (illustrated in Exhibit A), reflect that for the purposes of statutory accounting, a liability shall be defined as: a present obligation of an entity to transfer an economic benefit. A liability has two essential characteristics: (1) it is a present obligation, and (2) the obligation requires an entity to transfer or otherwise provide economic benefit to others. For the purposes of these characteristics, *transfer* is typically used to describe obligations to pay cash or convey assets, while the term *provide* is used to describe obligations to provide services or stand by to do so. This includes, but is not limited to, liabilities arising from policyholder obligations (e.g., policyholder benefits, reported claims and reserves for incurred but not reported claims). Liabilities shall be recorded on a reporting entity’s financial statements when incurred.

3. Estimates (e.g., loss reserves) are required in financial statements for many ongoing and recurring activities of a reporting entity. The mere fact that an estimate is involved does not of itself constitute a loss contingency. For example, estimates of losses utilizing appropriate actuarial methodologies meet the definition of liabilities as outlined above and are not loss contingencies. (The definition and recognition requirements of loss contingencies under SSAP No. 5R are not proposed to be revised and will continue as statutory accounting guidance.)

DISCUSSION

4. In December 2021, FASB issued *Concepts Statement No. 8, Conceptual Framework for Financial Reporting—Chapter 4, Elements of Financial Statements*, which introduced updated definitions of certain key elements used in financial reporting – most notably updating the fundamental definition of a liability. Through the FASB’s adoption of Concept Statement No. 8, the original Concept Statement No. 6 has been superseded. As statutory accounting currently reflects FASB’s historical definition, this issue paper is to review the prior concept definition (currently utilized by statutory accounting) and compare it to FASB’s updated concept definition and assess whether the revised concept definition shall be reflected in statutory accounting.

5. FASB concept statements do not reflect authoritative U.S. GAAP guidance. Rather concept statements are intended to set forth objectives and fundamental concepts that will be the basis for development of financial accounting and reporting guidance. The term “liability” is not captured or defined in the FASB Accounting Standards Codification (which is the source of authoritative U.S. GAAP.) Furthermore, although the concept statement is intended to be used as a guide in establishing authoritative

U.S. GAAP, the FASB is not restricted to the concepts when developing guidance, and the FASB may issue U.S. GAAP which may be inconsistent with the objectives and fundamental concepts set forth in Concept Statements. A change in a FASB Concept Statement does not 1) require a change in existing U.S. GAAP, 2) amend, modify or interpret the Accounting Standards Codification, or 3) justify either changing existing generally accepted accounting and reporting practices or interpreting the Accounting Standards Codification based on personal interpretations of the objectives and concepts in the concepts statement.

6. Under the prior FASB concept statement, which was reflected in SSAP No. 5R, a liability was defined as a probable future sacrifice of economic benefits arising from present obligations of a particular entity to transfer assets or to provide services to other entities in the future as a result of past transactions or events. In addition, the historical definition possessed three essential characteristics in that (1) it embodies a present duty or responsibility to one or more other entities that entails settlement by probable future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand, (2) the duty or responsibility obligates a particular entity, leaving it little or no discretion to avoid the future sacrifice, and (3) the transaction or other event obligating the entity has already happened.

7. Pursuant to the prior concept statement, and as incorporated in SSAP No. 5R, *probable*, as referenced both in the definition and essential characters, was used in a usual general meaning, rather than in a specific accounting or technical sense and referred to which can reasonably be expected or believed on the basis of available evidence or logic but is neither certain nor proved.

8. With the new FASB conceptual framework chapter, a liability is now defined as a present obligation of an entity to transfer an economic benefit. In addition, the current definition has two essential characteristics in that the liability is (1) a present obligation, and (2) the obligation requires an entity to transfer or otherwise provide economic benefits to others.

9. The updated liability definition from Concept Statement No. 8 no longer includes the term *probable* or the phrase *in the future* and *as a result of past transactions or events*. The FASB concluded that the term *probable* has historically been misunderstood as implying that a future obligation must meet a probability to a certain threshold before the definition of a liability was met. Thus, if the probability of a future transfer of an asset (or the requirement to provide a service) was low, a liability would likely not be recognized. In removing the term *probable* (and replacing it with “present obligation”), FASB concluded that in almost all situations, the presence of an obligation will be apparent. It stated that most present obligations are legally enforceable, including obligations arising from binding contracts, agreements, statutes, or other legal or contractual means. Chapter 4 also discusses the prevalence of certain business risks and how to assess if they result in the recognition of a liability. The FASB concluded that while certain businesses have a risk that a future event will cause them to transfer an economic benefit (an asset), the risk itself does not represent a present obligation because exposure to a potential negative consequence does not constitute a present obligation.

10. However, the FASB also stated that situations lacking clear legal or contractual evidence of a present obligation may pose particular challenges that may make it difficult to discern whether a present obligation exists. In these settings, the FASB stated that constructive obligations or other noncontractual obligations are created by circumstance rather than by explicit agreement. In the absence of an explicit agreement, sufficient information to distinguish a present obligation is likely only available at the specific standards level. Thus, the FASB concluded that the specific facts and circumstances at the standards level (or in the case of statutory accounting, at the SSAP level) must be utilized to determine whether the entity has created a constructive obligation and must recognize a liability.

11. The FASB also struck the phrase *as the result of past transactions or events*. With this action, the FASB clarified that if the liability represents a *present obligation*, by default, the obligation must have occurred as the result of a past transaction or event and thus this phraseology was deemed redundant and unnecessary.

12. When reviewing the substance of the revisions, the FASB concluded that the updated definition resulted in a clearer and more precise definition. Furthermore, while it did not fundamentally change the historical concept of a liability, the revised definition potentially expands the population of liabilities to include certain obligations to issue or potentially issue an entity's own shares rather than settle an obligation exclusively with assets. In essence, clarifying that instruments with characteristics of both liabilities and equity may in fact be classified as liabilities in certain situations.

13. In general, the FASB did not anticipate that the liability definition revisions would result in any material changes in instrument reclassification (e.g., items now being classified as a liability when previously they were not considered liabilities). Again, FASB Concept Statements are not authoritative and thus the guidance in any specific standard will still be utilized for instrument measurement and classification. For statutory accounting purposes, the updated definition should be viewed similarly, that is it does not change fundamental concepts, change current practices, or introduce a new, original or a modified accounting principle. The revisions to the definition of a liability clarify the definitional language and do not modify the original intent of SSAP No. 5R and thus the changes are deemed to be a statutory accounting principle clarification.

14. The remaining concepts and guidance articulated in SSAP No. 5R (e.g., contingencies, impairments, guarantees, etc.) were not proposed for revision and thus are not further discussed in this issue paper.

Actions of the Statutory Accounting Principles (E) Working Group

15. During the 2022 Spring National Meeting, the Working Group exposed this issue paper for public comment.

16. During the 2022 Summer National Meeting, the Working Group re-exposed this issue paper for public comment.

17. At the 2022 Fall National Meeting, the Working Group re-exposed this issue paper related to the definition change of a liability in *SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets*. This exposure intends to provide additional time for industry to review the changes in accordance with statutory accounting statements. NAIC staff were directed to collaborate with interested parties on proposed clarifying language.

18. At the 2023 Spring National Meeting, the Working Group exposed this issue paper with revisions to: 1) add an additional footnote to the definition of a liability in SSAP No. 5R which defers to more topic specific contradictory guidance and 2) revise the relevant literature section of SSAP No. 5R to note the modification. These clarifications were because of the authoritative treatment that statutory accounting provides to the definition of an asset and a liability in SSAP No. 4 and SSAP No. 5R. For U.S. GAAP, the FASB Conceptual statements definitions are not authoritative, but rather are concepts to consider when developing and applying guidance. The FASB basis for conclusions noted that some existing authoritative FASB literature regarding liabilities is inconsistent with the updates to Concepts Statement No. 8. Therefore, a modification regarding topic specific liabilities guidance was incorporated to address variations from the definition of a liability. Examples of existing SAP variations from the definition of a liability include but are not limited to:

- a. *SSAP No. 7—Asset Valuation Reserves and Interest Maintenance Reserves – AVR and IMR* establish liabilities for regulatory objectives.
- b. *SSAP No. 62R—Property and Casualty Reinsurance* – contains the provision for reinsurance liability guidance which results in a liability that is a regulatory valuation allowance for overdue and slow paying reinsurance and also enforces credit for reinsurance (*Credit for Reinsurance Model Law (#785)*) collateral requirements.

- c. *SSAP No. 92—Post Retirement Benefits Other than Pensions*, provides liability recognition, which adopts several U.S. GAAP standards with modifications.

19. At the 2023 Summer National Meeting, the Working Group adopted the exposed revisions to SSAP No. 5R as documented in this issue paper and adopted this issue paper.

RELEVANT STATUTORY ACCOUNTING AND GAAP GUIDANCE

Statutory Accounting

20. Relevant excerpts of SSAP No. 5R, paragraphs 2-3 regarding the definition of a liability accounting are as follows:

2. A liability is defined as certain or probable¹ future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or to provide services to other entities in the future as a result of a past transaction(s) or event(s).

3. A liability has three essential characteristics: (a) it embodies a present duty or responsibility to one or more other entities that entails settlement by probable¹ future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand, (b) the duty or responsibility obligates a particular entity, leaving it little or no discretion to avoid the future sacrifice, and (c) the transaction or other event obligating the entity has already happened. This includes, but is not limited to, liabilities arising from policyholder obligations (e.g., policyholder benefits, reported claims and reserves for incurred but not reported claims). Liabilities shall be recorded on a reporting entity's financial statements when incurred.

Generally Accepted Accounting Principles

21. Relevant paragraphs from *Concepts Statement No. 8, Conceptual Framework for Financial Reporting—Chapter 4, Elements of Financial Statements* have been included below:

Liabilities

E37. A liability is a present obligation of an entity to transfer an economic benefit

Characteristics of Liabilities

E38. A liability has the following two essential characteristics: a. It is a present obligation. b. The obligation requires an entity to transfer or otherwise provide economic benefits to others.²

E39. Liabilities commonly have features that help identify them. For example, many liabilities require the obligated entity to pay cash to one or more identified other entities. Liabilities may not require an entity to pay cash but may require the entity to convey other assets, provide services, or transfer other economic benefits or to be ready to do so. Liabilities are based on a foundation of legal rights and duties.

E40. Entities routinely incur liabilities in exchange transactions to acquire the funds, goods, and services they need to operate. For example, borrowing cash (acquiring funds) obligates an entity

¹ *FASB Statement of Financial Accounting Concepts No. 6, Elements of Financial Statements*, states: Probable is used with its usual general meaning, rather than in a specific accounting or technical sense (such as that in *FASB Statement 5, Accounting for Contingencies*, paragraph 3), and refers to that which can reasonably be expected or believed on the basis of available evidence or logic but is neither certain nor proved.

² This chapter continues the practice of describing liabilities as an obligation either to transfer or to provide economic benefits. For example, the term transfer has typically been used to describe obligations to pay cash or convey assets, and the term provide has typically been used to describe obligations to perform services or stand ready to do so.

to repay the amount borrowed, acquiring assets on credit obligates an entity to pay for the assets, and selling products with a warranty or guarantee obligates an entity to either pay cash or repair or replace any products that prove defective. Often, obligations incurred in exchange transactions are contractual based on written or oral agreements to pay cash or to provide goods or services to specified or determinable entities on demand at specified or determinable dates or on the occurrence of specified events.

Present obligation

E41. A liability requires that an entity be obligated to perform or act in a certain manner. In most cases it is apparent that liabilities are legally enforceable. Legally enforceable obligations include those arising from binding contracts, agreements, rules, statutes, or other requirements that would be upheld by a judicial system or government. Judicial systems vary in type and form, and the term judicial systems includes any such system that would enforce laws, statutes, and regulations. In the context most relevant to financial reporting, an obligation is any condition that binds an entity to some performance or action. In a financial reporting context, something is binding on an entity if it requires performance. Performance is what the entity is required to do to satisfy the obligation.

E42. Many obligations that qualify as liabilities stem from contracts and other agreements that are enforceable by courts or from governmental actions that have the force of law. Agreements, contracts, or statutory requirements often will specify or imply how an obligation was incurred and when and how the obligation is to be settled. For example, borrowing and lease agreements specify the amount of charges and the dates when the payments are due. The absence of a specified maturity date or event to require settlement may cast doubt that an obligation exists.

E43. Liabilities necessarily involve other parties, society, or law. The identity of the other party or recipient need not be known to the obligated entity before the time of settlement. An obligation of an entity to itself cannot be a liability. For example, in the absence of external requirements an entity is not obligated to repair the roof of its building or maintain its plant and equipment. Although those actions may be wise business moves, the entity may forgo or defer such activities because there is no present obligation to perform the activity.

E44. Certain obligations require nonreciprocal transfers from an entity to one or more other entities. Such obligations include taxes imposed by governments, donations pledged to charitable entities, and cash dividends declared but not yet paid.

E45. To have a liability, an entity must have a present obligation, that is, the obligation exists at the financial statement date. The settlement date of the liability may occur in the future, but the obligation must be present at the financial statement date. Transactions or other events or circumstances expected to occur in the future do not in and of themselves give rise to obligations today.

E46. An intention to purchase an item, for example, an asset, does not in and of itself create a liability. However, a contractual obligation that requires an entity to pay more than the fair value of the asset at the transaction date may create a liability before the asset is received, reflecting what the entity might have to pay to undo the unfavorable contract.

E47. Business risks result from the conduct of an entity's business activities. A business risk is not a present obligation, though at some point in the future an event may occur that creates a present obligation. Some businesses have the potential of carrying out activities and creating present obligations as a result of those activities. However, no present obligation exists even if it is virtually certain that an obligating event will occur, though at present no such event has occurred. The essence of distinguishing business risks from liabilities is determining the point in time when an entity has a present obligation.

E48. Some business risks result from an entity's transactions, for example, selling goods in overseas markets might expose an entity to the risk of future cash flow fluctuations because of changes in foreign exchange rates. Other business risks result from an entity's operating environment, for example, operating in a highly specialized industry might expose an entity to the

risk that it will be unable to attract sufficient skilled staff to sustain its operating activities. Those risks are not liabilities.

E49. To be presently obligated, an entity must be bound, either legally or in some other way, to perform or act in a certain way. Most liabilities are legally enforceable, including those arising from contracts, agreements, rules, and statutes. An entity also can become obligated by other means that would be expected to be upheld by a judicial process. However, the existence of a present obligation may be less clear in those circumstances.

E50. Some liabilities rest on constructive obligations, including some that arise in exchange transactions. A constructive obligation is created, inferred, or construed from the facts in a particular situation rather than contracted by agreement with another entity or imposed by government. An entity may become constructively obligated through customary business practice. In the normal course of business, an entity conducting certain activities may not create a clear contractual obligation but may nonetheless cause the entity to become presently obligated. For example, policies and practices for sales returns and those for warranties in the absence of a contract may create a present obligation because the pattern of behavior may create an enforceable claim for performance that would be upheld in the ultimate conclusion of a judiciary process.

E51. An entity's past behavior also may give rise to a present obligation. Repeated engagement in a certain behavior may obligate the entity to perform or act in a certain way on the basis of that pattern of behavior. For example, the entity may create a constructive obligation to employees for vacation pay or year-end bonuses by paying them every year even though it is not contractually bound to do so and has not announced a policy to do so.

22. The most notable changes regarding the definition of a liability included removal of the term *probable* and the phrase *as a result of past transactions or events*. Rationale for these changes were documented in *Chapter 4, Elements of Financial Statements* commentary as follows:

BC4.11. The definitions of both an asset and a liability in Concepts Statement 6 include the term *probable* and the phrases *future economic benefit* and *past transactions or events*. The term *probable* in the definitions in Concepts Statement 6 has been misunderstood as implying that a future economic benefit or a future sacrifice of economic benefit must be probable to a certain threshold before the definition of an asset or a liability is met. In other words, if the probability of future economic benefit is low, the asset definition is not met under that interpretation. A similar interpretation could be made for liabilities. The footnotes to the Concepts Statement 6 definition of assets and liabilities also were not helpful in clarifying the application of the term *probable* as used in the definitions of assets and liabilities. Accordingly, the Board decided to eliminate that term from the definitions of both assets and liabilities.

BC4.12. The term *future* in the definitions in Concepts Statement 6 focused on identifying a future flow of economic benefits to demonstrate that an asset exists or identifying a future transfer of economic benefits to demonstrate that a liability exists. The definitions in Concepts Statement 6 were often misunderstood as meaning that the asset (liability) is the ultimate future inflow (outflow). For example, in the instance of trade receivables, the definition in Concepts Statement 6 could be misunderstood to indicate that the asset is the successful collection of the receivable in the future. When applied appropriately, however, the definition would conclude that the asset is the present right to collection. Similar misunderstandings occurred in applying the liability definition. As a result, the Board concluded that a focus on the term *present* would appropriately shift the focus from identifying a future occurrence. Therefore, the Board decided to include the term *present right* to demonstrate that an asset exists and emphasize the term *present obligation* to demonstrate that a liability exists.

BC4.13. The definitions of assets and liabilities in Concepts Statement 6 both include the phrase *past transactions or events*. The Board concluded that if an entity has a present right or a present obligation, one can reasonably assume that it was obtained from some past transaction or event. Therefore, that phrase is considered redundant and has been eliminated from the definitions.

23. The other significant change to the definition of a liability included changing *future sacrifices* to a *present obligation*. Rationale for these changes were documented in *Chapter 4, Elements of Financial Statements* commentary as follows:

BC4.25. The term present obligation is included in the definition of a liability, both in this chapter and in Concepts Statement 6. Because the application of the liability definition under Concepts Statement 6 did not give sufficient emphasis to the term present obligation, the definition in this chapter more appropriately emphasizes that term. Assessing whether a present obligation exists is the primary criterion in the definition of a liability in this chapter. The primacy of the term present obligation is made more evident through the removal of many of the problematic terms in the definition of a liability in Concepts Statement 6, as discussed in paragraphs BC4.11–BC4.13.

BC4.26. Almost always, the existence of a present obligation will be apparent. Most present obligations are legally enforceable, including obligations arising from binding contracts, agreements, statutes, or other legal or contractual means. However, situations lacking clear legal or contractual evidence of a present obligation pose particular challenges that may make it difficult to discern whether a present obligation exists.

BC4.27. Determining when a present obligation exists has caused confusion with the existence of business risks. Business risks result from the nature of the business and where, when, and how an entity conducts its business. While certain businesses pose risks of future events occurring that will cause a transfer of economic benefits, the Board decided that the risks themselves are not present obligations because exposure to a potential negative consequence does not constitute a present obligation. Rather than viewing all business risks as liabilities, the Board decided that an entity has a present obligation only after an event occurs that demonstrates that the inherent business risk has created a present obligation. Thus, distinguishing when a business risk makes an entity presently obligated requires analysis of the facts and circumstances at the standards level.

BC4.28. Determining the existence of a present obligation is particularly challenging in evaluating constructive obligations. Interpreting constructive obligations too narrowly will tend to exclude significant actual obligations of an entity, while interpreting them too broadly will effectively nullify the definition by including items that lack an essential characteristic of liabilities.

BC4.29. Given that constructive obligations and other noncontractual obligations are created by circumstance rather than explicit agreement, it can be unclear whether a present obligation exists. In the absence of an explicit agreement, sufficient information to distinguish a present obligation is likely only available at the specific standards level. Thus, the Board decided that specific facts and circumstances at the standards level must be assessed to determine whether an entity has created a constructive obligation.

RELEVANT LITERATURE

Statutory Accounting

- Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy

Generally Accepted Accounting Principles

- FASB Statement of Financial Accounting Concepts No. 8, Conceptual Framework for Financial Reporting – Chapter 4, Elements of Financial Statements

Effective Date

24. As issue papers are not authoritative and are not represented in the Statutory Hierarchy (see Section V of the Preamble), the consideration and adoption of this issue paper will not have any impact on the SAP clarifications adopted to SSAP No. 5R by the Working Group on August 13, 2023.

EXHIBIT A – SAP Clarification Revisions to *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets* the other paragraphs of *SSAP No. 5R* are unchanged.

Statement of Statutory Accounting Principles No. 5 - Revised

Liabilities, Contingencies and Impairments of Assets

SCOPE OF STATEMENT

1. This statement defines and establishes statutory accounting principles for liabilities, contingencies and impairments of assets.

SUMMARY CONCLUSION

Liabilities

2. A liability is defined as a present obligation of an entity to transfer an economic benefit. ~~certain or probable FNI future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or to provide services to other entities in the future as a result of a past transaction(s) or event(s).~~

3. A liability¹ has three ~~two~~ essential characteristics: (a) it is a present obligation ~~embodies a present duty or responsibility to one or more other entities that entails settlement by probable FNI future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand, and~~ (b) the obligation required an entity to transfer or otherwise provide economic benefit to others ~~duty or responsibility obligates a particular entity, leaving it little or no discretion to avoid the future sacrifice, and~~ (c) ~~the transaction or other event obligating the entity has already happened.~~ This includes, but is not limited to, liabilities arising from policyholder obligations (e.g., policyholder benefits, reported claims and reserves for incurred but not reported claims). Liabilities shall be recorded on a reporting entity's financial statements when incurred.

4. Estimates (e.g., loss reserves) are required in financial statements for many ongoing and recurring activities of a reporting entity. The mere fact that an estimate is involved does not of itself constitute a loss contingency. For example, estimates of losses utilizing appropriate actuarial methodologies meet the definition of liabilities as outlined above and are not loss contingencies.

~~FN1—FASB Statement of Financial Accounting Concepts No. 6, Elements of Financial Statements, states: Probable is used with its usual general meaning, rather than in a specific accounting or technical sense (such as that in FASB Statement 5, Accounting for Contingencies, paragraph 3), and refers to that which can reasonably be expected or believed on the basis of available evidence or logic but is neither certain nor proved.~~

Relevant Literature

39. This statement adopts *FASB Statement No. 5, Accounting for Contingencies* (FAS 5), *FASB Statement 114, Accounting by Creditors for Impairment of a Loan* only as it amends in part FAS 5 ~~and~~

¹ The guidance in this statement regarding the definition of a liability is applicable unless another authoritative statement of statutory accounting principles (SSAP) provides more topic specific contradictory guidance. In such cases the topic specific guidance shall apply.

~~paragraphs 35 and 36 of FASB Statement of Financial Accounting Concepts No. 6—Elements of Financial Statements.~~ FASB Interpretation No. 14, *Reasonable Estimation of the Amount of a Loss, An Interpretation of FASB Statement No. 5* (FIN No. 14) is adopted with the modification to accrue the loss amount as the midpoint of the range rather than the minimum as discussed in paragraph 3 of FIN No. 14. This statement adopts with modification ASU 2013-04, *Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation is Fixed at the Reporting Date* with the same statutory modification adopted for FIN 14. [This statement incorporates the definition of a liability from FASB Statement of Financial Accounting Concepts No. 8, Chapter 4, Elements of Financial Statements, paragraphs E37 and E38 with modification reflected in this Statement regarding topic specific guidance.](#)

REFERENCES

Relevant Issue Papers

- *Issue Paper No. 5—Definition of Liabilities, Loss Contingencies and Impairments of Assets*
- *Issue Paper No. 20—Gain Contingencies*
- *Issue Paper No. 135—Guarantor’s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*
- [Issue Paper No. 168—Updates to the Definition of a Liability](#)

<https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/NationalMeetings/A.NationalMeetingMaterials/2023/8-13-23SummerNationalMeeting/Adoptions/22-01B-IPNo.168-Liabilityfinal.docx>

**Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A**

Issue: Negative IMR

Check (applicable entity):

	P/C	Life	Health
Modification of Existing SSAP	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>
New Issue or SSAP	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Interpretation	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Description of Issue: This agenda item has been developed to discuss the interest maintenance reserve (IMR) within statutory accounting, specifically the current guidance for the nonadmittance of disallowed negative IMR. Although the statutory accounting guidance has been in place for several years, the rising interest rate environment has created an increased likelihood for reporting entities to move to a negative IMR position. This agenda item intends to provide information on the background of IMR, current accounting guidance, recent discussions of the Life Actuarial (A) Task Force and some broad financial results from year-end 2021 and interim 2022 financial statements. The intent is to provide this information to facilitate Working Group discussion.

The following provides a high-level overview of the use of the terms positive IMR and negative IMR for entities filing the Life, Accident & Health / Fraternal annual statement blank:

- A positive IMR means that the net realized interest related gains which are amortized in the IMR calculation are greater than net realized interest related losses which are being amortized in the IMR calculation. A positive IMR is reported as a statutory liability and amortized to income over time.
- A negative IMR means that net realized interest related losses which are amortized in the IMR calculation are greater than net realized interested related gains which are amortized in the IMR calculation. A disallowed negative IMR is reported as a nonadmitted asset and amortized to income as a loss over time.

As IMR occurs in the general and separate account, there are specific guidelines in determining whether the IMR reflects a net disallowed negative or position in the annual statement instructions. These are on page 5.

A letter from the American Council of Life Insurers (ACLI) dated Oct. 31, 2022, raised concerns with existing statutory accounting requirements on the nonadmittance of disallowed negative IMR noting negative ramifications for insurers. Key summarized positions from this ACLI letter include:

- In general, rising interest rates are favorable to the financial health of the insurance industry and policyholders. However, with negative IMR, there is an inappropriate perception of decreased financial strength through lower surplus and risk-based capital.
- Negative IMR could impact the rating agency view of the industry or incentivize companies to avoid prudent investment transactions that are necessary to avoid mismatches between assets and liabilities. In either scenario, negative IMR encourages short-term non-economic activity that is not in the best long-term interest of a reporting entity’s financial health or its policyholders.

Background of IMR

The IMR was first effective in statutory accounting in 1992 and requires that a realized fixed income gains or losses attributable to changes in interest rates (excluding gains/losses that are credit related), be amortized into income over the remaining term to maturity of the fixed-income investments (and related hedging programs) sold rather than being reflected in income immediately.

Minutes, including adopted materials – in the Blue Book (Life Statement), from the 2002 4th Quarter NAIC Proceedings discussing IMR are provided below. Please note the last section that includes “Future Directions” which identifies recognition of negative IMR as a major area of effort.

Description and other components of IMR from the Blue Book, captured in the 2002 4th Quarter NAIC Proceedings, provides the following definition and other details: (*Only key excerpts included.*)

The Interest Maintenance Reserve (IMR): captures for all types of fixed income investments, all of the realized capital gains and losses which result from changes in the overall level of interest rates as they occur. Once captured, these capital gains or losses are amortized into income over the remaining life (period to maturity) of the investments sold. Realized gains and losses on derivative investments, which alter the interest rate characteristics of assets/liabilities, also are allocated to the IMR and are to be amortized into income over the life of the associated assets/liabilities. Note: certain significant unusual transactions may require immediate recognition of any realized capital gains or losses, as described in a later section. This reserve is not subject to any maximum.

VII. IMR MINIMUMS/MAXIMUMS: A. Minimums: **The IMR can be negative for any line of business as long as the aggregate IMR for the Company is not less than zero. Any otherwise negative IMR value is carried over to subsequent years.** B. Maximums: There is no maximum of the IMR

VIII. BACKGROUND/PERSPECTIVE: To insure solvency of a company, its assets should be invested so that the company has a very high probability of paying its contractual liabilities when they become due. In order to assess whether a company is able to fulfill its obligations, it must present its liabilities and assets on a financially integrated basis. Since the accounting practices prescribed for the life insurance annual statement are an important element in this discipline, it is imperative that the accounting practices be consistent for assets and liabilities. If they are inconsistent, then the annual statement will not reveal whether assets exceed liabilities; more importantly, neither regulators nor management can determine the risk of insolvency for the company.

The Valuation Actuary’s Opinion includes a statement that the assets backing the liabilities make adequate provision for the company’s liabilities. That is, the Actuary must look beyond the statutory valuation formulas and satisfy himself that the cash flows generated by the assets will probably be sufficient to discharge the liabilities. Prior to the AVR and IMR, there were many circumstances under which the statutory formula valuation methods gave rise to inappropriate results. Some examples were:

- Changes in values due to interest rate swings were recognized inconsistently on the asset and liability sides of the balance sheet. Liabilities are valued using interest rates fixed at issue while some assets may be valued using current interest rates through trading activity.
- When the assets are poorly matched to the liabilities, a significant adverse swing in the interest rates will reduce financial strength and could lead to insolvency even though the balance sheet value of the assets exceeds the balance sheet value of the liabilities. Using long term assets to back demand liabilities is dangerous if there is a significant upswing in interest rates. In addition, individual insurance premiums are received and invested for many years after the issue date on which the reserve interest rate is determined, creating a potential for inadequate yields that is not reflected in standard accounting procedures.
- The potential for future asset losses was not well reflected in the balance sheet or earnings statement.

It is desirable that the valuation of the assets and liabilities be made as consistent as possible to 1) minimize the instances where, in order to render a clean opinion, the actuary must establish extra reserves due to interest rate gains or potential for defaults and 2) increase the likelihood that assets supporting liabilities are sufficient even in the absence of an Actuarial Opinion. The development of an AVR and IMR will correct many of these deficiencies in consistency.

XII. AVR AND IMR BUILT ON AND COMPLEMENT EXISTING VALUATION PRACTICES: The existing framework of asset and liability valuation practices, as augmented by the NAIC Model Standard Valuation Law, played a key role in designing the AVR and IMR, including:

A. Reserve valuation standards should contain a provision for future losses. Although it is well understood that in cash flow testing provision must be made for future asset losses, it may not be as well understood that historically the minimum valuation standards implicitly contained such a provision.

B. Interest assumptions in reserve valuation generally recognize the potential for mismatch. Dynamic valuation rates are lower for ordinary life than for guaranteed investment contracts, for example, because the mismatch is almost inevitable on the former. In addition, it is required in other regulations, and in the NAIC Model Standard Valuation Law, that cash flow testing should be used and may result in the adoption of lower than the dynamic valuation rates if mismatch exists. Hence, with the one exception noted in section (c), there is no need for the IMR reserves to make provision for the risk of mismatch.

C. Asset valuations for fixed interest securities usually reflect the outlook at the time of purchase of an asset. In particular, bond amortization tends to reflect the yields available at time of purchase and the expected cash flow. Liabilities are established at the same time, and the interest rate assumptions on them are those appropriate to the outlook at that time. **But if securities are traded, a new amortization schedule is established that may be based on an entirely different yield environment, which may not be consistent with the liabilities that have been established. Using the IMR to absorb trading gains is desirable and appropriate to eliminate this subsequently created mismatch.**

D. Equities present special valuation problems. Common stocks are valued at market rather than amortized value; hence they require different treatment. Real estate and similar investments, although usually valued at depreciated value, require special consideration because of the great likelihood of major changes in yield and yield expectation after purchase.

XXII. RESERVE MAXIMUM AND MINIMUM LEVELS: No maximum is placed on the Interest Maintenance Reserve. The aggregate minimum value for the IMR for the Company is zero. The IMR may be negative for any Line of Business as long as the aggregate for all lines equals zero. Provision is made in the accounting rules that if an aggregate negative IMR is developed in the absence of the zero minimum, that negative value is carried over to subsequent years.

The basic rationale for the IMR would conclude that neither a maximum nor a minimum is appropriate. If the liability values are based on the assumption that the assets were purchased at about the same time as the liabilities were established, then there should be no bounds to the reserve which corrects for departures from that assumption; if a company has to set up a large reserve because of trading gains, it is in no worse position than if it had held the original assets. As for negative values of the IMR, the same rationale applies. However, the concept of a negative reserve in the aggregate has not been adopted.

XXVIII. EXCESSIVE WITHDRAWALS:

A. Background: Major book-value withdrawals or increases in policy loans can occur at a time of elevated interest rates. If these withdrawals or increases are far in excess of the withdrawals provided for in the company's reserving and cash flow testing, and **if asset sales at this point are, in effect, forced sales to fund liabilities that are no longer on the books, the allocation of a negative amount to the IMR is not correct.**

A company may also experience a "run on the bank" due to adverse publicity. This could occur even during a period of low interest rates, and the sale of assets to meet a run would conceivably produce gains. It is appropriate to register the gains immediately.

If the withdrawals were scheduled payments under a GIC, then there is a presumption that any gains or losses that might occur at the time of withdrawal should be added to the IMR since the gains or losses would be spurious if the company has followed a policy of matching its assets to its liabilities.

Note that many of the situations where an upsurge in withdrawal activity generates real losses arise when a company has a severe mismatch between its assets and its liabilities. Such losses can be present even in the absence of any realized gains or losses. The primary protection as to the adequacy of reserves in these circumstances is the requirement for an actuary's opinion.

- B. IMR Exclusions: All realized interest-related gains or losses which arise from the sale of investments required to meet "Excess Withdrawal Activity" as defined below will be excluded from the IMR and will be reflected in net income.

STANDARDS FOR ACTUARIAL RESERVES WITH AN IMR AND AN AVR

LXX. IMR RESERVE STANDARD The Interest Maintenance Reserve is a true actuarial reserve, and actuaries should use the assets supporting the Interest Maintenance Reserve when opining that the assets supporting the company's reserves make adequate provision for the company's obligations. **In the case of a negative IMR, the actuarial opinion should include an explicit statement that the impact of the negative IMR on reserve adequacy has been considered and that the reserves after deduction of the negative IMR still make adequate provision for the liabilities.**

LXXI. GENERAL EXPLANATION The IMR is designed to work with minimum statutory reserves based on formulas contained in laws or regulations. Where, for example, the valuation rate is based on the interest rate conditions prevailing in the year of deposit, the assets supporting the liabilities will be consistent with the liability assumptions. Disposal of the assets during a period of declining interest rates will produce interest-related gains, but these gains will be needed to support the liabilities that are still valued at the interest rate levels prevailing at time of deposit. Thus, it is appropriate in the case of positive IMR to treat the IMR as an additional reserve requirement above and beyond formula minimums.

In cash-flow-testing actuaries take future cash flows into account from existing assets. In an example such as described above, existing assets may well have been purchased at rates below those prevailing at the time reserves were established. The positive IMR that has been built up has captured the gains and not allowed them to be available for distribution. The IMR is recognized as part of the reserves available to meet future obligation cash flows.

Thus from either point of view a positive IMR is treated as a true actuarial reserve. The same arguments should apply equally well in the case of a negative IMR, but some concern has been expressed that in this case the net reserves are in effect lower than statutory formulas minimums, and therefore special considerations are required.

FUTURE DIRECTIONS

In late 2002, the interested persons (as its name had become) considered refinements of the AVR/IMR for the next several years, from that vantage point, some of the major areas of effort appear to be as follows:

- 1. There should be recognition of negative values of the IMR. The group had long recognized that the philosophical basis for the IMR supports negative values of the reserve as well as positive. There is a need to have investment return match the liabilities associated with the investment; and a need to remove the incentive for a company to make investment decisions based on the short term balance sheet effect; and these needs exist also on the negative side of the IMR.**

No doubt there are concerns that a negative reserve of this type could somehow lead to an unsound condition, so there has been appended to this report a discussion entitled "Why Are Negative Values For the IMR Necessary?" It also seems as though there should be additional safeguards in the case of a negative IMR. Rather than put arbitrary limits on the amount of the negative reserve, however, consideration is being given to an actuary's statement that an asset adequacy analysis has been carried out that demonstrates the soundness of the reserves.

(Staff Note: The NAIC library does not have a record of the report noted in the above paragraph.)

Current Accounting Guidance

The statutory accounting guidance for IMR (and the Asset Valuation Reserve – AVR) is within *SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve*, but the guidance within that SSAP is very limited. It provides a general description, identifies that IMR/AVR shall be calculated and reported per the guidance in the applicable SSAP, and if not explicit in the SSAP, in accordance with the Annual Statement Instructions. The SSAPs most often simply direct allocation to (or between) IMR and AVR, with the bulk of the guidance within the Annual Statement Instructions.

The guidance in the Annual Statement instructions provides information on the net IMR balance, which takes into consideration both the positive and negative balances in the general and separate accounts. As detailed, disallowed negative IMR is reported so that it is a direct reduction to surplus on the Summary of Operations, page 4, line 41 change in nonadmitted assets:

Line 6 – Reserve as of December 31, Current Year

Record any positive or allowable negative balance in the liability line captioned “Interest Maintenance Reserve” on Page 3, Line 9.4 of the General Account Statement and Line 3 of the Separate Accounts Statement. A negative IMR balance may be recorded as a negative liability in either the General Account or the Separate Accounts Statement of a company only to the extent that it is covered or offset by a positive IMR liability in the other statement.

If there is any disallowed negative IMR balance in the General Account Statement, include the change in the disallowed portion in Page 4, Line 41 so that the change will be appropriately charged or credited to the Capital and Surplus Account on Page 4. If there is any disallowed negative IMR balance in the Separate Accounts Statement, determine the change in the disallowed portion (prior year less current year disallowed portions), and make a direct charge or credit to the surplus account for the “Change in Disallowed Interest Maintenance Reserve” in the write-in line, in the Surplus Account on Page 4 of the Separate Accounts Statement.

The following information is presented to assist in determining the proper accounting:

General Account IMR Balance	Separate Account IMR Balance	Net IMR Balance
Positive	Positive	Positive (See rule a)
Negative	Negative	Negative (See rule b)
Positive	Negative	Positive (See rule c)
Positive	Negative	Negative (See rule d)
Negative	Positive	Positive (See rule e)
Negative	Positive	Negative (See rule f)

Rules:

- a. If both balances are positive, then report each as a liability in its respective statement.
- b. If both balances are negative, then no portion of the negative balances is allowable as a negative liability in either statement. Report a zero for the IMR liability in each statement and follow the above instructions for handling disallowed negative IMR balances in each statement.
- c. If the general account balance is positive, the separate accounts balance is negative and the combined net balance is positive, then all of the negative IMR balance is allowable as a negative liability in the Separate Accounts Statement.

- d. If the general account balance is positive, the separate account balance is negative, and the combined net balance is negative, then the negative amount not covered by the positive amount is not allowable. Report only the allowable portion as a negative liability in the Separate Accounts Statement and follow the above instructions for handling the disallowed portion of negative IMR balances in the Separate Accounts Statement.
- e. If the general account balance is negative, the separate account balance is positive, and the combined net balance is positive, then all of the negative IMR balance is allowable as a negative liability in the General Account Statement.
- f. If the general account balance is negative, the separate account balance is positive, and the combined net balance is negative, then the negative amount not covered by the positive amount is not allowable. Report only the allowable portion as a negative liability in the General Account Statement and follow the above instructions for handling the disallowed portion of negative IMR balances in the General Account Statement.

The Statutory Accounting Statement of Concepts in the Preamble to the AP&P provides the following on Recognition:

Recognition

35. The principal focus of solvency measurement is determination of financial condition through analysis of the balance sheet. However, protection of the policyholders can only be maintained through continued monitoring of the financial condition of the insurance enterprise. Operating performance is another indicator of an enterprise's ability to maintain itself as a going concern. Accordingly, the income statement is a secondary focus of statutory accounting and should not be diminished in importance to the extent contemplated by a liquidation basis of accounting.

36. The ability to meet policyholder obligations is predicated on the existence of readily marketable assets available when both current and future obligations are due. Assets having economic value other than those which can be used to fulfill policyholder obligations, or those assets which are unavailable due to encumbrances or other third party interests should not be recognized on the balance sheet but rather should be charged against surplus when acquired or when availability otherwise becomes questionable.

37. Liabilities require recognition as they are incurred. Certain statutorily mandated liabilities may also be required to arrive at conservative estimates of liabilities and probable loss contingencies (e.g., interest maintenance reserves, asset valuation reserves, and others).

Life Actuarial (A) Task Force 2022 Guidance

The Life Actuarial (A) Task Force considered comments from the ACLI that the inclusion of a negative IMR balance in asset adequacy testing, the disallowance of a negative IMR could result in double counting of losses (i.e., through the disallowance on the balance sheet and the potential AAT-related reserve deficiency). The Task Force identified that VM-20 Section 7.D.7.b notes that "...the company shall use a reasonable approach to allocate any portion of the total company balance that is disallowable under statutory accounting procedures (i.e., when the total company balance is an asset rather than a liability)." Question 22 of the AAA's Asset Adequacy Practice Note (Attachment 2) states that "... a negative IMR is not an admitted asset in the annual statement. So, some actuaries do not reflect a negative value of IMR in the liabilities used for asset adequacy analysis." However, Question 22 also notes a 2012 survey data that showed varying practices across companies, including some companies that allocated negative IMR.

On Nov. 17, 2022, in order to assist state regulators in achieving uniform outcomes for year-end 2022, the Task Force exposed guidance until November 30, 2022:

Recommendation In order to assist state regulators in achieving uniform outcomes for year-end 2022, we have the following recommendation: the allocation of IMR in VM-20, VM-21, and VM-30 should be principle-based, "appropriate", and "reasonable". Companies are not required to allocate any non-admitted

portion of IMR (or PIMR, as applicable) for purposes of VM-20, VM-21, and VM-30, as being consistent with the asset handling for the nonadmitted portion of IMR would be part of a principle-based, reasonable and appropriate allocation. However, if a company was granted a permitted practice to admit negative IMR as an asset, the company should allocate the formerly non-admitted portion of negative IMR, as again a principle-based, reasonable and appropriate IMR allocation would be consistent with the handling of the IMR asset. This recommended guidance is for year-end 2022, to address the current uncertainty and concerns with the “double-counting” of losses. This recommended guidance will help ensure consistency between states and between life insurers in this volatile rate environment. Refinement of this guidance may be considered beyond year-end 2022.

The Oct. 31, 2022 ACLI Letter also identified the following references to IMR in the valuation manual and Risk-Based Capital Calculations:

Regulation	Use	IMR references
Actuarial Opinion and Memorandum Regulation (VM-30)	Asset adequacy analysis for annual reserve opinion	An appropriate allocation of assets in the amount of the IMR, whether positive or negative, shall be used in any asset adequacy analysis.
Life principle-based reserves (VM-20)	Calculation of deterministic reserve	Calculate the deterministic reserve equal to the actuarial present value of benefits, expenses, and related amounts less the actuarial present value of premiums and related amounts, less the positive or negative pre-tax IMR balance at the valuation date allocated to the group of one or more policies being modeled
Life principle-based reserves (VM-20)	Calculation of stochastic reserve	Add the CTE amount (D) plus any additional amount (E) less the positive or negative pre-tax IMR balance allocated to the group of one or more policies being modeled
Variable annuities principle-based reserves (VM-21)	Reserving for variable annuities	The IMR shall be handled consistently with the treatment in the company’s cash-flow testing, and the amounts should be adjusted to a pre-tax basis.
C3 Phase 1 (Interest rate risk capital)	RBC for fixed annuities and single premium life	IMR assets should be used for C3 modeling.

Assessment of 2020-2022 IMR Balances:

Note – The following amounts reflect the general account IMR Reserve balance. (This is the amount shown as a liability and shows the decrease in the positive IMR reported since 2020.) This detail does not show the disallowed negative IMR reported as an asset and nonadmitted. Also, information on the separate account IMR, which is a factor in determining in disallowed negative IMR, will not be known until the year-end financial statements are filed (March 1, 2023).

	GA 2022 – Q3	GA 2022 – Q2	GA 2022 – Q1	GA YE – 2021	GA YE – 2020
Aggregate IMR	27,601,001,445	31,859,274,989	37,697,176,149	40,598,068,038	35,229,578,726
Change from Prior	(4,258,273,544)	(5,837,901,160)	(2,900,891,889)	5,368,489,312	
% Change	(13.4%)	(21.5%)	(7.1%)	15.2%	

Review of GA IMR Reserve Decrease:

- From the first quarter (Q1) to second quarter (Q2), 25 companies had decreases in the IMR reserve balance over \$50M totaling \$4,717,657,986, representing 80% of the overall change. 13 of these companies had decreases of IMR over \$100M, totaling \$3,959,569,339, representing 68% of the change. Four of these companies had decreases of IMR over \$400M. One of these companies reported a zero IMR liability and reported a disallowed IMR on the asset page of approx. \$570M.
- From the first quarter (Q1) to second quarter (Q2), 49 companies increased their prior reported positive IMR by \$61,390,564. From the second quarter (Q2) to third quarter (Q3), 56 companies increase their prior reported positive IMR by \$60,316,403
- From the second quarter (Q2) to third quarter (Q3), 16 companies had decreases in the IMR reserve balance over \$50M totaling \$3,161,570,362, representing 74% of the change. 8 of these companies had decreases of IMR over \$100M, totaling \$2,580,832,015, representing 60% of the change. All of these companies were still in a net positive IMR position.
- For the 30 companies that reflected the largest decline in reported IMR between the first to second quarter and then the second to third quarter, the following key details are noted.
 - From the first (Q1) to second quarter (Q2), the top 30 companies reflected a decrease in \$4,923,166,733, which is 84% of the total decrease.
 - From the second (Q2) to third quarter (Q3), the top 30 companies reflected a decrease in \$3,642,088,165, which is 85.5% of the total decrease.
 - 19 companies were noted as being in the population for both periods. 29 of the 30 companies reported a net positive IMR in the third quarter. One company reported a zero IMR in Q3.
- For the 15 companies that had the largest declines between the first quarter (Q1) to second quarter (Q2), eight of those companies also had the largest declines from second quarter (Q2) to third quarter (Q3).
- A limited number of companies are reporting a negative IMR on the liabilities side. Seven companies reported a net negative IMR balance in the third quarter (Q3) for a total of 11,031,998. One company made up \$10.5M of the aggregate balance and this company initially went negative in the second quarter (Q2). Six companies reported a net negative IMR balance for Q2 for a total of \$9,815,594. (The other companies with negative IMR were immaterial amounts.) *(Under the guidance in the A/S instructions, these companies should stop at zero and report the negative as disallowed nonadmitted asset.)*

Review of Disallowed IMR:

Although the assessment of the liability balance shows the decrease in positive IMR, it no longer tracks the decline for companies that go negative, as the reserve balance on the liability page should stop at zero. (This info may be identifiable from the IMR schedule, but not within the quarterly financials from a review of the IMR reported on the liability page.) As such, NAIC staff completed a review of the data to identify the companies that moved to a zero balance (from a prior positive balance) at year-end 2021 or in the 2022 quarters:

Companies that moved from a positive IMR (liability) to a zero balance:

- Initially went to zero in 2022 – Q3: 20 companies
- Initially went to zero in 2022 – Q2: 20 companies
- Initially went to zero in 2022 – Q1: 11 companies
- Initially went to zero YE 2021 – 20 companies (This is a comparison to YE 2020.)

For these 71 companies, NAIC staff has completed a manual review to the 2022 third quarter financial statements to determine if a disallowed IMR was reported as an aggregate write-in on the asset page. For these companies, 60 were identified with a disallowed IMR for a total of \$1 Billion as of the third quarter 2022.

Existing Authoritative Literature:***SSAP Authoritative Guidance:***

- *SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve*
- Life Annual Statement Instructions

(Guidance included as part of discussion.)

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups):

- Nov. 17, 2022, Discussion by Life Actuarial (A) Task Force as discussed above.

Information or issues (included in *Description of Issue*) not previously contemplated by the Working Group:
None**Convergence with International Financial Reporting Standards (IFRS):** NA**Recommendation:**

NAIC staff recommend that the Working Group include this item on their maintenance agenda as a New SAP Concept for discussion to assess the current guidance for disallowed negative IMR. NAIC staff recommend that at the Working Group's conclusion, documentation of the discussion, and resulting decisions, be captured for historical purposes in an Issue Paper.

Staff Review Completed by: Julie Gann - NAIC Staff, November 2022

Status:

On December 13, 2022, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a New SAP Concept and exposed the agenda item with a request for comments by industry on potential guardrails and details on unique considerations. The Working Group directed NAIC staff to coordinate with the Life Actuarial (A) Task Force and request regulator-only sessions with industry to receive specific company information.

On March 22, 2023, the Statutory Accounting Principles (E) Working Group directed NAIC staff regarding the consideration of negative interest maintenance reserve (IMR) with an intent to work on both a 2023 solution and a long-term solution as follows:

- a. Draft a referral to the Life Actuarial (A) Task Force on further consideration of the asset adequacy implications of negative IMR. Items to include: 1) developing a template for reporting within asset adequacy testing (AAT); 2) considering the actual amount of negative IMR that is admitted to be used in the AAT; 3) better consideration of cash flows within AAT (and documentation), as well as any liquidity stress test (LST) considerations; 4) ensuring that excessive withdrawal considerations are consistent with actual data (sales of bonds because of excess withdrawals should not use the IMR process); and 5) ensuring that any guardrails for assumptions in the AAT are reasonable and consistent with other aspects.
- b. Draft a referral to the Capital Adequacy (E) Task Force for the consideration of eliminating any admitted net negative IMR from total adjusted capital (TAC) and the consideration of sensitivity testing with and without negative IMR.
- c. Develop guidance for future Working Group consideration that would allow the admission of negative IMR up to 5% of surplus using the type of limitation calculation similar to that used for goodwill admittance. The guidance should also provide for a downward adjustment if RBC ratio is less than 300.
- d. Review and provide updates on any annual statement instructions for excess withdraws, related bond gains/losses and non-effective hedge gains/losses to clarify that those related gains/losses are through asset valuation reserve (AVR), not IMR.
- e. Develop accounting and reporting guidance to require the use of a special surplus (account or line) for net negative IMR.
- f. Develop governance related documentation to ensure sales of bonds are reinvested in other bonds.
- g. Develop a footnote disclosure for quarterly and annual reporting.

On April 10, 2023, the Working Group exposed a limited-time, optional INT to allow admittance of net negative (disallowed) IMR in the general account up to 5% of adjusted capital and surplus. The exposed INT proposed restrictions on what is permitted to be captured in the net negative IMR balance eligible for admittance as well as reporting and disclosure requirements.

On June 28, 2023, the Working Group discussed comments received on the exposed INT and directed NAIC staff to incorporate several revisions to the INT. The revised INT reflects the following:

- Requirement for RBC over 300% after adjustment to remove admitted positive goodwill, EDP equipment and operating system software, DTAs and admitted IMR.
- Allowance to admit up to 10% of adjusted capital and surplus – first in the GA, and then if all disallowed IMR in the GA is admitted and the percentage limit is not reached, then to the SA account proportionately between insulated and non-insulated accounts. *(The adjustments are the same that occur for the RBC adjustment and reduce capital and surplus before applying the 10% percentage limit.)*
- There is no exclusion for derivatives losses included in negative IMR if the company can demonstrate historical practice in which realized gains from derivatives were also reversed to IMR (as liabilities) and amortized.
- Inclusion of a new reporting entity attestation.

- Effective date through Dec. 31, 2025, with a note that it could be nullified earlier or extended based on WG actions to establish specific guidance on net negative (disallowed) IMR.
- Application guidance for admitting / recognizing IMR in both the general and separate accounts.

On July 5, 2023, the Working Group exposed via evote the revised INT for a shortened comment period ending July 21, 2023.

On August 13, 2023, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed INT 23-01 which provides optional, limited-time guidance, which allows the admittance of net negative (disallowed) interest maintenance reserve (IMR) up to 10% of adjusted capital and surplus. INT 23-01 is effective through December 31, 2025.

[https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2023/8-13-23 Summer National Meeting/Adoptions/22-19 - Negative IMR.docx](https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National%20Meetings/A.%20National%20Meeting%20Materials/2023/8-13-23%20Summer%20National%20Meeting/Adoptions/22-19%20-%20Negative%20IMR.docx)

Interpretation of the Statutory Accounting Principles (E) Working Group

Net Negative (Disallowed) Interest Maintenance Reserve

INT 23-01 Dates Discussed

April 10, 2023, June 28, 2023, August 13, 2023

INT 23-01 References

Current:

*SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve
Annual Statement Instructions*

INT 23-01 Issue

1. The statutory accounting guidance for interest maintenance reserve (IMR) and the asset valuation reserve (AVR) is within *SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve*, but the guidance within *SSAP No. 7* is very limited. It provides a general description, identifies that IMR/AVR shall be calculated and reported per the guidance in the applicable SSAP, and if not explicit in the SSAP, in accordance with the annual statement instructions. The SSAPs most often simply direct allocation to (or between) IMR and AVR, with the bulk of the guidance residing within the annual statement instructions.

2. As detailed in *SSAP No. 7*, paragraph 2, the guidance for IMR and AVR applies to life and accident and health insurance companies and focuses on IMR and AVR liability recognition and distinguishing between IMR and AVR:

2. Life and accident and health insurance companies shall recognize liabilities for an AVR and an IMR. The AVR is intended to establish a reserve to offset potential credit-related investment losses on all invested asset categories excluding cash, policy loans, premium notes, collateral notes and income receivable. The IMR defers recognition of the realized capital gains and losses resulting from changes in the general level of interest rates. These gains and losses shall be amortized into investment income over the expected remaining life of the investments sold. The IMR also applies to certain liability gains/losses related to changes in interest rates. These gains and losses shall be amortized into investment income over the expected remaining life of the liability released.

3. The IMR guidance in the annual statement instructions provides information on the net balance. A positive IMR represents net interest rate realized gains and is reported as a liability on a dedicated reporting line. A negative disallowed IMR represents net interest rate realized losses and is reported as a miscellaneous other-than-invested write-in asset in the general account and nonadmitted.

4. IMR balances between the general account and separate accounts are separate and distinct. Meaning, a net negative IMR in the general account only represents activity that occurred in the general account that was allocated to IMR. However, the net positive or negative balance of the general account influences how the net positive or negative balances are reported in separate account statements (and vice versa). (A net negative IMR balance in the general account may not be disallowed if there is a covering net positive IMR in the separate account. Negative IMR that is not disallowed is reported as a contra-liability.) The instructions for reporting the net negative and positive balances are detailed in the annual statement instructions:

Line 6 – Reserve as of December 31, Current Year

Record any positive or allowable negative balance in the liability line captioned “Interest Maintenance Reserve” on Page 3, Line 9.4 of the General Account Statement and Line 3 of the Separate Accounts Statement. A negative IMR balance may be recorded as a negative liability in either the General Account or the Separate Accounts Statement of a company only to the extent that it is covered or offset by a positive IMR liability in the other statement.

If there is any disallowed negative IMR balance in the General Account Statement, include the change in the disallowed portion in Page 4, Line 41 so that the change will be appropriately charged or credited to the Capital and Surplus Account on Page 4. If there is any disallowed negative IMR balance in the Separate Accounts Statement, determine the change in the disallowed portion (prior year less current year disallowed portions), and make a direct charge or credit to the surplus account for the “Change in Disallowed Interest Maintenance Reserve” in the write-in line, in the Surplus Account on Page 4 of the Separate Accounts Statement. The following information is presented to assist in determining the proper accounting:

General Account IMR Balance	Separate Account IMR Balance	Net IMR Balance
Positive	Positive	Positive (See rule a)
Negative	Negative	Negative (See rule b)
Positive	Negative	Positive (See rule c)
Positive	Negative	Negative (See rule d)
Negative	Positive	Positive (See rule e)
Negative	Positive	Negative (See rule f)

Rules:

- a. If both balances are positive, then report each as a liability in its respective statement.
- b. If both balances are negative, then no portion of the negative balances is allowable as a negative liability in either statement. Report a zero for the IMR liability in each statement and follow the above instructions for handling disallowed negative IMR balances in each statement.
- c. If the general account balance is positive, the separate accounts balance is negative and the combined net balance is positive, then all of the negative IMR balance is allowable as a negative liability in the Separate Accounts Statement.
- d. If the general account balance is positive, the separate account balance is negative, and the combined net balance is negative, then the negative amount not covered by the positive amount is not allowable. Report only the allowable portion as a negative liability in the Separate Accounts Statement and follow the above instructions for handling the disallowed portion of negative IMR balances in the Separate Accounts Statement.
- e. If the general account balance is negative, the separate account balance is positive, and the combined net balance is positive, then all of the negative IMR balance is allowable as a negative liability in the General Account Statement.
- f. If the general account balance is negative, the separate account balance is positive, and the combined net balance is negative, then the negative amount not covered by the positive amount is not allowable. Report only the allowable portion as a negative liability in the General Account Statement and follow the above instructions for handling the disallowed portion of negative IMR balances in the General Account Statement.

5. In October 2022, the ACLI requested the Statutory Accounting Principles (E) Working Group to reassess the guidance for net negative (disallowed) IMR, with a request to consider admittance of those

amounts. The ACLI noted that the nonadmittance of disallowed negative IMR can have adverse negative ramifications for insurers with two key themes:

- a. In general, rising interest rates are favorable to the financial health of the insurance industry and policyholders. However, with negative IMR, there is an inappropriate perception of decreased financial strength through lower surplus and risk-based capital.
- b. Negative IMR could impact the rating agency view of the industry or incentivize companies to avoid prudent investment transactions that are necessary to avoid mismatches between assets and liabilities. In either scenario, negative IMR encourages short-term non-economic activity that is not in the best long-term interest of a reporting entity's financial health or its policyholders.

6. In considering the request, the Working Group concluded that, for year-end 2022, there would be no change to statutory accounting guidance and deviations from statutory accounting principles would need to be approved via a permitted or prescribed practice. The Working Group then held company-specific educational sessions in January 2023 to receive detailed information regarding negative IMR and received a subsequent comment letter from the ACLI.

7. During the 2023 Spring National Meeting, the Working Group further discussed the topic of negative IMR and directed NAIC staff to proceed with drafting guidance for a 2023 solution and to begin work towards a long-term solution.

INT 23-01 Discussion

8. This interpretation prescribes limited-time, optional, statutory accounting guidance, as an exception to the existing guidance detailed in SSAP No. 7 and the annual statement instructions that requires nonadmittance of net negative (disallowed) IMR as a short-term solution. Specifically, this interpretation impacts the annual statement instruction rules regarding disallowed negative IMR detailed in rules 'b,' 'd' and 'f' shown in paragraph 4.

9. Reporting entities are permitted to admit net negative (disallowed) IMR with the following restrictions:

- a. Reporting entities that qualify pursuant to paragraph 9.b., are permitted to admit net negative (disallowed) IMR up to 10% of the reporting entity's adjusted general account¹ capital and surplus as required to be shown on the statutory balance sheet of the reporting entity for its most recently filed statement with the domiciliary state commissioner. The capital and surplus shall be adjusted to exclude any net positive goodwill, EDP equipment and operating system software, net deferred tax assets and admitted² net negative (disallowed) IMR.
- b. Reporting entities applying this interpretation are required to have a risk-based capital (RBC) greater than 300% authorized control level (ACL) after an adjustment to total adjusted capital (TAC) that reflects a reduction to remove any net positive goodwill, EDP equipment and operating system software, net deferred tax assets and admitted net negative (disallowed) IMR. Compliance with this adjusted RBC calculation shall be affirmed for all

¹ The general account capital and surplus includes surplus reflected in the separate account; therefore, an aggregation of general account and separate account surplus is not necessary.

² As the separate account does not have "admitted" assets, broad reference to "admitted net negative (disallowed) IMR" throughout this interpretation includes what is admitted in the general account and what is recognized as an asset in the separate accounts.

quarterly and annual financial statements for which net negative (disallowed) IMR is reported as an admitted asset in the general account or recognized as an asset in the separate accounts. Reporting entities shall provide documentation to illustrate compliance with this requirement upon state regulator request. Reporting entities with an adjusted RBC calculation of 300% ACL or lower are not permitted to admit net negative (disallowed) IMR in the general account or recognize IMR assets in the separate accounts.

- c. The net negative (disallowed) IMR permitted for admittance shall not include losses from derivatives that were reported at fair value prior to derivative termination³ unless the reporting entity has historically followed the same process for interest-rate hedging derivatives that were terminated in a gain position. In other words, there is a requirement for documented, historical evidence illustrating that unrealized gains from derivatives reported at fair value were reversed to IMR (as a liability) and amortized as part of IMR. Reporting entities that do not have evidence of this past application are required to remove realized losses from derivatives held at fair value from the net negative (disallowed) IMR balance to determine the amount permitted to be admitted. Reporting entities that begin a new process for the use of hedging derivatives, perhaps with a theoretical process to treat derivative losses and derivative gains similarly, but do not have evidence illustrating the historical treatment of derivative gains through IMR are not permitted to include derivative losses in the net negative (disallowed) IMR permitted to be admitted. This evidence is required separately for the general account, insulated separate account and non-insulated separate account if losses from derivatives previously reported at fair value are currently being allocated to IMR in those accounts.
10. Reporting entities that admit net negative (disallowed) IMR shall follow the following process:
 - a. All net negative (disallowed) IMR in the general account shall first be admitted until the capital and surplus percentage limit, as detailed in paragraph 9.a., is reached.
 - b. If all general account net negative (disallowed) IMR has been fully admitted, and the reporting entity is still below the paragraph 9.a. capital and surplus limit, then the reporting entity can report net negative (disallowed) IMR as an asset in the separate accounts. Reporting entities that have both insulated and non-insulated separate accounts shall recognize IMR assets proportionately between the insulated and non-insulated statements until the aggregated amount recognized as an admitted asset in the general account and as an asset in the insulated and non-insulated statements reaches the percentage limit of capital and surplus detailed in paragraph 9.a.
 11. Reporting entities that admit net negative (disallowed) IMR in the general account shall report the admittance in the balance sheet as follows:
 - a. Reporting entities shall report the net negative (disallowed) IMR as an aggregate write-in to miscellaneous other-than-invested assets (line 25) (named as “Admitted Disallowed IMR”) on the asset page. The net negative (disallowed) IMR shall be admitted to the extent permitted per paragraph 9.a., with the remaining net negative (disallowed) IMR balance nonadmitted.
 - b. Reporting entities shall allocate an amount equal to the general account admitted net negative (disallowed) IMR from unassigned funds to an aggregate write-in for special surplus funds (line 34) (named as “Admitted Disallowed IMR”). Although dividends are

³ Reference to derivative termination throughout this interpretation includes all actions that close out a derivative, including, but not limited to, termination, expiration, settlement, or sale.

contingent on state specific statutes and laws, the intent of this reporting is to provide transparency and preclude the ability for admitted negative IMR to be reported as funds available to dividend.

12. Reporting entities that record net negative (disallowed) IMR as an asset in the separate account shall report the recognition in the balance sheet as follows:

- a. Reporting entities shall report the permitted net negative (disallowed) IMR as an aggregate write-in to miscellaneous other-than-invested assets (line 15) (named as “Recognized Disallowed IMR”) on the asset page.
- b. Reporting entities shall allocate an amount from surplus equal to the asset recognized as disallowed IMR as an aggregate write-in for special surplus funds (line 19) (named as “Recognized Disallowed IMR) on the liabilities and surplus page.

13. Reporting entities admitting net negative (disallowed) IMR are required to complete the following disclosures in the annual and quarterly financial statements for IMR:

- a. Reporting entities that have allocated gains/losses to IMR from derivatives that were reported at fair value prior to the termination of the derivative shall disclose the unamortized balances in IMR from these allocations separately between gains and losses.
- b. Reporting entities shall complete a note disclosure that details the following:
 - i. Net negative (disallowed) IMR in aggregate and allocated between the general account, insulated separate account and non-insulated account,
 - ii. Amounts of negative IMR admitted in the general account and reported as an asset in the separate account insulated and non-insulated blank,
 - iii. The calculated adjusted capital and surplus per paragraph 9.a., and
 - iv. Percentage of adjusted capital and surplus for which the admitted net negative (disallowed) IMR represents (including what is admitted in the general account and what is recognized as an asset in the separate account).
- c. Reporting entities shall include a note disclosure that attests to the following statements:
 - i. Fixed income investments generating IMR losses comply with the reporting entity’s documented investment or liability management policies,
 - ii. IMR losses for fixed income related derivatives are all in accordance with prudent and documented risk management procedures, in accordance with a reporting entity’s derivative use plans and reflect symmetry with historical treatment in which unrealized derivative gains were reversed to IMR and amortized in lieu of being recognized as realized gains upon derivative termination.
 - iii. Any deviation to 13.c.i was either because of a temporary and transitory timing issue or related to a specific event, such as a reinsurance transaction, that mechanically made the cause of IMR losses not reflective of reinvestment activities.

- iv. Asset sales that were generating admitted negative IMR were not compelled by liquidity pressures (e.g., to fund significant cash outflows including, but not limited to excess withdrawals and collateral calls).

INT 23-01 Status

14. The consensuses in this interpretation were adopted on August 13, 2023, to provide limited-time exception guidance to SSAP No. 7 and the annual statement instruction for the reporting of net negative (disallowed) IMR. The provisions within this interpretation are permitted as a short-term solution until December 31, 2025, and will be automatically nullified on January 1, 2026.

15. The effective date of this interpretation may be adjusted (nullified earlier or with an extended effective date timeframe) in response to Statutory Accounting Principles (E) Working Group actions to establish statutory accounting guidance specific to net negative (disallowed) IMR.

16. No further discussion is planned.

Application Guidance for Admitting / Recognizing Net Negative (Disallowed) IMRGeneral Account:

1. Net negative IMR in the general account that exceeds net positive IMR in the separate accounts is considered “disallowed” general account IMR. (Determination of the disallowed IMR in the general account shall be compared against the aggregate IMR balance in all separate accounts.)
2. Net negative disallowed IMR in the general account shall be reported as an aggregate write-in for other-than-invested assets as “Admitted Disallowed IMR” on line 25 of the asset page and nonadmitted. The change in nonadmittance shall be reported on line 41 in the summary of operations.
3. To the extent the reporting entity is permitted to admit net negative disallowed IMR pursuant to the provisions in this interpretation, the reporting entity shall admit the disallowed IMR reported on line 25 of the asset page to the extent permitted, with the change in nonadmittance reflected on line 41 in the summary of operations.
4. Reporting entities shall report an amount equal to the general account admitted net negative (disallowed) IMR as an aggregate write-in for special surplus funds (line 34 of the Liabilities, Surplus and Other Funds page) named as “Admitted Disallowed IMR.”
5. Reporting entities shall include note disclosures in the quarterly and annual financial statements as required in paragraph 13 of the interpretation.

Separate Account:

6. Net negative IMR in the separate account (aggregated IMR in both insulated and non-insulated separate accounts) that exceeds net positive IMR in the general account is considered “disallowed” separate account IMR. If the aggregate separate account IMR is positive, with a negative IMR in the insulated separate account and positive IMR in non-insulated separate account (or vice versa), then the negative IMR in the insulated separate account is not permitted to be reported as an asset. In those situations, the separate account has an aggregate positive IMR balance.
7. Net negative (disallowed) IMR in the separate account permitted to be recognized as an asset, as the admittance in the general account did not utilize the full percentage of adjusted capital and surplus permitted within this interpretation, shall be proportionately divided between insulated and non-insulated separate accounts if both separate accounts are in a negative position. If the separate account IMR is an aggregate net negative, but only one separate account blank is in a negative position, then only the separate account blank with a net negative position can recognize disallowed IMR as an asset.
8. If negative IMR in the separate account has previously been recognized as a direct charge to surplus, the reporting entity shall recognize an asset as an aggregate write-in for other-than-invested assets as “Recognized Disallowed IMR” on line 15 of the separate account asset page, with an offsetting credit to surplus. This credit to surplus shall reverse the charge previously recognized. This process shall continue in subsequent quarters if additional separate account IMR is permitted as an asset to the extent IMR was previously taken as a direct charge to surplus. Once prior surplus impacts have been fully eliminated, then the entity shall follow the guidance for new net negative (disallowed) IMR as detailed in the following paragraph. If subsequent quarters result with a decline in the permitted IMR asset in the separate account, then the asset shall be credited with an offsetting charge to surplus.

9. If the reporting entity enters a net negative (disallowed) IMR position (meaning, there has not been a prior charge to surplus for net negative (disallowed) IMR), then the entity shall recognize the asset as an aggregate write-in for other-than-invested assets as “Disallowed IMR” on line 15 of the separate account balance sheet, with an offsetting credit to IMR (line 3 of the liability page) until the IMR liability equals zero. This process shall continue in subsequent quarters if additional net negative IMR is generated from operations and is permitted as an asset under the provisions of this interpretation. If subsequent quarters result with a decline in the permitted IMR asset in the separate account, then the asset shall be credited with an offsetting charge to surplus.
10. Reporting entities shall report an amount equal to the asset recognized reflecting net negative (disallowed) IMR as an aggregate write-in for special surplus funds (line 19) (named as “Recognized Disallowed IMR.” This shall be included in each separate account statement (insulated and non-insulated) if net negative disallowed IMR is recognized as an asset in that statement.
11. Reporting entities shall include note disclosures in the quarterly and annual financial statements as required in paragraph 13 of the interpretation.

**Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A**

Issue: SSAP No. 43R – CLO Financial Modeling

Check (applicable entity):

	P/C	Life	Health
Modification of Existing SSAP	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
New Issue or SSAP	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Interpretation	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Description of Issue: This agenda item proposes revisions to *SSAP No. 43R—Loan-Backed and Structured Securities* to incorporate edits to reflect changes adopted by the Valuation of Securities (E) Task Force on Feb. 21, 2023, to include collateralized loan obligations (CLOs) in the SVO financial modeling process.

This agenda item has been drafted to ensure the financial modeling guidance summarized in *SSAP No. 43R—Loan-Backed and Structured Securities* reflects the practices as directed by the *Purposes and Procedures Manual of the NAIC Investment Analysis Office (P&P Manual)*. (Note, while the *Accounting Practices and Procedures Manual* is higher than the P&P manual in the statutory hierarchy, the primary source of authoritative guidance for financial modeling is the P&P manual. Only a general description of the modeling process is included in SSAP No. 43R). The methodology to model CLOs is still being developed, but guidance that permits the SVO to model CLOs has been adopted and should be followed once CLOs begin to be financially modeled.

Existing Authoritative Literature:

SSAP No. 43R—Loan-Backed and Structured Securities

Designation Guidance

27. For RMBS/CMBS securities within the scope of this statement, the initial NAIC designation used to determine the carrying value method and the final NAIC designation for reporting purposes is determined using a multi-step process or the NAIC designation assigned by the NAIC Securities Valuation Office. The P&P Manual provides detailed guidance. A general description of the processes is as follows:

- a. Financial Modeling: Pursuant to the P&P Manual, the NAIC identifies select securities where financial modeling must be used to determine the NAIC designation. For a modeled legacy security, meaning one which closed prior to January 1, 2013, the NAIC designation is based on financial modeling incorporating the insurers' carrying value. For a modeled non-legacy security, meaning one which closed after December 31, 2012, the NAIC designation and NAIC designation category assigned by the NAIC Securities Valuation Office must be used. For those legacy securities that are financially modeled, the insurer must use NAIC CUSIP specific modeled breakpoints provided by the modelers in determining initial and final designation for these identified securities. As specified in the P&P Manual, a modeled legacy security RMBS or CMBS tranche that has no expected loss, as compiled and published by the NAIC Securities Valuation Office, under any of the selected modeling scenarios would be assigned an NAIC 1 designation and NAIC 1.A designation category regardless of the insurer's book/adjusted carrying value. The three-step process for modeled legacy securities is as follows:
 - i. Step 1: Determine Initial Designation – The current amortized cost (divided by remaining par amount) of a loan-backed or structured security is compared to the modeled breakpoint values assigned to each NAIC designation and NAIC designation category for each CUSIP to establish the **initial** NAIC designation.
 - ii. Step 2: Determine Carrying Value Method – The carrying value method, either the amortized cost method or the lower of amortized cost or fair value method, is then

determined as described in paragraph 26 based upon the initial NAIC designation from Step 1.

- iii. Step 3: Determine Final Designation – The final NAIC designation is determined by comparing the carrying value (divided by remaining par amount) of a security (based on paragraph 27.a.ii.) to the NAIC CUSIP specific modeled breakpoint values assigned to the NAIC designation and NAIC designation category for each CUSIP or is mapped to an NAIC designation category, according to the instructions in the P&P Manual. This final NAIC designation shall be applicable for statutory accounting and reporting purposes and the NAIC designation category will be used for investment schedule reporting and establishing RBC and AVR charges. The final NAIC designation is not used for establishing the appropriate carrying value method in Step 2 (paragraph 27.a.ii.).
- b. All Other Loan-Backed and Structured Securities: For securities not subject to paragraph 27.a. (financial modeling) follow the established designation procedures according to the appropriate section of the P&P Manual. The NAIC designation shall be applicable for statutory accounting and reporting purposes (including determining the carrying value method and establishing the AVR charges). The carrying value method is established as described in paragraph 26.

Specific Interim Reporting Guidance Financially Modeled Securities

28. For securities that will be financially modeled under paragraph 27, the guidance in this paragraph shall be applied in determining the reporting method for such securities acquired in the current year for quarterly financial statements. Securities reported as of the prior-year end shall continue to be reported under the prior-year end methodology for the current-year quarterly financial statements. For year-end reporting, securities shall be reported in accordance with paragraph 27, regardless of the quarterly methodology used.

- a. Reporting entities that acquired the entire financial modeling database for the prior-year end are required to follow the financial modeling methodology (paragraph 27.a.) for all securities acquired in the subsequent year that were included in the financial modeling data acquired for the prior year-end.
- b. Reporting entities that acquired identical securities (identical CUSIP) to those held and financially modeled for the prior year-end are required to follow the prior year-end financial modeling methodology (paragraph 27.a.) for these securities acquired subsequent to year-end.
- c. Reporting entities that do not acquire the prior-year financial modeling information for current-year acquired individual CUSIPS, and are not captured within paragraphs 28.a. or 28.b., are required to follow the analytical procedures for non-financially modeled securities (paragraph 27.b. as appropriate). Reporting entities that do acquire the individual CUSIP information from the prior-year financial modeling database shall use that information for interim reporting.
- d. Reporting entities that acquire securities not previously modeled at the prior year-end are required to follow the analytical procedures for non-financially modeled securities (paragraph 27.b. as appropriate).

SSAP No. 43R - EXHIBIT A – Question and Answer Implementation Guide Index to Questions

Questions 8-10 are specific to securities subject to the financial modeling process. (This process is limited to qualifying RMBS/CMBS securities reviewed by the NAIC Structured Securities Group.) The guidance in questions 8-10 shall not be inferred to other securities in scope of SSAP No. 43R.	
8	Do LBSS purchased in different lots result in a different NAIC designation for the same CUSIP? Can reporting entities use a weighted average method determined on a legal entity basis?
9	The NAIC Designation process for LBSS may incorporate loss expectations that differ from the reporting entity's expectations related to OTTI conclusions. Should the reporting entities be required

	to incorporate recovery values obtained from data provided by the service provider used for the NAIC Designation process for impairment analysis as required by SSAP No. 43R?
10	For companies that have separate accounts, can the NAIC designation be assigned based upon the total legal entity or whether it needs to be calculated separately for the general account and the total separate account?

8. Question – Do LBSS purchased in different lots result in a different NAIC designation for the same CUSIP? Can reporting entities use a weighted average method determined on a legal entity basis?

8.1 Under the financial modeling process (applicable to qualifying RMBS/CMBS reviewed by the NAIC Structured Securities Group), the amortized cost of the security impacts the “final” NAIC designation used for reporting and RBC purposes. As such, securities subject to the financial modeling process acquired in different lots can result in a different NAIC designation for the same CUSIP. In accordance with the current instructions for calculating AVR and IMR, reporting entities are required to keep track of the different lots separately, which means reporting the different designations. For reporting purposes, if a SSAP No. 43R security (by CUSIP) has different NAIC designations by lot, the reporting entity shall either 1) report the aggregate investment with the lowest applicable NAIC designation or 2) report the investment separately by purchase lot on the investment schedule. If reporting separately, the investment may be aggregated by NAIC designation. (For example, all acquisitions of the identical CUSIP resulting with an NAIC 1 designation may be aggregated, and all acquisitions of the identical CUSIP resulting with an NAIC 3 designation may be aggregated.)

9. Question – The NAIC Designation process for LBSS subject to the financial modeling process may incorporate loss expectations that differ from the reporting entity’s expectations related to OTTI conclusions. Should the reporting entities be required to incorporate recovery values obtained from data provided by the service provider used for the NAIC Designation process for impairment analysis as required by SSAP No. 43R?

9.1 In accordance with *INT 06-07: Definition of Phrase “Other Than Temporary,”* reporting entities are expected to “consider all available evidence” at their disposal, including the information that can be derived from the NAIC designation.

10. Question - For companies that have separate accounts, can the NAIC designation be assigned based upon the total legal entity or whether it needs to be calculated separately for the general account and the total separate account?

10.1 The financial modeling process for qualifying RMBS/CMBS securities is required for applicable securities held in either the general or separate account.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups):

The following edits have previously been reflected in the financial modeling guidance:

- Agenda Item 2018-19: To be consistent with the prior SVO P&P Manual revisions, eliminated the multi-step designation guidance for modified filing exempt (MFE) securities. The elimination of MFE was effective March 31, 2019, with early application permitted for year-end 2018. With the elimination of MFE, for securities that are filing exempt, the NAIC designation reported will correspond to the Credit Rating Provider (CRP) rating without adjustment based on carrying value.
- Agenda Item 2018-03: Clarified that securities acquired in lots shall not be reported with weighted average designations. With the adopted guidance, if a SSAP No. 43R security (by CUSIP) has different NAIC designations by lot, the reporting entity shall either 1) report the aggregate investment with the lowest applicable NAIC designation or 2) report the investment separately by purchase lot on the investment schedule. If reporting separately, the investment may be aggregated by NAIC designation. With the

elimination of MFE, the instances of different designations by lot are not expected to be prevalent, but could still occur with the financial modeling process for residential mortgage backed securities (RMBS) and commercial mortgage backed securities (CMBS).

- Agenda Item 2020-21: Edits incorporated adopted guidance to the P&P manual detailing the use and mapping of NAIC designations to NAIC designation categories. Reporting entities were to then utilize the new NAIC designation categories for accounting and reporting purposes.
- Agenda Item 2021-23: Adopted changes to summarize the financial modeling guidance in SSAP No. 43R. This guidance continues to refer users to the detailed financial modeling guidance in the P&P Manual.

Information or issues (included in *Description of Issue*) not previously contemplated by the Working Group:
None

Convergence with International Financial Reporting Standards (IFRS): Not Applicable

Staff Recommendation: NAIC staff recommends that the Working Group move this item to the active listing, categorized as a SAP clarification, and expose revisions to *SSAP No. 43R—Loan-backed and Structured Securities* to incorporate changes to add CLOs to the financial modeling guidance and to clarify that CLOs are not captured as legacy securities. These revisions reflect the guidance adopted for the P&P Manual in February 2023.

Proposed Revisions to *SSAP No. 43R—Loan-Backed and Structured Securities*

Designation Guidance

27. For [Residential Mortgage-Backed Securities \(RMBS\)](#), [Commercial Mortgage-Backed Securities \(CMBS\)](#) and [Collateralized Loan Obligations \(CLOs\)](#), ~~RMBS/CMBS~~ securities within the scope of this statement, the initial NAIC designation used to determine the carrying value method and the final NAIC designation for reporting purposes is determined using a multi-step process or the NAIC designation assigned by the NAIC Securities Valuation Office. The P&P Manual provides detailed guidance. A general description of the processes is as follows:
 - a. Financial Modeling: Pursuant to the P&P Manual, the NAIC identifies select securities where financial modeling must be used to determine the NAIC designation. For a modeled [RMBS/CMBS](#) legacy security, meaning one which closed prior to January 1, 2013, the NAIC designation is based on financial modeling incorporating the insurers' carrying value. For a modeled [RMBS/CMBS](#) non-legacy security, meaning one which closed after December 31, 2012, [or modeled CLO](#) the NAIC designation and NAIC designation category assigned by the NAIC Securities Valuation Office must be used. For those [RMBS/CMBS](#) legacy securities that are financially modeled, the insurer must use NAIC CUSIP specific modeled breakpoints provided by the modelers in determining initial and final designation for these identified securities. As specified in the P&P Manual, a modeled legacy security RMBS or CMBS tranche that has no expected loss, as compiled and published by the NAIC Securities Valuation Office, under any of the selected modeling scenarios would be assigned an NAIC 1 designation and NAIC 1.A designation category regardless of the insurer's book/adjusted carrying value. The three-step process for modeled [RMBS/CMBS](#) legacy securities is as follows:
 - i. Step 1: Determine Initial Designation – The current amortized cost (divided by remaining par amount) of a loan-backed or structured security is compared to the modeled breakpoint values assigned to each NAIC designation and NAIC designation category for each CUSIP to establish the initial NAIC designation.

- ii. Step 2: Determine Carrying Value Method – The carrying value method, either the amortized cost method or the lower of amortized cost or fair value method, is then determined as described in paragraph 26 based upon the initial NAIC designation from Step 1.
 - iii. Step 3: Determine Final Designation – The final NAIC designation is determined by comparing the carrying value (divided by remaining par amount) of a security (based on paragraph 27.a.ii.) to the NAIC CUSIP specific modeled breakpoint values assigned to the NAIC designation and NAIC designation category for each CUSIP or is mapped to an NAIC designation category, according to the instructions in the P&P Manual. This final NAIC designation shall be applicable for statutory accounting and reporting purposes and the NAIC designation category will be used for investment schedule reporting and establishing RBC and AVR charges. The final NAIC designation is not used for establishing the appropriate carrying value method in Step 2 (paragraph 27.a.ii.).
- b. All Other Loan-Backed and Structured Securities: For securities not subject to paragraph 27.a. (financial modeling) follow the established designation procedures according to the appropriate section of the P&P Manual. The NAIC designation shall be applicable for statutory accounting and reporting purposes (including determining the carrying value method and establishing the AVR charges). The carrying value method is established as described in paragraph 26.

Specific Interim Reporting Guidance Financially Modeled Securities

28. For securities that will be financially modeled under paragraph 27, the guidance in this paragraph shall be applied in determining the reporting method for such securities acquired in the current year for quarterly financial statements. Securities reported as of the prior-year end shall continue to be reported under the prior-year end methodology for the current-year quarterly financial statements. For year-end reporting, securities shall be reported in accordance with paragraph 27, regardless of the quarterly methodology used.

- a. Reporting entities that acquired the entire financial modeling database for the prior-year end are required to follow the financial modeling methodology (paragraph 27.a.) for all securities acquired in the subsequent year that were included in the financial modeling data acquired for the prior year-end.
- b. Reporting entities that acquired identical securities (identical CUSIP) to those held and financially modeled for the prior year-end are required to follow the prior year-end financial modeling methodology (paragraph 27.a.) for these securities acquired subsequent to year-end.
- c. Reporting entities that do not acquire the prior-year financial modeling information for current-year acquired individual CUSIPS, and are not captured within paragraphs 28.a. or 28.b., are required to follow the analytical procedures for non-financially modeled securities (paragraph 27.b. as appropriate) [until the current year financial modeling information becomes available and then follow the procedures for financially modeled securities \(paragraph 27.a., as appropriate\)](#). Reporting entities that do acquire the individual CUSIP information from the prior-year financial modeling database shall use that information for interim reporting.
- d. Reporting entities that acquire securities not previously modeled at the prior year-end are required to follow the analytical procedures for non-financially modeled securities (paragraph 27.b. as appropriate) [until the current year financial modeling information becomes available and then follow the procedures for financially modeled securities \(paragraph 27.a., as appropriate\)](#).

Staff Review Completed by: Julie Gann, NAIC Staff – February 2023

Status:

On March 22, 2023, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a SAP clarification, and exposed revisions to SSAP No. 43R to incorporate changes to add CLOs to the financial modeling guidance and to clarify that CLOs are not captured as legacy securities.

On August 13, 2023, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed revisions, as illustrated above, to SSAP No. 43R which incorporate changes to add collateralized loan obligations (CLOs) to the financial modeling guidance and to clarify that CLOs are not captured as legacy securities.

[https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2023/8-13-23 Summer National Meeting/Adoptions/23-02 - 43R - CLO FM.docx](https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National%20Meetings/A.%20National%20Meeting%20Materials/2023/8-13-23%20Summer%20National%20Meeting/Adoptions/23-02%20-%2043R%20-%20CLO%20FM.docx)

**Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A**

Issue: ASU 2022-06, Reference Rate Reform (Topic 848), Deferral of the Sunset Date of Topic 848

Check (applicable entity):

	P/C	Life	Health
Modification of Existing SSAP	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
New Issue or SSAP	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Interpretation	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Description of Issue:

The Financial Accounting Standards Board (FASB) issued *ASU 2022-06, Reference Rate Reform (Topic 848), Deferral of the Sunset Date of Topic 848* to extend the sunset date of the reference rate reform guidance that was included in *ASU 2020-04, Reference Rate Reform (Topic 848) Facilitation of the Effects of Reference Rate Reform on Financial Reporting* and *ASU 2021-01, Reference Rate Reform (Topic 848), Scope*.

As background, reference rate reform refers to the transition away from referencing the London Interbank Offered Rate (LIBOR), and other interbank offered rates (IBORs), and moving toward alternative reference rates that are more observable or transaction based. In July 2017, the governing body responsible for regulating LIBOR announced it would no longer require banks to continue rate submissions after 2021 – thus, likely sunsetting both the use and publication of LIBOR. An important item to note is that while LIBOR is the primary interbank offering rate, other similar rates are potentially affected by reference rate reform. For simplicity, LIBOR will be the sole IBOR referenced throughout this agenda item.

With a significant number of financial contracts referencing LIBOR, its discontinuance will require organizations to reevaluate and modify any contract which does not contain a substitute reference rate. A large volume of contracts and other arrangements, such as debt agreements, lease agreements, and derivative instruments, will likely need to be modified to replace all references of interbank offering rates that are expected to be discontinued. While operational, logistical, and legal challenges exist due to the sheer volume of contracts that will require modification, accounting challenges were presented as contract modifications typically require an evaluation to determine whether the modifications result in the establishment of a new contract or the continuation of an existing contract. As is often the case, a change to the critical terms (including reference rate modifications) typically requires remeasurement of the contract, or in the case of a hedging relationship, a dedesignation of the transaction.

To address ASU 2020-04 the Working Group issued *INT 20-01: Reference Rate Reform*, and this interpretation was then revised to incorporate guidance from ASU 2021-01. This agenda item intends to again revise INT 20-01 to include the revised sunset date of December 31, 2024.

Existing Authoritative Literature:

The Working Group adopted INT 20-01 to address ASU 2020-04, and further revised that interpretation to address ASU 2021-01. The modifications in ASU 2020-04 address hedge accounting and the allowance for a reporting entity to change the reference rate and other critical terms related to reference rate reform without having to dedesignate the hedging relationship. Alternative benchmark interest rates were previously addressed in agenda item 2018-46 – Benchmark Interest Rate.

ASU 2021-01 increased the scope of the optional, expedient accounting guidance for derivative instruments in ASU 2020-04 which would primarily affect *SSAP No. 86—Derivatives*. While detailed in the original agenda item (Ref #2020-12), additional SSAPs impacted by ASU 2020-04 were *SSAP No. 15—Debt and Holding Company Obligations* and *SSAP No. 22R—Leases*.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups):

The Working Group has taken several actions related to reference rate reform; each are summarized below.

1. Agenda item 2018-46 – Benchmark Interest Rate, incorporated revisions to SSAP No. 86, adding the Securities Industry and Financial Markets (SIFMA) Municipal Swap Rate and the Secured Overnight Financing Rate (SOFR) Overnight Index Swap (OIS) Rate as acceptable benchmark interest rates for hedge accounting. Prior to this change, only LIBOR and the Fed Funds Effective Swap Rate (also referred to as the Overnight Index Swap Rate) were considered acceptable benchmark interest rates.
2. Agenda item 2020-12 reviews ASU 2020-04, the foundation of which this agenda item and related ASU (2021-01) are based. Agenda item 2020-12 resulted in the Working Group adopting INT 20-01.
3. *INT 20-01: ASU 2020-04 - Reference Rate Reform*, adopted by the Working Group in April 2020, broadly adopted ASU 2020-04 for statutory accounting stating that for statutory accounting:
 - For all contracts within scope of ASU 2020-04, modifications due to reference rate reform are afforded an optional expedient to be accounted for as a continuation of the existing contract.
 - Debt and service agreement modifications, as a result of reference rate reform, should not typically rise to the level of requiring a reversal and rebooking of the liability, as *SSAP No. 15—Debt and Holding Company Obligations* states such liabilities should only be derecognized if extinguished.
 - Lease modifications, solely caused by reference rate reform and ones eligible for optional expedience, likely do not rise to the level of a modification requiring re-recognition as a new lease under *SSAP No. 22R—Leases*.
 - For derivative transactions within scope of ASU 2020-04, a change to the critical terms of the hedging relationship (due to reference rate reform), shall be afforded similar treatment in that the hedging relationship can continue the original hedge accounting rather than dedesignate the hedging relationship.
4. *INT 20-09: Basis Swaps as a Result of the LIBOR Transition*, adopted by the Working Group in July 2020, provided statutory accounting and reporting guidance for basis swaps issued by CCPs. This INT designated that basis swaps, issued by CCPs, in response to reference rate reform (i.e., the discounting transition), shall be classified as a derivative used for hedging. This categorization allowed for the basis swap derivatives to be admitted under SSAP No. 86. Additionally, the INT directed that basis swap derivatives shall not be reported as “effective” unless the instrument qualifies, with the required documentation, as highly effective under SSAP No. 86.
5. Agenda item 2021-09 further revised INT 20-01 and increased the scope of the optional, expedient accounting guidance for derivative instruments in ASU 2020-04.

Information or issues (included in *Description of Issue*) not previously contemplated by the Working Group:
None

Convergence with International Financial Reporting Standards (IFRS): None

Staff Recommendation:

NAIC staff recommends that the Working Group move this item to the active listing, categorized as SAP clarification and expose temporary (optional) expedient and exception interpretative guidance, to revise the expiration date of the guidance in *INT 20-01: ASU 2020-04 & 2021-01 - Reference Rate Reform* to be December 31, 2024.

The proposed modifications to INT 20-01 temporarily override SSAP No. 15, SSAP No. 22R and SSAP No. 86 guidance, therefore the policy statement in Appendix F requires 2/3rd (two-thirds) of the Working Group members to be present and voting and a supermajority of the Working Group members present to vote in support of the interpretation before it can be finalized.

Staff Review Completed by: Jake Stultz—February 2023

Status:

On March 22, 2023, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a SAP clarification, and exposed temporary (optional) expedient and exception interpretative guidance, to revise the expiration date of the guidance in *INT 20-01: 2020-04, 2021-01 & 2022-06 - Reference Rate Reform* to be December 31, 2024, as reflected in INT 20-01.

On August 13, 2023, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed revisions, as reflected in *INT 20-01: ASUs 2020-04, 2021-01 & 2022-06 - Reference Rate Reform* which revises expiration date of the interpretation to December 31, 2024.

<https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/NationalMeetings/A.NationalMeetingMaterials/2023/8-13-23SummerNationalMeeting/Adoptions/23-05a-ASU2022-06-LIBOR.docx>

Interpretation of the Statutory Accounting Principles (E) Working Group

INT 20-01: ~~ASUs 2020-04, & 2021-01~~ ASUs 2020-04, 2021-01 & 2022-06 – Reference Rate Reform

INT 20-01 Dates Discussed

March 26, 2020; April 15, 2020; March 15, 2021, May 20, 2021, [March 22, 2023](#), [August 13, 2023](#)

INT 20-01 References

Current:

SSAP No. 15—Debt and Holding Company Obligations

SSAP No. 22R—Leases

SSAP No. 86—Derivatives

This INT applies to all SSAPs with contracts within scope of ASU 2020-04, which allows for modifications due to reference rate reform and provides for the optional expedient to be accounted for as a continuation of the existing contract.

INT 20-01 Issue

1. This interpretation has been issued to provide statutory accounting and reporting guidance for the adoption with modification of *ASU 2020-04, Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting*, ~~and ASU 2021-01, Reference Rate Reform (Topic 848)~~, and ASU 2022-06, Reference Rate Reform (Topic 848) for applicable statutory accounting principles. The Financial Accounting Standards Board (FASB) issued ~~both~~ ASU 2020-04, ~~and~~ ASU 2021-01 and ASU 2022-06 to provide optional, transitional and expedient guidance as a result of reference rate reform.
2. “Reference rate reform” typically refers to the transition away from referencing the London Interbank Offered Rate (LIBOR), and other interbank offered rates (IBORs), and moving toward alternative reference rates that are more observable or transaction based. In July 2017, the governing body responsible for regulating LIBOR announced it will no longer require banks to continue LIBOR submissions after 2021 – likely sunseting both the use and publication of LIBOR. An important note is that while LIBOR is the primary interbank offering rate, other similar rates are potentially affected by reference rate reform.
3. With a significant number of financial contracts solely referencing IBORs, their discontinuance will require organizations to reevaluate and modify any contract that does not contain a substitute reference rate. A large volume of contracts and other arrangements, such as debt agreements, lease agreements, and derivative instruments, will likely need to be modified to replace all references of interbank offering rates that are expected to be discontinued. While operational, logistical, and legal challenges exist due to the sheer volume of contracts that will require modification, accounting challenges were presented as contract modifications typically require an evaluation to determine whether the modifications result in the establishment of a new contract or the continuation of an existing contract. As is often the case, a change to the critical terms (including reference rate modifications) typically requires remeasurement of the contract, or in the case of a hedging relationship, a dedesignation of the transaction.
4. The overall guidance in ASU 2020-04 is that a qualifying modification (as a result of reference rate reform) should not be considered an event that requires contract remeasurement at the modification date or reassessment of a previous accounting determination. FASB concluded that as reference rate changes are a market-wide initiative, one that is required primarily due to the discontinuance of LIBOR, it is outside the control of an entity and is the sole reason compelling an entity to make modifications to contracts or hedging strategies. As such, FASB determined that the traditional financial reporting requirements of discontinuing such contracts and treating the modified contract as an entirely new contract or hedging relationship would 1) not provide decision-useful information to financial statement users and 2) require a reporting entity to incur significant costs in the financial

statement preparation and potentially reflect an adverse financial statement impact, one of which may not accurately reflect the intent or economics of a modification to a contract or hedging transaction.

5. Guidance in ASU 2020-04 allows a method to ensure that the financial reporting results would continue to reflect the intended continuation of contracts and hedging relationships during the period of the market-wide transition to alternative reference rates – thus, generally not requiring remeasurement or dedesignation if certain criteria are met.

6. Guidance in ASU 2021-01 expanded the scope of ASU 2020-04 by permitting the optional, transitional, expedient guidance to also include derivative contracts that undergo a similar transition but do not specifically reference a rate that is expected to be discontinued. While these contract modifications do not reference LIBOR (or another reference rate expected to be discontinued), the changes are the direct result of reference rate reform and were deemed to be eligible for similar exception treatment. ASU 2021-01 allows for modifications in interest rates indexes used for margining, discounting or contract price alignment, as a result of reference rate reform initiatives (commonly referred to as a “discounting transition”) to be accounted for as a continuation of the existing contract and hedge accounting. [On August 13, 2023, the Working Group added the guidance in ASU 2022-06 which only acts to defer the sunset date of Topic 848 from December 31, 2022, to December 31, 2024, after which entities will no longer be permitted to apply the relief from the prior ASUs.](#)

7. The optional, expedient and exceptions guidance provided by the amendments in ASU 2020-04, ~~and~~ ASU 2021-01 ~~and ASU 2022-04~~ are applicable for all entities. However, they are only effective as of March 12, 2020 through December 31, ~~2024~~2022. This is because the amendments are intended to provide relief related to the accounting requirements in generally accepted accounting principles (GAAP) due to the effects of the market-wide transition away from IBORs. The relief provided by the amendments is temporary in its application in alignment with the expected market transition period. However, the FASB will monitor the market-wide IBOR transition to determine whether future developments warrant any changes, including changes to the end date of the application of the amendments in this ASU. If such an update occurs, the Working Group may also consider similar action. It is not expected that the Working Group will take action prior to or in the absence of a FASB amendment.

8. The accounting issues are:

- a. Issue 1: Should a reporting entity interpret the guidance in ASU 2020-04 as broadly accepted for statutory accounting?
- b. Issue 2: Should the optional, expedient and exception guidance in ASU 2020-04 apply to debt and other service agreements addressed in SSAP No. 15?
- c. Issue 3: Should the optional, expedient and exception guidance in ASU 2020-04 apply to lease transactions addressed in SSAP No. 22R?
- d. Issue 4: Should the optional, expedient and exception guidance in ASU 2020-04 apply to derivative transactions addressed in SSAP No. 86?
- e. Issue 5: Should the optional, expedient and exception guidance in ASU 2021-01 apply to derivative transactions addressed in SSAP No. 86?

INT 20-01 Discussion

9. For Issue 1, the Working Group came to the consensus that ASU 2020-04 shall be adopted, to include the same scope of applicable contracts or transactions for statutory accounting with the only modification related to a concept not utilized by statutory accounting, as noted below. The Working Group agreed the amendments provide appropriate temporary guidance that alleviate the following concerns due to reference rate reform:

- a. Simplifies accounting analyses under current GAAP and statutory accounting principles (SAP) for contract modifications.

- i. All contracts within scope of ASU 2020-04, which allows for modifications due to reference rate reform and provides for the optional expedient to be accounted for as a continuation of the existing contract.
- b. Allows hedging relationships to continue without dedesignation upon a change in certain critical terms.
- c. Allows a change in the designated benchmark interest rate to a different eligible benchmark interest rate in a fair value hedging relationship.
- d. Suspends the assessment of certain qualifying conditions for fair value hedging relationships for which the shortcut method for assuming perfect hedge effectiveness is applied.
- e. Simplifies or temporarily suspends the assessment of hedge effectiveness for cash flow hedging relationships.
- f. The only SAP modification to this ASU is related to the option to sell debt currently classified held-to-maturity. This concept is not employed by statutory accounting and thus is not applicable.

10. For Issue 2, the Working Group came to the consensus that debt and service agreement modifications, as a result of reference rate reform, should not typically rise to the level of requiring a reversal and rebooking of the liability, as SSAP No. 15 states such liabilities should only be derecognized if extinguished. A reference rate modification should not generally require de-recognition and re-recognition under statutory accounting. Nonetheless, for clarity and consistency with ASU 2020-04, the Working Group came to the consensus that should an eligible contract be affected by reference rate reform, then the temporary guidance in ASU 2020-04 shall apply.

11. For Issue 3, the Working Group came to the consensus that lease modifications, solely caused by reference rate reform and ones eligible for optional expedience, likely do not rise to the level of a modification requiring re-recognition as a new lease under statutory accounting. SSAP No. 22R, paragraph 17 states only modifications in which grant the lessee additional rights shall be accounted for as a new lease. These changes are outside the scope allowed for optional expedience in ASU 2020-04. Nonetheless, for clarity and consistency with ASU 2020-04, the Working Group came to a consensus that if an eligible lease affected by reference rate reform, then the temporary guidance in ASU 2020-04 shall apply.

12. For Issue 4, the Working Group came to the consensus that ASU 2020-04 shall be applied to derivative transactions as the following considerations provided in the ASU are appropriate for statutory accounting:

- a. For any hedging relationship, upon a change to the critical terms of the hedging relationship, allow a reporting entity to continue hedge accounting rather than dedesignate the hedging relationship.
- b. For any hedging relationship, upon a change to the terms of the designated hedging instrument, allow an entity to change its systematic and rational method used to recognize the excluded component into earnings and adjust the fair value of the excluded component through earnings.
- c. For fair value hedges, allow a reporting entity to change the designated hedged benchmark interest rate and continue fair value hedge accounting.
- d. For cash flow hedges, adjust the guidance for assessment of hedge effectiveness to allow an entity to continue to apply cash flow hedge accounting.

13. For Issue 5, the Working Group came to a consensus on May 20, 2021, that ASU 2021-01 shall be applied to derivative transactions for statutory accounting. Accordingly, derivative instruments that are modified to change the reference rate used for margining, discounting, or contract price alignment that is a result of reference rate reform (regardless of whether the reference rate that is expected to be discontinued) are eligible for the exception

guidance afforded in ASU 2020-04 in that such a modification is not considered a change in the critical terms that would require dedesignation of the hedging relationship. In addition, for all derivatives (those qualifying for hedge accounting, those that do not qualify for hedge accounting and replication (synthetic asset) transactions (RSAT)), a reporting entity may account for and report modifications (that are within the scope of INT 20-01) as a continuation of the existing contract even when the legal form of the modification is a termination of the original contract and its replacement with a new reference rate reform contract. This includes in-scope modifications of centrally cleared swap contracts whether they are automatically transitioned at a cessation date or voluntarily executed prior to cessation.

14. Additionally, for GAAP purposes, if an entity has not adopted the amendments in *ASU 2017-12, Derivatives and Hedging*, it is precluded from being able to utilize certain expedients for hedge accounting. For statutory accounting purposes, only the hedge documentation requirements were adopted from ASU 2017-12, while the remainder of the items are pending statutory accounting review. The Working Group concluded that all allowed expedient methods are permitted as elections for all reporting entities under statutory accounting. However, if a reporting entity is a U.S. GAAP filer, the reporting entity may only make elections under ASU 2017-12 if such elections were also made for their U.S. GAAP financials.

INT 20-01 Status

15. ~~No further~~Further discussion is planned.

<https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/NationalMeetings/A.NationalMeetingMaterials/2023/8-13-23SummerNationalMeeting/Adoptions/23-05b-INT20-01-ReferenceRateReform.docx>

**Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A**

Issue: Additional Updates on ASU 2021-10, Government Assistance

Check (applicable entity):

	P/C	Life	Health
Modification of Existing SSAP	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
New Issue or SSAP	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Interpretation	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Description of Issue:

On August 10, 2022, the Statutory Accounting Principles (E) Working Group adopted, revisions to *SSAP No. 24—Discontinued Operations and Unusual or Infrequent Items* in agenda item 2022-04: ASU 2021-10, Government Assistance. The revisions incorporate certain disclosures, adopted with modification from ASU 2021-10, to supplement existing disclosures regarding unusual or infrequent items.

This agenda item is to provide additional clarifications to SSAP No. 24, regarding follow-up questions, that NAIC staff received regarding the adoption of the disclosures about government assistance in ASU 2021-10. The primary questions were regarding whether the adoption with modification of the ASU disclosures intended to allow insurers to use the grant and contribution model. If the intent was not to allow for the use of the grant and contribution model, then the question becomes in what situation would these disclosures be required. Because NAIC staff understanding is that the grant and contribution model is not intended to be permitted for statutory accounting, additional modifications to clarify this point have been proposed which reject ASU 2021-10 but still incorporate government assistance disclosures.

In November 2021, the Financial Accounting Standards Board (FASB) issued *Accounting Standards Update (ASU) 2021-10, Government Assistance, Disclosures by Business Entities about Government Assistance* to increase financial statement transparency regarding certain types of government assistance by increasing the disclosure of such information in the notes to the financial statements.

The new disclosure aims to increase transparency by enhancing the identification of 1) the types of assistance received, 2) an entity's accounting for said assistance, and 3) the effects of the assistance in an entity's financial statements. The disclosures will contain information about the nature of the transactions, which includes a general description of the transaction and identification of the form (cash or other) in which the assistance was received. In terms of the effects on the financial statement, disclosure will include identification of the specific line items in both the balance sheet and income statement and a description of the extent to which they have been impacted by any government assistance. In addition, an entity will be required to disclose information about any significant terms of the transaction with a government entity, with items including durations of such agreements and any provisions for potential recapture.

ASU 2021-10 defines "government assistance," in a comprehensive manner to capture most types of assistance from governmental entities and includes examples of tax credits, cash grants, or grants of other assets. ASU 2021-10 does not apply to not-for-profit entities or benefit plans, and only applies to government assistance transactions analogizing either a grant or contribution model.

With the specificity of these additional disclosures only applying in certain circumstances (only applicable in cases where the government assistance is not accounted for in accordance with other accounting standards – i.e., revenue in the normal course of business or debt), NAIC staff believe the occurrence of such items requiring disclosure per ASU 2021-10 will likely be relatively infrequent.

NAIC Staff Note – as mentioned above, NAIC staff believe that as these additional disclosures are not applicable for transactions that are in scope of other accounting standards, and only apply when the transaction is accounted for by analogy using the grant or contribution model, the prevalence of such items will be infrequent. As such, the most appropriate location for these items is reflected in SSAP No. 24.

Existing Authoritative Literature:

The following revisions were adopted to *SSAP No. 24—Discontinued Operations and Unusual or Infrequent Items* in agenda item 2022-04

Disclosures [Unusual/Infrequent Items]

16. The nature, including a general description of the transactions, and financial effects of each unusual or infrequent event or transaction shall be disclosed in the notes to the financial statements. Gains or losses of a similar nature that are not individually material shall be aggregated. This disclosure shall include the line items which have been affected by the event or transaction considered to be unusual and/or infrequent. If the unusual or infrequent item is as the result of government assistance (as defined in ASU 2021-10, Government Assistance, Disclosures by Business Entities about Government Assistance) disclosure shall additionally include the form in which the assistance has been received (for example, cash or other assets), and information regarding significant terms and conditions of the transaction, with items including, to the extent applicable, the duration or period of the agreement, and commitments made by the reporting entity, provisions for recapture, or other contingencies.

Relevant Literature

24. This statement adopts ASU 2021-10, Government Assistance: Disclosure by Business Entities about Government Assistance, with modification to require disclosure by all entity types.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups):

Agenda item 2022-04: ASU 2021-10, Government Assistance was adopted on August 10, 2022.

Information or issues (included in *Description of Issue*) not previously contemplated by the Working Group:

None.

Convergence with International Financial Reporting Standards (IFRS): None.

Staff Review Completed by: Robin Marcotte – NAIC Staff

Staff Recommendation: NAIC staff recommends that the Working Group move this item to the active listing, categorized as a SAP clarification, and expose revisions to SSAP No. 24 as illustrated below. These revisions will clarify the rejection of ASU 2021-10, Government Assistance and the incorporation of disclosures regarding government assistance.

17. The nature, including a general description of the transactions, and financial effects of each unusual or infrequent event or transaction shall be disclosed in the notes to the financial statements. Gains or losses of a similar nature that are not individually material shall be aggregated. This disclosure shall include the line items which have been affected by the event or transaction considered to be unusual and/or infrequent. If the unusual or infrequent item is as the result of government assistance, ~~(as defined in ASU 2021-10, Government Assistance, Disclosures by Business Entities about Government Assistance)~~ disclosure shall additionally include the form in which the assistance has been received (for example, cash or other assets), and information regarding significant terms and conditions of the transaction, with items including, to the extent applicable, the duration or period of the agreement, and commitments made by the reporting entity, provisions for recapture, or other contingencies.

Relevant Literature

24. This statement ~~adopts~~ rejects ASU 2021-10, *Government Assistance: Disclosure by Business Entities about Government Assistance*. However, it does incorporate general disclosures about government assistance for all reporting entity types. ~~, with modification to require disclosure by all entity types.~~

Status:

On March 22, 2023, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a SAP clarification, and exposed revisions to SSAP No. 24 to specify rejection of ASU 2021-10, *Government Assistance* but that the statutory guidance does incorporate general disclosures regarding government assistance for all entity types.

On August 13, 2023, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed revisions, as illustrated above, to SSAP No. 24 which specifies the rejection of ASU 2021-10 but incorporates general disclosures regarding government assistance for all entity types.

<https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/NationalMeetings/A.NationalMeetingMaterials/2023/8-13-23SummerNationalMeeting/Adoptions/23-06-ASU2021-10GovtAssistance.docx>

**Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A**

Issue: ASU 2019-08, Codification Improvements to Topic 718 and Topic 606

Check (applicable entity):

	P/C	Life	Health
Modification of existing SSAP	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
New Issue or SSAP	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Interpretation	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Description of Issue: In November 2019, FASB issued *ASU 2019-08 Compensation—Stock Compensation (Topic 718) and Revenue from Contracts with Customers (Topic 606): Codification Improvements—Share-Based Consideration Payable to a Customer*, which includes amendments to Topics 718 and 606. The changes to Topic 718 include share-based payment transactions for acquiring goods and services from nonemployees and in doing so superseded guidance in Subtopic 505-50, *Equity—Equity-Based Payments to Non-Employees*. The changes to Topic 606 expand the scope of the codification to include share-based payment awards granted to a customer in conjunction with selling goods or services.

The amendments in ASU 2019-08 require that an entity measure and classify share-based payment awards granted to a customer by applying the guidance in Topic 718. The amount recorded as a reduction of the transaction price is required to be measured on the basis of the grant-date fair value of the share-based payment award in accordance with Topic 718. The grant date is the date at which a grantor (supplier) and a grantee (customer) reach a mutual understanding of the key terms and conditions of a share-based payment award. The classification and subsequent measurement of the award are subject to the guidance in Topic 718 unless the share-based payment award is subsequently modified and the grantee is no longer a customer.

For statutory accounting assessments, prior U.S. GAAP guidance related to share-based payments has been predominantly adopted with modification in *SSAP No. 104R—Share-Based Payments*. Statutory accounting modifications to the U.S. GAAP guidance have mostly pertained to statutory terms and concepts. (For example, statutory reporting lines, nonadmittance of prepaid assets, etc.)

Existing Authoritative Literature:

Stock Compensation is covered by *SSAP No. 104R—Share-Based Payments* and *SSAP No. 95—Nonmonetary Transactions*.

The ASUs related to ASC Topic 606 have been rejected in *SSAP No. 47—Uninsured Plans*.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups):

Agenda item 2018-35 adopted with modification *ASU 2018-07, Improvements to Nonemployee Share-Based Payment Accounting* and incorporated the U.S. GAAP amendments from that project into SAP.

Agenda items 2016-19 and 2017-37 address the main ASUs related to *ASC Topic 606* and there have been several other agenda items for minor updates to revenue recognition guidance, all of which have been rejected in *SSAP No. 47*.

Per the comment letter received on June 9, 2023, interested parties had no comments on Agenda item 2023-07.

Information or issues (included in *Description of Issue*) not previously contemplated by the Working Group:
None.

Convergence with International Financial Reporting Standards (IFRS):

None.

Staff Recommendation:

Staff recommends that the Working Group move this item to the active listing, categorized as a SAP clarification, and expose revisions to adopt with modification *ASU 2019-08 Compensation—Stock Compensation (Topic 718) and Revenue from Contracts with Customers (Topic 606): Codification Improvements—Share-Based Consideration Payable to a Customer* for statutory accounting. These revisions would add language to include share-based consideration payable to customers under SSAP No. 104R guidance in the same manner as U.S. GAAP. With the revisions proposed to SSAP No. 104R, revisions are also proposed to *SSAP No. 95—Nonmonetary Transactions* to update previously adopted U.S. GAAP guidance. In addition, proposed revisions to *SSAP No. 47—Uninsured Plans*, reject Topic 606 guidance in ASU 2019-08. The proposed revisions to SSAP No. 95, SSAP No. 104R, and *SSAP No. 47—Uninsured Plans*, are illustrated in the Form A.

Proposed Revisions to SSAP No. 95—Nonmonetary Transactions

Accounting for a Convertible Instrument Granted or Issued to a Nonemployee for Goods or Services or Services and Cash (in combination or individually), or a ~~Combination of Goods or Services and Cash~~ Consideration Payable to a Customer

17. The guidance in paragraph 18 addresses a convertible instrument that is issued or granted to a nonemployee in exchange for goods or services or a combination of goods or services and cash or consideration payable to a customer. The convertible instrument contains a nondetachable conversion option that permits the holder to convert the instrument into the issuer's stock.

19. To determine the fair value of a convertible instrument granted as part of a share-based payment transaction to a nonemployee in exchange for goods or services or as consideration payable to a customer that is equity in form or, if debt in form, that can be converted into equity instruments of the issuer, the entity shall first apply SSAP No. 104R.

Proposed Revisions to SSAP No. 104R—Share-Based Payments**SUMMARY OF ISSUE**

2. The objective of accounting for transactions under share-based payment arrangements is to recognize in the financial statements the goods or services received in exchange for equity instruments granted or liabilities incurred and the related cost to the entity as those goods or services are received. This statement uses the terms “compensation” and “payment” in their broadest senses to refer to the consideration paid for goods, ~~or~~ services, or the consideration paid to a customer.

Scope and Scope Exceptions

4. This statement applies to all share-based payment transactions in which a grantor acquires goods or services to be used or consumed in the grantor’s own operations or provides consideration payable to a customer by issuing (or offering to issue) its shares, share options, or other equity instruments or by incurring liabilities to an employee or nonemployee that meet either of the following conditions:

- a. The amounts are based, at least in part, on the price of the entity’s shares or other equity instruments.
- b. The awards require or may require settlement by issuing the entity’s equity shares or other equity instruments.

5. Share-based payments awarded to a grantee by a related party or other holder of an economic interest in the entity as compensation for goods or services provided to the reporting entity are share-based payment transactions to be accounted for under this statement unless the transfer is clearly for a purpose other than compensation for goods or services to the reporting entity. The substance of such a transaction is that the economic interest holder makes a capital contribution to the reporting entity, and that entity makes a share-based payment to the grantee in exchange for services rendered or goods received. An example of a situation in which such a transfer is not compensation is a transfer to settle an obligation of the economic interest holder to the grantee that is unrelated to goods or services to be used or consumed in a grantor's own operations.

6. The guidance in this statement does not apply to:

- a. Equity instruments held by an employee stock ownership plan. Such equity instruments shall follow the guidance in SSAP No. 12—Employee Stock Ownership Plans.
- b. Transactions involving equity instruments granted to a lender or investor that provides financing to the issuer.
- c. Transactions involving equity instruments granted in conjunction with selling goods or services to customers as part of a contract (for example, sales incentives). If consideration payable to a customer is payment for a distinct good or service from the customer, then the entity shall account for the purchase of the good or service in the same way it accounts for other purchases from suppliers. Therefore, share-based payment awards granted to a customer for a distinct good or service to be used or consumed in the grantor's own operations are accounted for under this statement.

Recognition

11. This guidance does not address the period(s) or the manner (that is, capitalize versus expense) in which an entity granting the share-based payment award (the purchaser or grantor) to a nonemployee shall recognize the cost of the share-based payment award that will be issued, other than to require that a nonadmitted prepaid asset or expense be recognized (or previous recognition reversed) in the same period(s) and in the same manner as if the grantor had paid cash for the goods or services instead of paying with or using the share-based payment award.

Initial Measurement

35. An entity shall account for the compensation cost from share-based payment transactions in accordance with the fair-value-based method set forth in this statement. That is, the cost of goods obtained or services received in exchange for awards of share-based compensation generally shall be measured based on the grant-date fair value of the equity instruments issued or on the fair value of the liabilities incurred. The cost of goods obtained or services received by an entity as consideration for equity instruments issued or liabilities incurred in share-based compensation transactions with employees shall be measured based on the fair value of the equity instruments issued or the liabilities settled. The portion of the fair value of an instrument attributed to goods obtained or services received is net of any amount that a grantee pays (or becomes obligated to pay) for that instrument when it is granted. For example, if a grantee pays \$5 at the grant date for an option with a grant-date fair value of \$50, the amount attributed to goods or services provided by the grantee is \$45.

Measurement Objective – Fair Value at Grant Date

38. The measurement objective for equity instruments awarded to grantees is to estimate the fair value at the grant date of the equity instruments that the entity is obligated to issue when grantees have delivered the good or rendered the service and satisfied any other conditions necessary to earn the right to benefit

from the instruments (for example, to exercise share options). That estimate is based on the share price and other pertinent factors, such as expected volatility, at the grant date.

- a. Measurement Objective and Measurement Date for Awards Classified as Liabilities: At the grant date, the measurement objective for liabilities incurred under share-based compensation arrangements is the same as the measurement objective for equity instruments awarded to grantees as described in paragraph 38. However, the measurement date for liability instruments is the date of settlement.
- b. Intrinsic Value Option for Awards Classified as Liabilities: A reporting entity shall make a policy decision of whether to measure all of its liabilities incurred under share-based payment arrangements (for employee and nonemployee awards) issued in exchange for goods or services at fair value or ~~to measure all such liabilities~~ at intrinsic value. However, the reporting entity shall initially and subsequently measure awards determined to be consideration payable to a customer at fair value.

52. A reporting entity may not be able to reasonably estimate the fair value of its equity share options, nonemployee awards and similar instruments because it is not practicable for the reporting entity to estimate the expected volatility of its share price. In that situation, the entity shall account for its equity share options, nonemployee awards and similar instruments based on a value calculated using the historical volatility of an appropriate industry sector index instead of the expected volatility of the entity's share price (~~the calculated-permitted~~ value). A reporting entity's use of ~~calculated-permitted~~ value shall be consistent between employee share-based payment transactions and nonemployee share-based payment transactions. Throughout the remainder of this statement, provisions that apply to accounting for share options, nonemployee awards and similar instruments at fair value also apply to calculated value.

Staff Note: Paragraph 98 references "permitted value in accordance with paragraph 52", but terminology was not consistent between paragraphs. NAIC staff changed "calculated value" to "permitted value" to allow for easier cross-referencing.

54. A reporting entity that elects to apply the practical expedient in paragraph 53 shall apply the practical expedient to a share option or similar award that has all of the following characteristics:

- a. The share option or similar award is granted at the money.
- b. The grantee has only a limited time to exercise the award (typically 30-90 days) if the grantee no longer provides goods~~or~~, terminates service after vesting, or ceases to be a customer.
- c. The grantee can only exercise the award. The grantee cannot sell or hedge the award.
- d. The award does not include a market condition.

Subsequent Measurement

68. The total amount of compensation cost recognized for share-based payment awards to nonemployees shall be based on the number of instruments for which a good has been delivered or a service has been rendered. To determine the amount of compensation cost to be recognized in each period, an entity shall make an entity-wide accounting policy election for all nonemployee share-based payment awards, including share-based payment awards granted to customers, to do either of the following:

- a. Estimate the number of forfeitures expected to occur. The entity shall base initial accruals of compensation cost on the estimated number of nonemployee share-based payment awards for which a good is expected to be delivered or service is expected to be rendered.

The entity shall revise that estimate if subsequent information indicates that the actual number of instruments is likely to differ from previous estimates. The cumulative effect on current and prior periods of a change in the estimates shall be recognized in compensation cost in the period of the change.

- b. Recognize the effect of forfeitures in compensation cost when they occur. Previously recognized compensation cost for a nonemployee share-based payment award shall be reversed in the period that the award is forfeited.
80. A freestanding financial instrument issued to a grantee ~~in exchange for goods or services received (or to be received)~~ that is subject to initial recognition and measurement guidance within this statement shall continue to be subject to the recognition and measurement provisions of this statement throughout the life of the instrument, unless its terms are modified after a ~~nonemployee grantee~~ vests in the award and is no longer providing goods or services, a grantee vests in the award and is no longer a customer, or a grantee is no longer an employee. Only for purposes of this paragraph, a modification does not include a change to the terms of an award if that change is made solely to reflect an equity restructuring provided that both of the following conditions are met:
- a. There is no increase in fair value of the award (or the ratio of intrinsic value to the exercise price of the award is preserved, that is, the holder is made whole) or the antidilution provision is not added to the terms of the award in contemplation of an equity restructuring.
 - b. All holders of the same class of equity instruments (for example, stock options) are treated in the same manner.

81. Other modifications of that instrument that take place after a ~~nonemployee grantee~~ vests in the award and is no longer providing goods or services, is no longer a customer, or ~~a grantee~~ is no longer an employee shall be subject to the modification guidance in paragraph 83. Following modification, recognition and measurement of the instrument shall be determined through reference to other applicable statutory accounting principles.

Subsequent Measurement - Awards Classified as Liabilities

97. Changes in the fair value (or intrinsic value for a reporting entity that elects that method) of a liability incurred under a share-based payment arrangement issued in exchange for goods or services that occur during the employee's requisite service period or the nonemployee's vesting period shall be recognized as compensation cost over that period. The percentage of the fair value (or intrinsic value) that is accrued as compensation cost at the end of each period shall equal the percentage of the requisite service that has been rendered for an employee award or the percentage that would have been recognized had the grantor paid cash for the goods or services instead of paying with a nonemployee award at that date. Changes in the fair value (or intrinsic value) of a liability issued in exchange for goods or services that occur after the end of the employee's requisite service period or the nonemployee's vesting period are compensation costs of the period in which the changes occur. Any difference between the amount for which a liability award issued in exchange for goods or services is settled and its fair value at the settlement date as estimated in accordance with the provisions of this statement is an adjustment of compensation cost in the period of settlement.

98. Reporting entities shall measure a liability award under a share-based payment arrangement based on the award's fair value (or permitted value in accordance with paragraph 52) remeasured at each reporting date until the date of settlement. Compensation costs for each period until settlement shall be based on the change (or a portion of the change, depending on the percentage of the requisite service that has been rendered for an employee award or the percentage that would have been recognized had the grantor paid cash for the goods and services instead of paying with a nonemployee award at the reporting date) in the

fair value of the instrument for each reporting period. [A reporting entity shall subsequently measure awards determined to be consideration payable to a customer at fair value.](#)

Effective Date and Transition

132. Since the initial adoption of SSAP No. 104, subsequent revisions were effective as follows:

- b. [ASU 2019-08, Compensation—Stock Compensation \(Topic 718\) and Revenue from Contracts with Customers \(Topic 606\): Codification Improvements—Share-Based Consideration Payable to a Customer.](#)

REFERENCES

Other

- *SSAP No. 12—Employee Stock Ownership Plans*

Proposed Revisions to SSAP No. 47—Uninsured Plans

RELEVANT LITERATURE

15. This statement rejects *ASU 2014-09, Revenue from Contracts with Customers*; *ASU 2015-14, Revenue From Contracts With Customers*; *ASU 2016-08, Revenue From Contracts with Customers: Principal versus Agent Considerations (Reporting Revenue Gross versus Net)*; *ASU 2016-10, Revenue from Contracts with Customers: Identifying Performance Obligations and Licensing*; *ASU 2016-12, Revenue from Contracts with Customers: Narrow-Scope Improvements and Practical Expedients*; *ASU 2016-20, Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers*; *ASU 2018-18, Collaborative Arrangements (Topic 808), Clarifying the Interaction between Topic 808 and Topic 606, [the Topic 606 guidance included in ASU 2019-08, Codification Improvements to Stock Compensation \(Topic 718\) and Share-Based Consideration Payable to a Customer \(Topic 606\)](#)*, *ASU 2021-02, Franchisors—Revenue from Contracts with Customers*, *ASU 2021-08, Business Combinations, Accounting for Contract Assets and Contract Liabilities from Contracts with Customers*

Staff Review Completed by:

NAIC Staff – William Oden, February 2023

Status:

On March 22, 2023, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a SAP clarification, and exposed revisions to SSAP No. 95, SSAP No. 104R, and SSAP No. 47 to adopt, with modification, *ASU 2019-08 Compensation—Stock Compensation (Topic 718) and Revenue from Contracts with Customers (Topic 606): Codification Improvements—Share-Based Consideration Payable to a Customer*, as illustrated above.

On August 13, 2023, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed revisions, as illustrated above, to SSAP Nos. 47, 95, and 104R to adopt, with modification, ASU 2019-08 which expands the scope of stock compensation guidance to share-based consideration payable to customers.

<https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/NationalMeetings/A.NationalMeetingMaterials/2023/8-13-23SummerNationalMeeting/Adoptions/23-07-ASU2019-08-StockComp.docx>

**Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A**

Issue: ASU 2019-07, Codification Updates to SEC Sections

Check (applicable entity):

	P/C	Life	Health
Modification of Existing SSAP	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
New Issue or SSAP	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Interpretation	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Description of Issue:

FASB issued *ASU 2019-07—Codification Updates to SEC Sections: Amendments to SEC Paragraphs Pursuant to SEC Final Rule Releases No. 33-10532, Disclosure Update and Simplification, and Nos. 33-10231 and 33-10442, Investment Company Reporting Modernization, and Miscellaneous Updates*, which primarily effects the codifications of Financial Services—Depository and Lending (Topic 942), Financial Services—Insurance (Topic 944), and Financial Services—Investment Companies (Topic 946). The update amends and supersedes certain SEC sections in Topic 942, 944, and 946 to align codification guidance with SEC Releases No. 33-10532, 33-10231, and 33-10442. These SEC Releases amend a wide range of disclosure requirements which were determined to be redundant, duplicative, overlapping, outdated, or superseded by other relevant literature. Additionally, the SEC Releases include several miscellaneous updates and corrections intended to clarify SEC guidance.

Existing Authoritative Literature:

Historically, SEC guidance from ASUs have been rejected as not applicable for statutory accounting in Appendix D. Regardless, all ASUs are reviewed for statutory accounting purposes to determine if the guidance should be considered for statutory accounting.

Debt is covered in *SSAP No. 15—Debt and Holding Company Obligations*, surplus is covered in *SSAP No. 72—Surplus and Quasi-Reorganizations*, and consolidation guidance is discussed in *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): None.

Per the comment letter received on June 9, 2023, interested parties had no comments on Agenda item 2023-08.

Information or issues (included in *Description of Issue*) not previously contemplated by the Working Group: None.

Convergence with International Financial Reporting Standards (IFRS): None

Staff Recommendation:

NAIC staff recommends that the Working Group move this item to the active listing, categorized as a SAP clarification, and expose revisions to *Appendix D—Nonapplicable GAAP Pronouncements to reject ASU 2019-07—Codification Updates to SEC Sections: Amendments to SEC Paragraphs Pursuant to SEC Final Rule Releases No. 33-10532, Disclosure Update and Simplification, and Nos. 33-10231 and 33-10442, Investment Company Reporting Modernization, and Miscellaneous Updates* as not applicable to statutory accounting. This item is proposed to be rejected as not applicable as ASU 2019-07 is specific to amendment of SEC paragraphs, which are not applicable for statutory accounting purposes.

Staff Review Completed by: William Oden – February 2023

Status:

On March 22, 2023, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a SAP clarification, and exposed revisions to Appendix D to reject *ASU 2019-07—Codification Updates to SEC Sections: Amendments to SEC Paragraphs Pursuant to SEC Final Rule Releases No. 33-10532, Disclosure Update and Simplification, and Nos. 33-10231 and 33-10442, Investment Company Reporting Modernization, and Miscellaneous Updates* as not applicable to statutory accounting.

On August 13, 2023, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed revisions to *Appendix D—Nonapplicable GAAP Pronouncements* to reject ASU 2019-07 as not applicable to statutory accounting.

<https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/NationalMeetings/A.NationalMeetingMaterials/2023/8-13-23SummerNationalMeeting/Adoptions/23-08-ASU2019-07-SECUpdates.docx>

**Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A**

Issue: *ASU 2020-09—Amendments to SEC Paragraphs Pursuant to SEC Release No. 33-10762—Debt (Topic 470)*

Check (applicable entity):

	P/C	Life	Health
Modification of Existing SSAP	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
New Issue or SSAP	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Interpretation	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Description of Issue:

FASB issued *ASU 2020-09, Amendments to SEC Paragraphs Pursuant to SEC Release No. 33-10762—Debt (Topic 470)*, which effects the codification in Debt (Topic 470). The update amends and supersedes certain SEC sections in Topic 470 to align codification guidance with SEC Release No. 33-10762. No. 33-10762 amends the SEC financial disclosure requirements for guarantors and issuers of guaranteed securities registered or being registered, and issuers' affiliates whose securities collateralize securities registered or being registered in Regulation S-X to improve those requirements for both investors and registrants. The changes are intended to provide investors with material information given the specific facts and circumstances, make the disclosures easier to understand, and reduce the costs and burdens to registrants.

Existing Authoritative Literature:

Historically, SEC guidance from ASUs have been rejected as not applicable for statutory accounting in Appendix D. Regardless, all ASUs are reviewed for statutory accounting purposes to determine if the guidance should be considered for statutory accounting.

Debt is covered in *SSAP No. 15— Debt and Holding Company Obligations*. Basic discussion of the nature of liabilities is covered in *SSAP No. 5R— Liabilities, Contingencies and Impairments of Assets*.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups):

Per the comment letter received on June 9, 2023, interested parties had no comments on Agenda item 2023-09.

Information or issues (included in *Description of Issue*) not previously contemplated by the Working Group:

None

Convergence with International Financial Reporting Standards (IFRS): None

Staff Recommendation:

NAIC staff recommends that the Working Group move this item to the active listing, categorized as a SAP clarification, and expose revisions to *Appendix D—Nonapplicable GAAP Pronouncements to reject ASU 2020-09, Amendments to SEC Paragraphs Pursuant to SEC Release No. 33-10762—Debt (Topic 470)* as not applicable to statutory accounting. This guidance is not applicable as it pertains to an exception of issuers or guarantors filing financial statements with the SEC when the issuer or guarantor is included in filed consolidated financial statements and other conditions are met.

Staff Review Completed by: William Oden – February 2023

Status:

On March 22, 2023, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a SAP clarification, and exposed revisions to Appendix D to reject *ASU 2020-09, Amendments to SEC Paragraphs Pursuant to SEC Release No. 33-10762—Debt (Topic 470)* as not applicable to statutory accounting.

On August 13, 2023, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed revisions to *Appendix D—Nonapplicable GAAP Pronouncements* to reject ASU 2020-09 as not applicable to statutory accounting.

<https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/NationalMeetings/A.NationalMeetingMaterials/2023/8-13-23SummerNationalMeeting/Adoptions/23-09-ASU2020-09-SECUpdates.docx>

**Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A**

Issue: *ASU 2022-05, Transition for Sold Contracts*

Check (applicable entity):

	P/C	Life	Health
Modification of existing SSAP	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
New Issue or SSAP	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Interpretation	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Description of Issue: This agenda item has been drafted to consider *ASU 2022-05, Transition for Sold Contracts* (ASU) for statutory accounting. The FASB issued the ASU in December 2022 to amend specific sections of *ASU 2018-12, Targeted Improvements for Long-Durations Contracts* (LDTI). The amendments made by the ASU are intended to reduce implementation costs and complexity associated with the adoption of LDTI for contracts that have been derecognized in accordance with the ASU before the LDTI effective date. The revisions captured in the ASU are summarized as follows:

The amendments in the ASU amend the LDTI transition guidance to allow an insurance entity to make an accounting policy election on a transaction-by-transaction basis. An insurance entity may elect to exclude contracts that meet certain criteria from applying the amendments in the LDTI. To qualify for the accounting policy election, as of the LDTI effective date both of the following conditions must be met:

- a. The insurance contracts must have been derecognized because of a sale or disposal of individual or a group of contracts or legal entities.
- b. The entity has no significant continuing involvement with the derecognized contracts.

ASU 2018-12, as amended by 2022-05, is effective for public entities for fiscal years beginning after December 15, 2022, and interim periods within those fiscal years. For nonpublic entities, the LDTI is effective for fiscal years beginning after December 15, 2024, and interim periods within fiscal years beginning after December 15, 2025. The LDTI includes different transition provisions as follows:

- For the liability for future policyholder benefits and deferred acquisition costs, insurance entities should apply the amendments to contracts in force as of the beginning of the earliest period presented on the basis of their existing carrying amounts, adjusted for the removal of any related amounts in accumulated other comprehensive income. Insurance entities are permitted to apply the amendments retrospectively (with a cumulative catch-up adjustment to the opening balance of retained earnings), using actual historical experience information as of contract inception. (Estimates of historical experience may not be substituted for actual historical experience.) If electing retrospective application, it must be applied entity-wide for the same contract issue year, and all subsequent contract issue years. (Meaning, it must be used to all products and contracts issued in the first year in which retrospective application will be applied, and all subsequent products and contracts issued in later years.)
- For market risk benefits, insurance entities should apply the amendments retrospectively as of the beginning of the earliest year presented. An insurance entity may use hindsight in instances in which assumptions in a prior period are unobservable or otherwise unavailable and cannot be independently substantiated. The difference between fair value and the carrying value at the transition date, excluding the effect of changes in the instrument-specific credit risk, requires an adjustment to the opening balance of retained earnings.

Existing Authoritative Literature:

The key changes reflected in ASU 2018-12 revised U.S. GAAP guidance previously rejected for statutory accounting. (In a couple instances, the prior U.S. GAAP guidance was not reviewed for SAP - as the guidance was not Board Directed or was still pending SAP review.)

References from Appendix D – Cross-Reference to SAP:

U.S. GAAP	SAP Accounting Provisions
<i>FAS 60, Accounting and Reporting by Insurance Entities</i>	Rejected in SSAP No. 40R, SSAP No. 50, SSAP No. 51R, SSAP No. 52, SSAP No. 53, SSAP No. 54R, SSAP No. 57, SSAP No. 59, and SSAP No. 71
<i>FAS 97, Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments</i>	Rejected in SSAP No. 50, SSAP No. 51R, SSAP No. 52 and SSAP No. 71
<i>FSP FAS 97-1, Situations in Which Paragraphs 17(b) and 20 of FAS 97 Permit or Require Accrual of an Unearned Revenue Liability</i>	Not Board Directed
<i>SOP 95-1, Accounting for Certain Insurance Activities of Mutual Life Insurance Enterprises</i>	Rejected in SSAP No. 51R and SSAP No. 52
<i>SOP 03-1, Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts</i>	Rejected in SSAP No. 56
<i>SOP 05-1, Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection with Modifications or Exchange of Insurance Contracts</i>	Rejected in SSAP No. 71
<i>SOP 00-3, Accounting by Insurance Enterprises for Demutualizations and Formations of Mutual Insurance Holding Companies and for Certain Long-Duration Participating Contracts</i>	Pending SAP
<i>AICPA Practice Bulletin 8, Application of FAS 97 to Insurance Enterprises</i>	Rejected in SSAP No. 51R and SSAP No. 52R
<u>ASU 2018-12, Financial Services—Insurance (Topic 944): Targeted Improvements to the Accounting for Long-Duration Contracts</u>	<u>Rejected in Preamble, SSAP No. 50, SSAP No. 51R, SSAP No. 52, SSAP No. 54R, SSAP No. 55, SSAP No. 56, SSAP No. 71, and SSAP No. 86</u>

Other U.S. GAAP revised as a result of the ASU include:

- FAS 133, Accounting for Derivative Instruments and Hedging Activities* (and related DIGs) – The framework of FAS 133 was adopted with modification in *SSAP No. 86—Derivatives*. The revisions from ASU 2018-12 indicate that contracts with market risk benefits do not need to be bifurcated as embedded derivatives, as the guidance in ASU 2018-12 requires market risk benefits to be measured at fair value. The ASU revisions also delete or revise related implementation guidance for assessing whether embedded derivatives shall be bifurcated under U.S. GAAP. **This guidance will not impact the FAS 133 guidance adopted with modification, as SSAP No. 86 specifies that embedded derivatives shall not be separated from the derivative instrument.**

- *FAS 130, Other Comprehensive Income* – FAS 130 was rejected as not applicable under statutory accounting. The revisions from ASU 2018-12 modify FAS 130 to specify the additional components (e.g., changes in discount rate assumptions) that are recognized through OCI. These modifications will not impact the prior statutory accounting decision to reject FAS 130 for statutory accounting.

The following relevant SAP guidance is noted:

- ***SSAP No. 51—Life Contracts:*** This SSAP establishes statutory accounting principles for income recognition and policy reserves for life contracts. This SSAP identifies that policy reserves shall be established as required in *Appendix A-820, Minimum Life and Annuity Reserves* and *Appendix A-822, Asset Adequacy Analysis Requirements* or the *Valuation Manual*.
- ***SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses:*** This SSAP establishes statutory accounting principles for recording liabilities for unpaid claims and claim adjustment expenses for life insurance contracts and accident and health contracts. (It also addresses unpaid losses and LAE for property and casualty contracts.) Pursuant to the guidance in paragraph 12, for each line of business, and for all lines of business in the aggregate, management shall record its best estimate of its liabilities for unpaid claims, unpaid losses and loss/claim adjustment expenses. This guidance identifies that management shall follow the concept of conservatism when determining estimates, but there is not a specific requirement to include a provision for adverse deviation in claims. With the revisions reflected in ASU 2018-12, the U.S. GAAP guidance has been revised to specify that the assumptions used in determining a liability for future policy benefits shall not include a provision for the risk of adverse deviation. Prior to these revisions, the guidance in ASC 944-40-30-7 specifically stated that the assumptions shall include a provision for the risk of adverse deviation. (*Note, as detailed in the proposed statutory accounting modifications, reference to the old U.S. GAAP guidance for adverse deviation is included in the Preamble and is proposed to be deleted.*)
- ***SSAP No. 71—Policy Acquisition Costs and Commissions:*** This SSAP establishes statutory accounting principles for policy acquisition costs and commissions. Pursuant to SSAP No. 71, all policy acquisition costs and commissions shall be expensed when incurred. Although the ASU is streamlining the amortization of capitalized deferred acquisition costs, this revision will not impact statutory accounting. (*Note, as detailed in the proposed statutory accounting modifications, reference to the old U.S. GAAP guidance is included in the Preamble and is proposed to be modified to reflect the new guidance.*)

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups):

Per the comment letter received on June 9, 2023, interested parties support the conclusion reached on Agenda item 2023-07.

Information or issues (included in *Description of Issue*) not previously contemplated by the Working Group:

None

Convergence with International Financial Reporting Standards (IFRS):

In 2008, the FASB undertook an insurance contracts project jointly with the International Accounting Standards Board (IASB). In 2013, after considering comments from the exposure of a 2010 Discussion Draft and a 2013 Proposed Update, the FASB decided to separate from the IASB project, and instead focus on targeted improvements to existing U.S. GAAP concepts. The decision to focus on targeted improvements to existing U.S. GAAP guidance, with the continued limitation of the guidance to insurance companies, was strongly supported by commenters in lieu of introducing a completely new accounting model that would apply to all entities that issued “insurance contracts.”

Staff Recommendation:

NAIC staff recommends that the Working Group move this item to the active listing, categorized as a SAP clarification, and expose proposed revisions to reject *ASU 2022-05, Transition for Sold Contracts* as not applicable for statutory accounting in *SSAP No. 50—Classifications of Insurance or Managed Care Contracts*; *SSAP No. 51R—Life Contracts*; *SSAP No. 52—Deposit-Type Contracts*; *SSAP No. 56—Separate Accounts*; *SSAP No. 71—Policy Acquisition Costs and Commissions* and *SSAP No. 86—Derivatives*. The guidance in *ASU 2022-05* provides updated transition guidance for *ASU 2018-12*, which had previously been rejected for statutory accounting. The proposed revisions are illustrated below:

SSAP No. 50—Classifications of Insurance or Managed Care Contracts

46. This statement rejects the U.S. GAAP classifications (i.e., short-duration and long-duration) found in [ASU 2022-05 Transition for Sold Contracts](#), *ASU 2018-12, Targeted Improvements to the Accounting for Long-Duration Contracts*, *FASB Statement No. 60, Accounting and Reporting by Insurance Enterprises*, *FASB Statement No. 97, Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments*, and *FASB Statement No. 120, Accounting and Reporting by Mutual Life Insurance Enterprises and by Insurance Enterprises for Certain Long Duration Participating Contracts*.

SSAP No. 51R—Life Contracts

56. This statement rejects [ASU 2022-05 Transition for Sold Contracts](#), *ASU 2018-12, Targeted Improvements to the Accounting for Long-Duration Contracts*, *FASB Statement No. 60, Accounting and Reporting by Insurance Enterprises*, *FASB Statement No. 97, Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments*, *FASB Statement 120, Accounting and Reporting by Mutual Life Insurance Enterprises and by Insurance Enterprises for Certain Long-Duration Participating Contracts*, *AICPA Practice Bulletin No. 8, Application of FASB Statement No. 97, Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses From the Sale of Investments*, *to Insurance Enterprises*, the *AICPA Audit and Accounting Guide—Audits of Stock Life Insurance Companies*, *AICPA Statement of Position 95-1, Accounting for Certain Activities of Mutual Life Insurance Enterprises* relating to accounting and reporting for policy reserves for short and long duration contracts, and *FASB Interpretation No. 40, Applicability of Generally Accepted Accounting Principles to Mutual Life Insurance and Other Enterprises, an interpretation of FASB Statements No. 12, 60, 97, and 113*.

SSAP No. 52—Deposit-Type Contracts

25. This statement rejects [ASU 2022-05 Transition for Sold Contracts](#), *ASU 2018-12, Targeted Improvements to the Accounting for Long-Duration Contracts*, *FASB Statement No. 60, Accounting and Reporting by Insurance Enterprises*, *FASB Statement No. 97, Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments*, *FASB Statement 120, Accounting and Reporting by Mutual Life Insurance Enterprises and by Insurance Enterprises for Certain Long-Duration Participating Contracts*, *AICPA Practice Bulletin No. 8, Application of FASB Statement No. 97, Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses From the Sale of Investments*, *to Insurance Enterprises*, the *AICPA Audit and Accounting Guide—Audits of Stock Life Insurance Companies*, *AICPA Statement of Position 95-1, Accounting for Certain Activities of Mutual Life Insurance Enterprises* relating to accounting and reporting for policy reserves for short and long duration contracts, and *FASB Interpretation No. 40, Applicability of Generally Accepted Accounting Principles to Mutual Life Insurance and Other Enterprises, an interpretation of FASB Statements No. 12, 60, 97, and 113*.

SSAP No. 56—Separate Accounts

41. This statement rejects [ASU 2022-05 Transition for Sold Contracts](#), *ASU 2018-12, Targeted Improvements to the Accounting for Long-Duration Contracts*, *AICPA Statement of Position 03-1,*

Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts (SOP 03-1). The disclosure elements included within this SSAP are derived from the criteria for separate account reporting under SOP 03-1; however, this SSAP does not restrict separate account reporting pursuant to the criteria established in SOP 03-1.

SSAP No. 71—Policy Acquisition Costs and Commissions

6. This statement rejects [ASU 2022-05 Transition for Sold Contracts](#), ASU 2018-12, *Targeted Improvements to the Accounting for Long-Duration Contracts*, ASU 2010-26, *Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts*, FASB Statement No. 60, *Accounting and Reporting by Insurance Enterprises*, FASB Statement No. 97, *Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments*, and *Statement of Position 05-1, Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection with Modifications or Exchanges of Insurance Contracts*.

SSAP No. 86—Derivatives

73. This statement rejects [ASU 2022-05 Transition for Sold Contracts](#), 2020-06, *Debt—Debt with Conversion and Other Options (Subtopic 470-20) and Derivatives and Hedging—Contracts in Entity’s Own Equity (Subtopic 815-40)*, *Accounting for Convertible Instruments and Contracts in an Entity’s Own Equity*, ASU 2020-01, *Investments—Equity Securities (Topic 321)*, *Investments—Equity Method and Joint Ventures (Topic 323)*, and *Derivatives and Hedging (Topic 815)*, *Clarifying the Interactions between Topic 321, Topic 323 and Topic 815*, ASU 2018-03, *Recognition and Measurement of Financial Assets and Financial Liabilities*, and ASU 2016-03, *Intangibles—Goodwill and Other, Business Combinations, Consolidation, Derivatives and Hedging*.

Staff Review Completed by:

William Oden, NAIC Staff – December 2022

Status:

On March 22, 2023, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a SAP clarification to reject *ASU 2022-05, Transition for Sold Contracts* in *SSAP No. 50—Classifications of Insurance or Managed Care Contracts*; *SSAP No. 51R—Life Contracts*; *SSAP No. 52—Deposit-Type Contracts*; *SSAP No. 56—Separate Accounts*; *SSAP No. 71—Policy Acquisition Costs and Commissions* and *SSAP No. 86—Derivatives*, which is consistent with prior agenda items related to this topic.

On August 13, 2023, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed revisions to reject ASU 2022-05 in SSAP Nos. 50, 51R, 52, 56, 71, and 86.

<https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/NationalMeetings/A.NationalMeetingMaterials/2023/8-13-23SummerNationalMeeting/Hearing/13-23-10-ASU2022-05-SoldContracts.docx>

**Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A**

Issue: PIK Interest Disclosure Clarification

Check (applicable entity):

	P/C	Life	Health
Modification of Existing SSAP	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
New Issue or SSAP	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Interpretation	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Description of Issue: This agenda item has been developed to further clarify, and incorporate a practical expedient, to the paid-in-kind (PIK) interest aggregate disclosure adopted in *SSAP No. 34—Investment Income Due and Accrued* for year-2023. In response to questions received on how paydowns / disposals would impact PIK interest included in the cumulative balance, it was noted that clarifying guidance would assist with consistent application. Furthermore, without clarification it was identified that companies and investment software vendors may interpret the need to detail the retrospective PIK allocations and paydowns / disposals as evidence for the resulting amount.

To eliminate the potential inconsistent application on how paydowns / disposals impact PIK interest included in cumulative principal / par balance, as well as to streamline the calculation, this agenda item proposes the following clarifications:

- Any decreasing amounts to principal balances (paydowns / disposals / sales, etc.,) shall first be applied to any PIK interest included in the principal balance. For example, if original par was \$100, PIK interest received overtime was \$50 and paydowns received were \$30, the resulting PIK included in the cumulative balance would be \$20 - (\$50 less \$30). No reduction to the original principal would occur until the PIK interest had been fully eliminated from the balance. If in this scenario paydowns of \$70 had occurred, the company would report zero in the disclosure for cumulative PIK interest, as the amount received would have fully eliminated the \$50 in PIK interest.
- The determination of PIK interest in cumulative balance can be calculated through a practical expedient calculation of original par / principal value to current par / principal value, not to go less than zero. This calculation will determine the resulting balance from PIK interest over time as well as paydowns / disposals, etc. The intent of this calculation is to prevent companies and investment software vendors from creating a schedule that details PIK interest and paydowns received retroactively since the origination of the investment. The practical expedient calculation from the original to current par / principal value shall result with the same resulting PIK interest amount included in the cumulative balance without the retroactive scheduling required.

The adopted disclosure in SSAP No. 34 is not intended to change, but the proposed clarification and practical expedient guidance is intended to be captured in the annual statement instructions. This agenda item is being exposed at the SAPWG, as the source of the adopted disclosure, and will be used to subsequently provide a memo to blanks for year-end 2023 application and to revise the formal instructions for 2024.

Existing Authoritative Literature:

- **SSAP No. 34—Investment Income Due and Accrued**

Disclosures

7. The following disclosures shall be made for investment income due and accrued in the financial statements. (SSAP No. 37 captures disclosures for mortgage loans on nonaccrual status pursuant to paragraph 6.)

- The bases by category of investment income for excluding (nonadmitting) any investment income due and accrued;
- Disclose total amount excluded;
- Disclose the gross, nonadmitted and admitted amounts for interest income due and accrued;
- Disclose aggregate deferred interest;
- Disclose cumulative amounts of paid-in-kind (PIK) interest included in the current principal balance.

- **A/S Instructions – Life, Accident and Health / Fraternal Companies**

7. Investment Income Instruction:

Disclose the following for investment income due and accrued in the financial statements:

- The bases, by category of investment income, for excluding (nonadmitting) any investment income due and accrued,
- The total amount excluded.
- The gross, nonadmitted and admitted amounts for interest income due and accrued. (1) Gross amount for interest income due and accrued. (2) Nonadmitted amount for interest income due and accrued. (3) Admitted amount for interest income due and accrued.
- The aggregate deferred interest.
- The cumulative amounts of paid-in-kind (PIK) interest included in the current principal balance.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups):

- Agenda item 2022-17: Interest Income Disclosure update was adopted March 22, 2023. This disclosure data-captured existing and incorporated new disclosures, to SSAP No. 34, which included the cumulative amount of paid-in-kind (PIK) interest included in the current principal balance. The revisions were adopted for year-end 2023 and are shown in the authoritative literature section above.
- Blanks Proposal 2023-11BWG intends to adopt instructions and illustrations for the revised disclosures in May 2023.

Information or issues (included in *Description of Issue*) not previously contemplated by the Working Group:
None

Convergence with International Financial Reporting Standards (IFRS): NA

Recommendation:

NAIC staff recommend that the Working Group include this item on their maintenance agenda as a SAP clarification and expose this agenda item to clarify and incorporate a practical expedient, to the paid-in-kind (PIK) interest aggregate disclosure for SSAP No. 34 and annual statement instruction purposes. For annual statement purposes, this instruction will be an editorial change only and can be provided by the SAPWG in a memo posted on the Blanks Working (E) Group page if adopted after the deadline to incorporate into the annual statement instructions for 2023. Comments on this exposure are requested by June 30, 2023, to allow for adoption consideration at the 2023 Summer National Meeting.

Proposed Revisions to SSAP No. 34

7. The following disclosures shall be made for investment income due and accrued in the financial statements. (SSAP No. 37 captures disclosures for mortgage loans on nonaccrual status pursuant to paragraph 6.)

- a. The bases by category of investment income for excluding (nonadmitting) any investment income due and accrued;
- b. Disclose total amount excluded;
- c. Disclose the gross, nonadmitted and admitted amounts for interest income due and accrued;
- d. Disclose aggregate deferred interest;
- e. Disclose cumulative amounts of paid-in-kind (PIK) interest included in the current principal balance ~~./ par value^{FN}.~~

New Footnote: In disclosing the cumulative amount of PIK interest, identify the specific amounts of PIK interest by lot and aggregate the amounts by CUSIP/PPN that have a net increase to the original par value. The net increase includes PIK interest added to the par value less disposals (i.e., repayments; sales) that are first applied to any PIK interest outstanding. As a practical expedient, an insurer may calculate the cumulative amount of PIK interest on a bond by subtracting the original principal / par value from the current principal / par value, but not less than \$0.

Proposed instruction for inclusion in the Annual Statement Instructions (or 2023 memo to Blanks):

7. Investment Income Instruction:

Disclose the following for investment income due and accrued in the financial statements:

- A. The bases, by category of investment income, for excluding (nonadmitting) any investment income due and accrued,
- B. The total amount excluded.
- C. The gross, nonadmitted and admitted amounts for interest income due and accrued. (1) Gross amount for interest income due and accrued. (2) Nonadmitted amount for interest income due and accrued. (3) Admitted amount for interest income due and accrued.
- D. The aggregate deferred interest.
- E. The cumulative amounts of paid-in-kind (PIK) interest included in the current principal balance.

For the PIK interest included in the current principal balance, include the amount of reported interest in which the terms permit “paid in kind” (PIK) instead of cash. The amount reported shall reflect the cumulative amount of PIK interest included in the current principal balance / par value. In disclosing the cumulative amount of PIK interest, identify the specific amounts of PIK interest by lot and aggregate the amounts by CUSIP/PPN that have a net increase to the original par value. The net increase includes PIK interest added to the par value less disposals (i.e., repayments; sales) that are first applied to any PIK interest outstanding. As a practical expedient, an insurer may calculate the cumulative amount of PIK interest on a bond by subtracting the original principal / par value from the current principal / par value, but not less than \$0.

Staff Review Completed by: Julie Gann - NAIC Staff, May 2023

Status:

On May 16, 2023, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a SAP clarification, and exposed revisions to SSAP No. 34 and the Annual Statement Instructions to clarify and incorporate a practical expedient to the paid-in-kind (PIK) interest aggregate disclosure. These SSAP No. 34 revisions, when adopted, will also result in editorial changes to the annual statement instructions.

August 13, 2023, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed revisions, as illustrated above, to SSAP No. 34 and directed that the proposed updates to the Annual Statement Instructions be forwarded to the Blanks (E) Working Group. These revisions provide a practical expedient to the paid-in-kind (PIK) interest aggregate disclosure.

<https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/NationalMeetings/A.NationalMeetingMaterials/2023/8-13-23SummerNationalMeeting/Adoptions/23-13-PIKInterest.docx>

**Revisions to the
As of March 2023, Accounting Practices and Procedures Manual**

On **September 21, 2023**, the Statutory Accounting Principles (E) Working Group adopted the following revisions to the *As of March 2023 Accounting Practices and Procedures Manual*. Documents associated with these revisions are linked to the reference items in bold text.

Ref #	SSAP/ Appendix	Title	Summary
INT 23-02	SSAP No. 9 SSAP No. 101	<p><i>INT 23-02: Third Quarter 2023 Inflation Reduction Act – Corporate Alternative Minimum Tax SAP Clarification</i></p> <p>Effective immediately for third quarter 2023 reporting (September 21, 2023); Automatically nullifies on November 16, 2023</p>	Adoption provides guidance for third quarter 2023 CAMT reporting and requires disclosures, but not accrual of a liability.
2023-04	INT 23-03 SSAP No. 4 SSAP No. 9 SSAP No. 101	<p><i>INT 23-03: Inflation Reduction Act – Corporate Alternative Minimum Tax SAP Clarification</i></p> <p>Effective for reporting on or after December 31, 2023</p>	Adoption provides guidance for CAMT reporting on or after year-end 2023 and addresses accounting, the statutory valuation allowance, admissibility, disclosures, and year-end 2023 transition.
2023-12	SSAP No. 43R SSAP No. 48	<p>Residuals in SSAP No. 48 Investments</p> <p><i>SAP Clarification</i></p> <p>Effective for year-end December 31, 2023</p>	Adoption includes revisions to <i>SSAP No. 43R—Loan-Backed and Structured Securities</i> , <i>SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies</i> , and the annual statement instructions for the reporting of residual interests, so that all residuals are captured on the dedicated Schedule BA – Other Long-Term Invested Assets reporting lines.

[https://naiconline.sharepoint.com/teams/frsstatutoryaccounting/national meetings/a. national meeting materials/2023/9-21-23/adoptions/00 - adoptions 09.21.2023 toc.docx](https://naiconline.sharepoint.com/teams/frsstatutoryaccounting/national%20meetings/a.national%20meeting%20materials/2023/9-21-23/adoptions/00-adoptions%2009.21.2023.toc.docx)

Interpretation of the Statutory Accounting Principles (E) Working Group

INT 23-02: Third Quarter 2023 Inflation Reduction Act – Corporate Alternative Minimum Tax

INT 23-02 Dates Discussed

August 13, 2023; September 21, 2023

INT 23-02 References

Current:

SSAP No. 9— Subsequent Events

SSAP No. 101—Income Taxes

INT 23-02 Issue

Key Provisions of the Inflation Reduction Act

1. The Inflation Reduction Act (Act) was enacted on August 16, 2022, and included a new corporate alternative minimum tax (CAMT). The CAMT is effective for tax years beginning after 2022. Reporting entities shall refer to the Act and the resulting regulations and other tax guidance to determine application, but a high-level summary of the CAMT is below.

- a. The tentative CAMT is 15% of the corporation’s “adjusted financial statement income” for the tax year, reduced by the corporate alternative minimum foreign tax credit.
- b. The CAMT differs from the previous traditional alternative minimum tax (AMT) that applied under pre-2018 tax law in that it starts at a financial statement measure (book income) – not an Internal Revenue Code taxable income calculation. Adjusted financial statement income does not include other comprehensive income including unrealized gains and losses on available for sale securities. The determination of whether the CAMT applies is made on a tax-controlled group basis (scope determination), the tentative CAMT is based on the group’s adjusted financial statement income (not adjusted regular taxable income), and any tax due (liability determination) is based on a comparison of consolidated tentative CAMT to consolidated regular tax.
- c. The CAMT applies only to corporations (determined on a tax-controlled group basis as defined for federal income tax purposes, this could include standalone unaffiliated entities which meet the specified income thresholds) with average annual adjusted financial statement income in excess of \$1 billion for three prior taxable years. The threshold is reduced to \$100 million in the case of certain foreign-owned corporations. A corporation that meets the applicable threshold is an “applicable corporation.” Applicable corporations generally remain applicable corporations for subsequent taxable years unless certain limited exceptions apply. Applicable corporation status means that CAMT must be tentatively determined and compared to regular tax liability.
- d. A corporation's adjusted financial statement income is the amount of net income or loss the corporation reports on its applicable financial statement. The income is adjusted for various purposes including certain adjustments in the case of consolidated returns or for foreign income.

- e. The Act includes references to the tax code which provides a hierarchy for determining the “applicable financial statement.” At a high level, the first choice is U.S. generally accepted accounting principles (GAAP) financial statements; the second choice is international financial reporting standards (IFRS) financial statements. If GAAP and IFRS financial statements are not available, the financial statements filed by the taxpayer with any other regulatory or government body are acceptable. If the taxpayer is part of a tax-controlled group of corporations, the group’s applicable financial statement is the applicable financial statement for each member of the group.
- f. To determine its U.S. federal income tax liability, an applicable corporation will need to compute taxes under both systems—the regular tax system and the CAMT system. The CAMT is payable to the extent the tentative CAMT exceeds the sum of the regular corporate income tax plus base erosion and anti-abuse tax (BEAT) liability.
- g. Any CAMT paid is available indefinitely as a credit carryover that would reduce future regular tax in future years when the regular tax liability is in excess of CAMT tax liability. That is, the CAMT tax credit can be used to reduce the regular tax but not below CAMT liability.
- h. A foreign tax credit (FTC) may reduce the tentative minimum CAMT. Note that unused FTCs may be carried forward for 5 years. General business credits can generally offset up to 75% of the sum of regular and minimum tax.

2. The Working Group previously issued *INT 22-02: Third Quarter 2022 through Second Quarter 2023 Reporting of the Inflation Reduction Act - Corporate Alternative Minimum Tax* which addressed third quarter 2022 through second quarter 2023. INT 22-02 noted that a reasonable estimate of the CAMT was not possible for those reporting periods and required disclosures.

3. This interpretation is focused on addressing accounting and reporting aspects of the CAMT for third quarter 2023 reporting (reporting period July 1 through September 30, 2023). While most insurers will not be applicable corporations, this interpretation provides temporary third quarter 2023 statutory accounting guidance for all reporting entities that are or expect to be applicable entities with respect to the CAMT. A separate interpretation is being developed for year-end 2023 and periods thereafter.

4. Although it is likely that most insurers that are applicable corporations will be members of a tax-controlled group of corporations and included in a consolidated federal income tax return with other members of the group, this interpretation applies to all applicable reporting entities. For reporting entities subject to the CAMT, this includes an unaffiliated corporation¹ that files a separate tax return, a member of a tax-controlled group not included in the common parent company’s consolidated tax return that files a separate company tax return or a separate consolidated tax return with other members of the group, or as a member of the common parent’s consolidated return group.

Interpretation Issues

5. *SSAP No. 101—Income Taxes*, paragraph 7.e. requires the statutory valuation allowance adjustment as a direct reduction in the gross DTA if, based on the weight of available evidence, it is more likely than not that some or all of the gross DTAs will not be realized. Gross DTA less the statutory valuation allowance results in adjusted gross DTAs. The statutory valuation allowance adjustment is not reported as a separate line in the statutory financial statements (it is an off-balance sheet item that reduces the gross DTAs). The statutory valuation allowance is disclosed.

¹ As used herein, an “unaffiliated” corporation is one that is not a member of a tax-controlled group.

6. The statutory accounting calculation for admissible DTAs is determined using adjusted gross DTAs (gross DTAs reduced by the valuation allowance). For statutory accounting, admittance of adjusted gross DTAs in SSAP No. 101 depends on a three-component calculation, for which the second step limits admittance of adjusted gross DTAs to those that are expected to be realized in a timeframe that does not exceed three years. The actual number of years permitted depends on specifics for each reporting entity (type and other information about the reporting entity), but the maximum timeframe is three years. The last step admits DTAs which can be offset by DTLs.

7. Guidance in *SSAP No. 9—Subsequent Events* requires consideration of Type I and Type II² subsequent events through the date of the statutory financial statements and the date of issuance of the audited financial statements, or the date in which audited financial statements are available to be issued. For subsequent events identified after the statutory financial statements reporting date (example September 30) but before the statements are filed (example, November 15), reporting entities are generally required by their domestic state to reflect estimates in their filed statutory financial statements. Under this guidance, as additional information is made available on the impact of the Act, or information becomes available to update estimates and assessments, under existing statutory accounting guidance in SSAP No. 9, reporting entities would need to identify updated estimates as a Type I subsequent event in the audited financial statements.

Issue 1 – Consideration of the Act for Third Quarter 2023 Financial Statements

8. Under statutory accounting guidance, reporting entities filing statutory financial statements would have to consider the applicability of the CAMT and if applicable, attempt to determine the impact on the statutory valuation allowance as well as assess DTAs for admissibility (e.g., realization timeframe). These elements will be collectively referred to as “calculations impacted by the Act” or “calculations impacted by the CAMT.” Exceptions to these calculations impacted by the CAMT have previously been provided under INT 22-02 through second quarter 2023.

9. This interpretation will address the issue for what reporting entities are required to report or disclose regarding the calculations impacted by the CAMT for third quarter 2023 (July 1 through September 30, 2023, financial statements.)

Issue 2 – Consideration of Subsequent Events for Third Quarter 2023 Financial Statements

10. SSAP No. 9 requires consideration of subsequent events through the date of the statutory financial statements and the date of issuance of the audited financial statements, or the date in which audited financial statements are available to be issued. An exception to this requirement has previously been provided under INT 22-02 through second quarter 2023.

11. For reporting entities that materially revise or establish calculations impacted by the CAMT during the third quarter 2023 or immediately subsequent to the third quarter (including the statutory valuation allowance, the timing of determination of net admitted DTAs, and the determination of the applicability of the CAMT and any related liabilities), this interpretation will address the extent a Type I or Type II subsequent event assessment is required for third quarter 2023 financial reporting.

INT 23-02 Discussion

² A Type I subsequent event relates to an event or transaction that provides additional evidence with respect to conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements. Under SSAP No. 9, entities shall recognize in the financial statements the effects of all material Type I subsequent events. A Type II subsequent event pertains to events or transactions that provide evidence to conditions that did not exist at the balance sheet date but arose after that date. Type II events are disclosed in the financial statements.

12. The Statutory Accounting Principles (E) Working Group tentative consensuses to the noted issues are included below.

Response: Issue 1 – Consideration of the Act for Third Quarter 2023 Financial Statements

13. Reporting entities that are aware they will be subject to the CAMT would normally have to reflect the effects of the Act on the calculations impacted by the CAMT if reasonably estimable for the third quarter 2023. The Act was adopted in August 2022; however, entities may continue to have a considerable number of unknown variables for September 30, 2023, reporting. As such, the Working Group has determined that a reasonable estimate might not be determinable for third quarter 2023 interim financial statements for the calculations impacted by the CAMT for some entities.

14. If a reporting entity is an applicable corporation and has determined a reasonable estimate, it shall be disclosed. If a reporting entity is an applicable corporation and cannot determine a reasonable estimate, the reporting entity shall disclose that they expect to be an applicable corporation but have not determined a reasonable estimate.

15. Because reasonable estimates of calculations impacted by the CAMT might not be determinable, reporting entities shall only disclose impacts related to CAMT for third quarter 2023 financial statements for which reasonable estimates are possible. If the reporting entity is an applicable corporation, they shall make the following disclosures regarding the CAMT and the Act:

- a. A statement regarding whether the reporting entity (or the controlled group of corporations of which the reporting entity is a member) has determined if it expects to be liable for CAMT in 2023. For example:
 - i. The reporting entity (or the controlled group of corporations of which the reporting entity is a member) has determined that it does not expect to be liable for CAMT in 2023.
 - ii. The reporting entity (or the controlled group of corporations of which the reporting entity is a member) has not determined as of the reporting date if it will be liable for CAMT in 2023. The third quarter 2023 financial statements do not include an estimated impact of the CAMT because a reasonable estimate cannot be made.
 - iii. The reporting entity (or the controlled group of corporations of which the reporting entity is a member) has determined that it expects to be liable for CAMT in 2023. The third quarter 2023 financial statements shall disclose the estimated impact of the CAMT.

Response: Issue 2 – Consideration of Subsequent Events for Third Quarter 2023 Financial Statements

16. For third quarter 2023 reporting, CAMT updated estimates or other calculations affected by the Act determined subsequent to third quarter statutory financial statement or filing date shall not be recognized as Type I subsequent events. Meaning, third quarter financial statements are not required to reflect updated estimates subsequent to the third quarter reporting date and prior to the filing of the third quarter financial statements. With the disclosure required under Issue 1, additional subsequent event disclosure (such as what would be required for Type II event) is not required.

17. Reporting entities shall be working in good faith to complete the accounting for the changes adopted under the Act.

INT 23-02 Status

18. The tentative consensuses in this interpretation were adopted on September 21, 2023 to provide reporting guidance regarding the calculations impacted by the CAMT and provide limited-scope, limited-time exceptions to the valuation allowance and DTA calculations in response to legislation under SSAP No. 101 as well as Type I subsequent event requirements in SSAP No. 9 for September 30, 2023, statutory reporting. As detailed, the exceptions to SSAP No. 101 and SSAP No. 9 are effective for the third quarter 2023.

19. This interpretation will be automatically nullified on November 16, 2023, and as additional guidance for year end 2023 reporting is being separately developed.

20. No further discussion is planned.

[https://naiconline.sharepoint.com/teams/frsstatutoryaccounting/national meetings/a. national meeting materials/2023/9-21-23/adoptions/int 23-02 3q camt final.docx](https://naiconline.sharepoint.com/teams/frsstatutoryaccounting/national%20meetings/a.%20national%20meeting%20materials/2023/9-21-23/adoptions/int%2023-02%203q%20camt%20final.docx)

**Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A**

Issue: Corporate Alternative Minimum Tax Guidance

Check (applicable entity):

	P/C	Life	Health
Modification of Existing SSAP	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
New Issue or SSAP	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Interpretation	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Description of Issue:

The Inflation Reduction Act (Act) was enacted on August 16, 2022, and included a new corporate alternative minimum tax (CAMT). In December 2022, the Working Group adopted temporary guidance to address the CAMT in *INT 22-02: Third Quarter 2022 through First Quarter 2023 Reporting of the Inflation Reduction Act - Corporate Alternative Minimum Tax*.

This agenda item is to begin the project of providing guidance regarding the CAMT for periods after the first quarter 2023. Interested parties of the SAPWG have submitted initial informal recommendations to assist with preparing the guidance.

The Act and the CAMT go into effect for tax years beginning after 2022. A high-level summary regarding the CAMT is as follows:

- a. The CAMT is 15% of the corporation's "adjusted financial statement income" for the tax year, reduced by corporate alternative minimum foreign tax credit. The CAMT differs from the previous traditional alternative minimum tax (AMT) in that it starts at a financial statement measure (book income) – not an Internal Revenue Code tax calculation.
- b. The CAMT will only apply to corporations (determined on an affiliated group basis) with an average adjusted financial statement income in excess of \$1 billion for the three prior tax years. This threshold is reduced to \$100 million in the case of certain foreign-parented corporations. When a corporation becomes subject to the CAMT, it remains subject to the calculation of the CAMT, even if its average adjusted financial statement income is less than \$1 billion, unless an exception applies.
- c. A corporation's adjusted financial statement income is the amount of net income or loss the corporation reports on its applicable financial statement. The income is adjusted for various purposes including certain adjustments in the case of consolidated returns or for foreign income tax.
- d. The Act includes references to the tax codes which provides a hierarchy for determining the "applicable financial statement." At a high level, the first choice is U.S. generally accepted accounting principles (GAAP) financial statements; the second choice is international financial reporting standards (IFRS) financial statements. If GAAP and IFRS financial statements are not available, the financial statements filed by the taxpayer with any other regulatory or government body is acceptable. If the taxpayer is part of an affiliated group of corporations filing a consolidated return the adjustable financial statement income for the group considers the group's applicable financial statement.
- e. To determine its U.S. federal income tax liability, a corporation will need to compute taxes under both systems — the regular tax system and the CAMT system. The CAMT is payable to the extent the tentative CAMT exceeds the regular corporate income tax. The tentative corporate alternative minimum tax will be the excess of the tentative corporate alternative minimum tax over regular income tax + base erosion and

anti-abuse tax (BEAT) liability. A foreign tax credit (FTC) will reduce the tentative minimum CAMT. Note that unused FTCs can be carried forward 5 years.

- f. General business credits can generally offset up to 75% of regular and minimum tax.
- g. Any CAMT paid is available indefinitely as a tax credit carryover that could reduce future regular tax if the regular tax liability plus the base erosion and anti-abuse tax (BEAT) exceeds the tentative minimum tax is in excess of CAMT tax liability. That is, the CAMT tax credit (CAMT DTA) can be used to reduce the regular tax but not below CAMT liability.
- h. The Act directs the Treasury to issue regulations and other guidance relate to implementing the CAMT. As of February 2023, several issues are pending detailed clarifications from the Treasury.

The CAMT presents several accounting challenges including:

1. Financial Projections - There will be challenges estimating future applicable financial statement income for a group of companies outside of the reporting entity. In addition, there are challenges related to projecting partnership/alternative investment income for applicable financial statement income projections.
2. Payment of the CAMT creates a deferred tax asset which can be carried forward indefinitely. Determining the future period when the CAMT credit can be used will require projections of future regular tax and CAMT, which may also require information external to the reporting entity.
3. Tax sharing agreements and allocation of the CAMT liability which is determined on a consolidated basis.
4. The CAMT DTA (tax credit) can be used to reduce the general tax liability but not below the CAMT. Therefore, the Working Group will need to review treatment under the statutory valuation allowance and also the interaction of the realizability of the CAMT DTA on other DTAs. That is, use of the CAMT DTA, may reduce the realizability of other DTAs. Related topics are as follows:
 - a. Is an estimate of future CAMT required for the determination of DTA realization under the “with and without” calculation? CAMT DTAs would reduce realization under the with and without approach,
 - b. Under GAAP, for the analysis of realizably of non-AMT credit deferred tax assets, the company may elect to consider or disregard its AMT status as long as it is consistent. If the company elects to consider AMT, must book the valuation allowance in the period of enactment (period that includes August of 2022). If material, the company has to disclose the accounting policy election.
 - c. Admissibility of CAMT DTAs under SSAP No. 101, particularly for the paragraph 11b admissibility calculation, presents challenges.

Existing Authoritative Literature:

SSAP No. 101—Income Taxes provides the federal income tax guidance for statutory accounting.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): In December 2022, the Working Group adopted *INT 22-02: Third Quarter 2022 through First Quarter 2023 Reporting of the Inflation Reduction Act - Corporate Alternative Minimum Tax*.

In addition, *INT 22-03: Inflation Reduction Act - Corporate Alternative Minimum Tax* was exposed for comment in October 2022, but not finalized.

In 2019 the Working Group revised the *SSAP No. 101—Income Taxes-Implementation Q&A* to update examples and guidance in response to the federal Tax Cuts and Jobs Act which repealed of the Alternative Minimum Tax in agenda item 2019-09: SSAP No. 101 – Q&A Updates – TCJA.

Information or issues (included in *Description of Issue*) not previously contemplated by the Working Group:
None

Convergence with International Financial Reporting Standards (IFRS): None.

Staff Review Completed by: Robin Marcotte– NAIC Staff, February 2023

Staff Recommendation: NAIC staff recommends that the Working Group move this item to the active listing, categorized as a SAP clarification and direct NAIC staff, to continue to work with industry on developing guidance for the reporting of the CAMT for future Working Group discussion.

The CAMT presents several accounting challenges, Working Group input will be needed on several decisions points including: treatment of tax sharing agreements, consideration regarding the CAMT DTA in the statutory valuation allowance, and the treatment of CMATs DTAs, in the overall DTA admissibility calculation. Staff will also need Working Group input on whether to maintain an RBC threshold for the SSAP No. 101, paragraph 11b admissibility test and the overall extent of admissibility of the CAMT DTAs.

Status:

On March 22, 2023, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a SAP clarification, and directed staff to work with industry on developing guidance for CAMT for interim discussion.

On August 13, 2023, the Statutory Accounting Principles (E) Working Group exposed *INT 23-03: Inflation Reduction Act - Corporate Alternative Minimum Tax* for comment with a proposed effective date of year-end 2023. After discussion, the Working Group also directed that the exposed INT 23-03T, including guidance which provides for the admissibility of CAMT credits under SSAP No. 101, paragraph 11c. should be consistent with the treatment of other DTAs under this step (see exposure paragraph 34).

On September 21, 2023, the Statutory Accounting Principles (E) Working Group adopted *INT 23-03: Inflation Reduction Act - Corporate Alternative Minimum Tax*, which incorporated the majority of the revisions proposed by interested parties. However, these revisions did not change the overall principles exposed. This interpretation applies for reporting periods on or after December 31, 2023

[https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2023/8-13-23 Summer National Meeting/Exposures/23-04 - CAMT.docx](https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National%20Meetings/A.%20National%20Meeting%20Materials/2023/8-13-23%20Summer%20National%20Meeting/Exposures/23-04%20-%20CAMT.docx)

Interpretation of the Statutory Accounting Principles (E) Working Group

INT 23-03: Inflation Reduction Act – Corporate Alternative Minimum Tax

INT 23-03 Dates Discussed

August 13, 2023; September 21, 2023

INT 23-03 References

Current:

SSAP No. 4—Assets and Nonadmitted Assets

SSAP No. 9— Subsequent Events

SSAP No. 101—Income Taxes

INT 23-03 Issue

Key Provisions of the Inflation Reduction Act

1. The Inflation Reduction Act (Act) was enacted on August 16, 2022, and included a new corporate alternative minimum tax (CAMT). The CAMT is effective for tax years beginning after 2022. Reporting entities shall refer to the Act and the resulting regulations and other tax guidance to determine application, but a high-level summary of the CAMT is below.

- a. The tentative CAMT is 15% of the corporation’s “adjusted financial statement income” for the tax year, reduced by corporate alternative minimum foreign tax credit.
- b. The CAMT differs from the previous traditional alternative minimum tax that applied under pre-2018 tax law in that it starts at a financial statement measure (book income) – not an Internal Revenue Code taxable income calculation. Adjusted financial statement income does not include other comprehensive income including unrealized gains and losses on available for sale securities. The determination of whether the CAMT applies is made on a tax-controlled group basis (scope determination), the tentative CAMT is based on the group’s adjusted financial statement income (not adjusted regular taxable income), and any tax due (liability determination) is based on a comparison of consolidated tentative CAMT to consolidated regular tax (non-CAMT).
- c. The CAMT applies only to corporations (determined on a tax-controlled group basis as defined for federal income tax purposes, this could include standalone unaffiliated entities which meet the specified income thresholds – see paragraph 3) with average annual adjusted financial statement income in excess of \$1 billion for three prior taxable years. The threshold is reduced to \$100 million in the case of certain foreign-owned corporations. A corporation that meets the applicable threshold is an “applicable corporation.” Applicable corporations generally remain applicable corporations for subsequent taxable years unless certain limited exceptions apply. Applicable corporation status means that CAMT must be tentatively determined and compared to regular (non-CAMT) tax liability.
- d. A corporation's adjusted financial statement income is the amount of net income or loss the corporation reports on its applicable financial statement. The income is adjusted for various purposes including certain adjustments in the case of consolidated returns or for foreign income.

INT 23-03: Inflation Reduction Act - Corporate Alternative Minimum Tax

- e. The Act includes references to the tax code which provides a hierarchy for determining the applicable financial statement. At a high level, the first choice is U.S. generally accepted accounting principles (GAAP) financial statements; the second choice is international financial reporting standards (IFRS) financial statements. If GAAP and IFRS financial statements are not available, the financial statements filed by the taxpayer with any other regulatory or government body are acceptable. If the taxpayer is part of a tax-controlled group of corporations, the group's applicable financial statement is the applicable financial statement for each member of the group.
- f. To determine its U.S. federal income tax liability, an applicable corporation will need to compute taxes under both systems – the regular tax system and the CAMT system. The CAMT is payable to the extent the tentative CAMT exceeds the sum of the regular corporate income tax plus base erosion and anti-abuse tax (BEAT) liability.
- g. Any CAMT paid is available indefinitely as a credit carryover that would reduce future regular tax in future years when the regular tax liability is in excess of the tentative CAMT liability. That is, the CAMT credit can be used to reduce the regular tax but not below tentative CAMT liability.
- h. A foreign tax credit (FTC) may reduce the tentative minimum CAMT. Note that unused FTCs may be carried forward for 5 years. General business credits can generally offset up to 75% of the sum of regular and minimum tax.

2. This interpretation is focused on addressing accounting and reporting aspects of the CAMT. As most reporting entities will not be above the applicable corporation threshold and will not be subject to the CAMT calculation, this guidance has been developed as an interpretation. While most insurers will not be applicable corporations, this interpretation provides comprehensive statutory accounting guidance for all reporting entities with respect to the CAMT. This interpretation incorporates a principles-based approach for purposes of statutory accounting for the CAMT.

3. Although it is likely that most insurers that are applicable corporations will be members of a tax-controlled group of corporations and included in a consolidated federal income tax return with other members of the group, this interpretation applies to all reporting entities subject to the CAMT, whether an unaffiliated corporation¹ that files a separate tax return, a member of a tax-controlled group not included in the common parent company's consolidated tax return that files a separate company tax return or a separate consolidated tax return with other members of the group, or as a member of the common parent's consolidated return group.

4. For reporting entities that are included in a consolidated tax return, the fundamental statutory tax accounting issue for the CAMT is how to reflect in the reporting entity's separate company financial statements a portion of what is essentially an add-on tax for a consolidated tax return group that is based on the group's financial statement income and group tax rate. Even if a member of a tax-controlled group of corporations files its own separate federal income tax return, the tax law does not provide for a separate company scope determination, but rather looks to the tax-controlled group for applicable corporation status and determination of the applicable financial statement.

INT 23-03 Discussion

5. The discussion along with the Statutory Accounting Principles (E) Working Group tentative consensuses are included below.

¹ As used herein, an "unaffiliated" corporation is one that is not a member of a tax-controlled group.

Categories of Reporting Entities

6. In an annual determination of applicable corporation status, all reporting entities are separated into one of the following categories:
- a. Nonapplicable reporting entities
 - b. Applicable reporting entities
 - c. Applicable reporting entities with tax allocation agreement (also called tax sharing agreements) exclusions.

Nonapplicable Reporting Entities

7. Nonapplicable reporting entities are reporting entities that do not reasonably expect to be an applicable corporation either as a member of a tax-controlled group of corporations² or individually as an unaffiliated corporation, for the taxable year that includes the current reporting period. Nonapplicable reporting entities are not required to calculate or recognize a payable for CAMT. If a reporting entity is not subject to pay CAMT, then they will have no CAMT credit carryforward. For nonapplicable reporting entities, further assessment of the CAMT is not required for current or deferred tax computations, and the remaining accounting components of the interpretation do not apply. Applicable disclosures are required.

8. A reporting entity that was an applicable corporation for the preceding taxable year shall reasonably expect to be an applicable corporation for the current taxable year, unless one of the tax law exceptions to continued applicable corporation status applies.

Applicable Reporting Entities

9. Applicable reporting entities are reporting entities that reasonably expect to be applicable corporations for the taxable year that includes the current reporting period, either individually as an unaffiliated corporation or as a member of a tax-controlled group of corporations³. Applicable reporting entities are required to consider CAMT in current and deferred tax computations in the manner set forth in this interpretation.

10. Because CAMT is not payable by an applicable corporation unless it is in excess of regular tax liability, the CAMT calculations for applicable reporting entities within this interpretation may or may not result in different current and deferred income taxes than if the CAMT was not taken into account. (Applicable reporting entities with tax allocation agreement exclusions that meet the requirements of paragraph 11 of this interpretation shall follow the guidance in paragraph 12 of this interpretation.)

Applicable Reporting Entities with Tax Allocation Agreement Exclusions

11. Applicable reporting entities with tax allocation agreement exclusions are reporting entities that qualify as an applicable corporation as a member of a tax-controlled group of corporations pursuant to

² A reporting entity that is a member of a tax-controlled group that does not reasonably expect to be applicable corporation on a group basis is not required to make a separate company determination as the CAMT is determined on a group basis.

³ Determination of applicable reporting entity within a tax-controlled group is subject to the tax law. A reporting entity within a tax-controlled group is captured with the group's applicable corporation status regardless of if they were excluded from the consolidated tax return and filed their own separate return. For example, if the reporting entity is a life insurance company and i) the group has not made a "life-nonlife" consolidated return election, or ii) the reporting entity has been recently acquired and is excluded from the life-nonlife consolidated return for a period of 5 years.

paragraphs 9 and 10 of this interpretation, and is a party to a tax allocation agreement that is in effect for the reporting period that has all of the following terms:

- a. The reporting entity is excluded from charges for any portion of the group's CAMT, and
- b. The reporting entity is not allocated any portion of the group's CAMT credit carryover.

12. Reporting entities with tax allocation agreement exclusions which qualify under paragraph 11 of this interpretation, are not required to calculate, or recognize CAMT in their current or deferred tax computations. Even with the tax allocation agreement exclusions, the general current tax liability guidance pursuant to *SSAP No. 101—Income Taxes*, paragraph 3 continues to apply. This guidance requires the reporting entity to recognize the amount the reporting entity has paid or is payable, which includes any additional amount the reporting entity expects to pay on behalf of its co-obligors.

Accounting for Applicable Reporting Entities

Impact of Tax Allocation Agreements

13. This interpretation is based on the principle that the statutory accounting for the CAMT for reporting entities included in a consolidated tax return should be matched to the CAMT charges reasonably estimated to be paid by the reporting entity and the corresponding CAMT credits reasonably estimated to be received by the reporting entity. For such reporting entities, this interpretation applies the provisions of the intercompany tax allocation agreement⁴ (also referred to as a tax sharing agreement) that governs allocation of consolidated taxes to individual members of the group.

14. SSAP No. 101, paragraph 16 provides that in the case of a reporting entity that files a consolidated income tax return with one or more affiliates, income tax transactions between the affiliated parties shall be recognized if such transactions are economic transactions as defined in *SSAP No. 25—Affiliates and Other Related Parties*; are pursuant to a written tax allocation agreement; and income taxes incurred are accounted for in a manner consistent with the principles of FAS 109 the predecessor of what is now ASC 740, as modified by SSAP No. 101.

15. For a reporting entity that is included in a consolidated tax return and is subject to a qualifying tax allocation agreement which is consistent with paragraphs 16 and 17 of SSAP No. 101, the amount of CAMT payable (expense) or CAMT credit carryforward is recognized in accordance with the tax allocation agreement.

Recognition of CAMT Payable

16. Reporting entities that are applicable corporations, excluding those having qualifying tax allocation agreement exclusions per paragraph 11 of this interpretation, are required to take CAMT payable into account in the calculation of current income tax expense pursuant to SSAP No. 101. Reporting entities shall accrue the CAMT owed, reflecting the amount owed as a separate return filer or in accordance with the amount allocated through the consolidated tax return group's tax sharing agreement pursuant to paragraph 15 of this INT.

⁴ SSAP No. 101, paragraphs 16 and 17 provide requirements for tax allocation agreement recognition. Tax allocation agreements are also subject to internal revenue service requirements and are subject to domiciliary regulator review under the Insurance Holding Company System Regulatory Act (Model #440), which also requires that the terms of intercompany agreements be fair and reasonable. In assessing fair and reasonable, state insurance regulators are encouraged to assess the terms of the TSA for allocations to the insurance reporting entity for both CAMT payables and CAMT credit carryforwards.

17. Consistent with SSAP No. 101, paragraph 8, changes in deferred tax assets (DTAs) and deferred tax liabilities (DTLs), including changes attributable to changes in tax rates and changes in tax status, if any, shall be recognized as a separate component of gains and losses in unassigned funds (surplus) as “change in net deferred income tax,” excluding any change reflected in unrealized capital gains.

18. Paragraph 8.3 of SSAP No. 101 Exhibit A – Implementation Questions and Answers (Q&A) is not applicable to reporting entities subject to CAMT through a tax-controlled group structure. This exclusion is provided due to the consolidated nature of the CAMT calculation. Any theoretical separate entity calculation of the CAMT liability may be unrelated to the actual consolidated tax return computations and to the tax allocation agreement allocation of liability.

Recognition of CAMT Credit Deferred Tax Asset

19. Reporting entities shall recognize a corresponding DTA which represents the non-expiring tax credit carryforward equal and offsetting to the current CAMT accrued. The CAMT credit can be used to reduce regular tax in future years when the regular tax liability is in excess of the tentative CAMT liability as permitted under the tax law. The CAMT credit carryforward is a type of deferred tax asset.

Impact of CAMT to the Statutory Valuation Allowance

20. SSAP No. 101—Income Taxes, paragraph 7.e. requires the statutory valuation allowance adjustment as a direct reduction in the gross DTA if, based on the weight of available evidence, it is more likely than not that some or all of the gross DTAs will not be realized. Gross DTA less the statutory valuation allowance results in adjusted gross DTAs. The statutory valuation allowance adjustment is not reported as a separate line in the statutory financial statements (it is an off-balance sheet item that reduces the gross DTAs). The statutory valuation allowance is disclosed.

21. The determination of a statutory valuation allowance⁵ for CAMT credit deferred tax assets depends on whether the reporting entity is part of a consolidated tax return group or a separate tax return filer:

- a. Consolidated Tax Return Group: A reporting entity that is an applicable entity and a member of consolidated tax return group shall utilize the statutory valuation assessment for the CAMT credit deferred tax assets completed at the consolidated tax return group level. A reporting entity is not required to adjust the group statutory valuation allowance for CAMT credit deferred tax assets. Rather, the group determined statutory valuation allowance and the resulting credit deferred tax asset deemed to be more likely than not to be realized, is permitted to be allocated (consistent with tax allocation agreement) to the reporting entity and reflected as an CAMT credit adjusted gross DTA. The reporting entity shall continue to have a separate statutory valuation allowance calculation for non-CAMT deferred tax assets as required under SSAP No. 101. The combination of the CAMT credit adjusted gross deferred tax asset (as received from the group) and the adjusted gross deferred tax assets from non-CAMT deferred tax assets shall equal the total adjusted gross deferred tax assets reviewed for admittance within the scope of this interpretation.
- b. Separate Tax Return Filer: A reporting entity that is an applicable entity and files a separate tax return, is required to complete a statutory valuation allowance for all deferred tax assets, including CAMT credit deferred tax assets, in determining their total adjusted gross DTAs. (The CAMT credit deferred tax assets can be assessed separately from non-

⁵ Although reporting entities may conclude that the non-expiring CAMT DTA more likely than not will ultimately be realized, reporting entities will not be able to utilize the tax credit until the reporting entity if a separate tax return filer, or the tax consolidated group of corporations if the reporting entity is a member of such group, are no longer CAMT payors and have sufficient tax liability that permits the group the ability to use the CAMT credits.

CAMT deferred tax assets in determining whether the deferred tax asset is more likely than not to be realized.) The total adjusted gross deferred tax assets are then reviewed for admittance within the scope of this interpretation.

22. A reporting entity is allowed an accounting policy election to either consider or disregard CAMT when evaluating the need for a valuation allowance for its non CAMT deferred tax assets.⁶ The accounting policy election applies for valuation allowance purposes only – that is, in the determination of adjusted gross deferred tax assets other than the CAMT credit deferred tax assets. This accounting policy election cannot be used to avoid a valuation allowance analysis for CAMT credit DTAs. The accounting policy election must be disclosed in the notes to the financial statements and applied consistently in subsequent reporting periods.

Admissibility

Admittance - Implications of Group Tax Assessment (Related Parties)

23. For reporting entities that are applicable corporations as they are a member of a tax-controlled group of corporations, the reporting entity may be subject to the CAMT, or be hindered from utilizing the CAMT credit, through the actions of their consolidated tax return group related parties. (As noted in footnote 5, although a reporting entity may have earned a non-expiring tax credit through payment of CAMT, the reporting entity is not eligible to utilize that tax credit until the consolidated tax return group has sufficient tax liability that allows the members of the group to utilize their tax credit. This means that on a group basis they are no longer CAMT payors.) SSAP No. 4—*Assets and Nonadmitted Assets* requires assets that are restricted by the action of a related party to be nonadmitted assets.

SSAP No. 4, Footnote 2: If assets of an insurance entity are pledged **or otherwise restricted by the action of a related party, the assets are not under the exclusive control of the insurance entity and are not available to satisfy policyholder obligations due to these encumbrances or other third-party interests. Thus, pursuant to paragraph 2, such assets shall not be recognized as an admitted asset on the balance sheet.** Additional guidance for assets pledged as collateral is included in INT 01-31.

24. A key focus of this interpretation is the admittance of the CAMT deferred tax assets (credits). However, it is recognized that under the existing statutory accounting guidance in SSAP No. 4 a reporting entity recognizing CAMT credit deferred tax assets would not be permitted to admit those deferred tax assets if as part of a consolidated tax return group the ability to receive those CAMT credits is explicitly linked to the actions of other entities within the group. If the group on a collective basis does not incur enough tax to allow utilization of the tax credits, then the reporting entity cannot use the tax credits, regardless of the income or tax paid by the reporting entity. This aspect is not impacted by the tax sharing agreement. Although the tax sharing agreement may specify how the CAMT credits will be allocated among the group, such tax credits allocated to the reporting entity can only be realized when the group qualifies for the credit.

25. For the CAMT credit adjusted gross deferred tax assets allocated to the reporting entity to be eligible to be admitted, this interpretation provides an exception to the guidance in SSAP No. 4, footnote 2, recognizing that the impact to ultimately utilize the allocated tax credits is dependent on the actions of the other parties within the group.

Admittance – Adjusted Gross DTAs

⁶ SSAP No. 101, FAS 109 and ASC 740 do not specifically address whether future years' CAMT should be anticipated in a valuation allowance assessment for non-CAMT DTAs. Accordingly, an accounting policy election is allowed for GAAP purposes as to whether to consider or disregard CAMT when evaluating the need for a valuation allowance for non-CAMT DTAs.

26. The guidance in SSAP No. 101 allows admittance of adjusted gross DTAs (gross DTAs reduced by the statutory valuation allowance) pursuant to a three-component calculation, for which the second step limits admittance of adjusted gross DTAs to those that are expected to be realized in a timeframe that does not exceed three years. The actual number of years to realization permitted depends on specifics for each reporting entity (type and other information about the reporting entity), but the maximum timeframe is three years. The last step (SSAP No. 101, paragraph 11.c.) admits DTAs which can be offset by DTLs.

27. Due to the following aspects regarding the CAMT credits, specific admittance guidance for the CAMT credit DTAs has been established:

- a. The CAMT credit is a tax credit DTA that does not expire. As long as the reporting entity is a CAMT payor or is part of a tax-consolidated group that is a CAMT payor, the reporting entity cannot utilize the tax credit.
- b. The ability to utilize the CAMT credit is contingent on the actions and tax paying behaviors of the consolidated tax return group. Although the reporting entity may be paying sufficient tax above the CAMT threshold, if other parties within the group do not act in a similar manner, putting the group below the CAMT threshold, then the CAMT credit cannot be utilized by the reporting entity.

28. With these noted limitations in utilization of the earned tax credits, reporting entities are only permitted to admit CAMT credits if the reporting entity tax projections (if a separate tax return filer) or projections of the tax-consolidated group (if a member of such group) indicate that the CAMT credit will be realizable within the stated timeframes using the applicable SSAP No. 101, paragraph 11 realization table thresholds⁷. This means that the tax projections will have sufficient tax liability that permits utilization of the CAMT credits. For example, a reporting entity with greater than 300% ExDTA ACL RBC can only admit CAMT credits that are expected to be realized (consistent with the tax allocation agreement) in three years. Reporting entities that have ExDTA ACL RBC between 200-300% can only admit CAMT credits that are expected to be realized in one year. If a reporting entity cannot project (either on its own if a separate return filer or at the group if a consolidated tax return group member) sufficient tax liability that allows them to utilize the CAMT credit within the applicable realizable timeframes for admittance, then the portion of CAMT credits that cannot be utilized are required to be nonadmitted under SSAP No. 101, paragraph 11.b.

29. CAMT credits included in the SSAP No. 101, paragraphs 11 and 11.b. calculation as they are expected to be realized within the applicable 1 or 3 year permitted timeframes shall then be combined with non-CAMT adjusted gross deferred tax assets and admitted to the extent that the total DTAs admitted under paragraph 11.b. do not exceed the capital and surplus percentage limit for the company type. All references to SSAP No. 101, paragraph 11.b. include the modifications in this Interpretation.

30. Reporting entities shall use the Realization Threshold Limitations Tables in SSAP No. 101, paragraph 11.b. as applicable to the entity for determination of the admissibility of the CAMT credits. The percentage limitations of capital and surplus of and the projected realization periods continue to apply to admitted adjusted gross DTAs, including the adjusted gross DTA for any CAMT credit DTA.

31. A reporting entity which meets or exceeds the top line of the applicable of the Realization Threshold Limitation Table (Ex. 3 years and 15%) is **not required** to take the CAMT into account in calculating the

⁷ The examples in this paragraph reference Ex-DTA ACL RBC, however, SSAP No. 101, paragraph 11.b. also includes realization threshold tables which apply to non-RBC filers.

“with and without⁸” tax liability for purposes of determining the amount expected to be realized under SSAP No. 101, paragraph 11.b. for non-CAMT DTAs. Specifically, the reporting entity’s “with and without” regular tax liability is not reduced by CAMT, if any, reasonably expected to be incurred during the SSAP No. 101, paragraph 11.b. applicable period. In the case of a reporting entity included in a consolidated federal income tax return, the amount expected to be incurred refers to the portion of the consolidated CAMT, if any, reasonably expected to be allocable to the reporting entity pursuant to the group’s tax allocation agreement. However, any admitted CAMT credits in this step must be realizable within the applicable time period specified in the applicable Realization Threshold Limitation Table (Ex, top line - 3 years), determined consistent with the tax allocation agreement. The post-valuation allowance adjusted gross DTA for any CAMT credit DTA is admitted following the guidance in SSAP No. 101, paragraph 11.b.i. as modified by this Interpretation. The 15% limitation of capital and surplus which is provided in SSAP No. 101, paragraph 11.b.ii. continues to apply to admitted adjusted gross DTAs, including the adjusted gross DTA for any CAMT credit DTA.

32. A reporting entity which meets the second line of the applicable Realization Threshold Limitation Table (Ex. 1 year and 10%), the amount expected to be realized under SSAP No. 101, paragraph 11.b.i. within the applicable period determined under paragraph 11.b. **is based** on the reporting entity’s “with and without” regular tax liability reduced by CAMT, if any, reasonably expected to be incurred during the paragraph 11.b. applicable period. In the case of a reporting entity included in a consolidated federal income tax return, the amount expected to be realized is reduced by the portion of the consolidated CAMT, if any, reasonably expected to be allocable to the reporting entity pursuant to the group’s tax allocation agreement. CAMT credit utilization during the applicable period is recognized based on the same principles, – that is, as an admitted DTA. The purpose of these computations is to account for CAMT in deferred taxes in the same manner as CAMT would be reflected in current taxes.

33. A reporting entity which meets or is below the third line of the applicable Realization Threshold Limitation Table (Ex. 0 years and 0%), is not permitted to admit either CAMT credit DTAs or non-CAMT DTAs under SSAP No. 101, paragraph 11.b.

34. The adjusted gross DTA for any CAMT credit carryforward which does not qualify for admission under SSAP No. 101, paragraph 11.b. is permitted to be recognized as an offset against DTLs in accordance with SSAP No. 101, paragraph 11.c. The reporting entity shall admit the remaining amount of adjusted gross DTAs, after application of paragraphs 11.a. and 11.b. that can be offset against existing gross DTLs. The reporting entity shall consider the character (i.e., ordinary versus capital) of the DTAs and DTLs such that offsetting would be permitted in the tax return under existing enacted federal income tax laws and regulations.

Admittance - Projections

35. Projections of CAMT liability, if any, (and CAMT credit utilization) during the applicable period involve forward-looking data, groupings, of assets and liabilities, estimates and other adjustments for both the reporting entity and the group of which it is a member. The manner in which this is done shall be conducted in a reasonable and consistent manner. A reporting entity shall retain internal documentation to support these computations and the methodologies so employed. Modifications to the estimation methodology are permitted should events or circumstances change from a previous period – such as a change in materiality or administrative costs associated with the computations, or system changes that affect the level of detail available. Entities that make such modifications should be prepared to rationalize the

⁸ “With and without” is further described in SSAP No. 101.

changes. Disclosure of material modifications, and the general reason for such, should be made in the notes to the financial statements.⁹

Admittance - Tax Planning Strategies

36. SSAP No. 101 provides that tax-planning strategies are required to be considered in the valuation allowance analysis and may be considered in determining the admission of DTAs under SSAP No. 101, paragraph 11. For reporting entities that are part of a consolidated tax return group, tax planning strategies impacting the CAMT are determined at a group level, as long as the tax planning strategies at the group level do not conflict with tax planning strategies at the reporting level and vice versa. For reporting entities that are separate tax return filers, a reporting entity must consider tax-planning strategies in making the valuation allowance analysis required under this interpretation.

Transition Guidance

37. Even though the CAMT was enacted in 2022 and generally became effective January 1, 2023, the requirements for statutory tax accounting for the CAMT have effectively been deferred by INT 22-02. This paragraph provides the applicable transition rules for year-end 2023 statutory accounting for requests for a timely-filed tax allocation agreement amendment or a new tax allocation agreement for the 2023 taxable year.

- a. Because the CAMT was newly enacted effective for 2023, tax allocation agreements in effect for periods prior to the 2023 taxable year include no explicit provisions relating to the CAMT. Thus, applicable reporting entities (with and without tax allocation agreement exclusions) may need to amend tax allocation agreements to deal with the CAMT effective for the entire 2023 taxable year. A reporting entity would file a request for amendment to a tax allocation agreement or a new tax allocation agreement on Form D – Prior Notice of a Transaction as required under the *Insurance Holding Company System Regulatory Act* (Model #440) and the related regulation, (Model #450) with its applicable domiciliary regulator(s) and commercial domiciliary regulator(s).
- b. Time is of the essence in both requesting and approving tax allocation agreement amendments or a new tax allocation agreement relating to the CAMT for the 2023 taxable year to be applicable to the 2023 reporting period. Accordingly, if a reporting entity files the applicable Form D request(s) for tax allocation agreement amendment or a new tax allocation agreement prior to the end of 2023 to address the CAMT for 2023 and subsequent taxable years, and the domiciliary regulator has confirmed in writing that they have no objections to using the new tax allocation agreement amendment or new tax allocation agreement, while under review. The reporting entity shall be allowed to account for the tax allocation agreement as applicable for the entire 2023 reporting period.
- c. If the final approved tax allocation agreement differs in its treatment of the CAMT allocation from the tax allocation agreement originally requested on the Form D, the difference shall be recorded as follows:
 - i. If Form D approval occurs subsequent to the balance sheet date, but before the issuance of the statutory financial statements and before the date the audited financial statements are issued, or available to be issued, such approval shall be considered a Type I subsequent event within the meaning of *SSAP No. 9— Subsequent Events*.

⁹ See paragraph 2.9 of the *SSAP No. 101 Q&A* for similar requirements in the context of grouping of assets and liabilities for measurement.

- ii. If the Form D approval occurs after the period which defines a subsequent event in SSAP No. 9, the difference created by such approval shall be recognized and disclosed in the period in which the approval is given.
- d. The transition guidance in paragraph 37 does not apply to a reporting entity that does not file a Form D request for a CAMT-related tax allocation agreement amendment or a new tax allocation agreement prior to the end of 2023.

38. Consistent with *SSAP No. 3—Accounting Changes and Corrections of Errors*, paragraph 4, initial application of this interpretation shall not be considered a change in accounting principle, but instead application of a new principle for the first time.

Disclosures

39. The reporting entity shall disclose whether it is a nonapplicable reporting entity; an applicable reporting entity with tax allocation agreement exclusions or an applicable reporting entity.

40. Additionally, the following disclosures shall be made in the notes to the financial statements of applicable reporting entities (which do not have tax allocation agreement exclusions in accordance with paragraph 11 of this interpretation):

- a. If the reporting entity has made an accounting policy election to either consider or disregard CAMT when evaluating the need for a valuation allowance for its non-CAMT DTAs described in paragraph 22 of this interpretation.
- b. Any disclosure of material modifications to the methodology used to project CAMT as required by paragraph 35 of this interpretation.

41. Relevant disclosures required by SSAP No. 101 also apply including but not limited to, the following:

- a. The disclosure of the statutory valuation allowance as required by SSAP No. 101, paragraph 21.
- b. The disclosure of tax planning strategies is required by SSAP No. 101. In the disclosure required by SSAP No. 101, paragraph 28.b., a statement as to whether the reporting entity may be charged with a portion of CAMT incurred by the consolidated group (or credited with a portion of the consolidated group's CAMT credit utilization).
- c. Inclusion of CAMT credit DTAs, if any, in the disclosure required by SSAP No. 101, paragraph 26.a. regarding the origination dates and expiration of tax credit carry forwards.
- d. The impact of CAMT -planning strategies, if any, in the disclosure required by SSAP No. 101, paragraph 22.f.

INT 23-03 Status

42. The consensuses in this interpretation are effective beginning with year-end 2023 financial statements and periods thereafter.

43. No further discussion is planned.

Examples

Basic Facts Used in All Examples

44. The reporting entity is a member of a tax-affiliated group of corporations that files consolidated federal income tax returns which reasonably expects to be an applicable corporation for 20X3.
- a. Reporting entity also has \$200x of non-CAMT adjusted gross DTAs (i.e., has already reduced by any required valuation allowance of \$40x). Of this \$200x of which \$150x reverses over the 3-year applicable period 20X4-20X6 and is expected to be realized.
 - b. At the end of 20X3, reporting entity has a \$50x CAMT credit DTA (pursuant to the consolidated group's tax allocation agreement, reporting entity was allocated a portion of the group's expected 20X3 current CAMT expense, which reporting entity included in its 20X3 current tax expense).
 - c. The consolidated group of which the reporting entity is a member establishes a \$20x valuation allowance against its \$50x CAMT credit DTA, resulting in a CAMT adjusted gross DTA of \$30x that is more likely than not to be realized.
 - d. The reporting entity makes an accounting policy election to disregard CAMT when evaluating the need for a valuation allowance for its non-CAMT DTAs.
 - e. Reporting entity's capital and surplus for purposes of calculating the limitation under SSAP No. 101, paragraph 11.b. ii. is \$2,000. Therefore, the 15% of surplus limitation is \$300 (based on the top line of the applicable SSAP No. 101 paragraph 11.b. realization threshold limitation table), the 10% limitation is \$200 (based on the second line of the applicable SSAP No. 101 paragraph 11.b. realization threshold limitation table).
 - f. For the purposes of these examples any DTA admittance under SSAP No. 101, paragraphs 11.a. and 11.c. is ignored.

Example 1 – Applicable reporting entity meets or exceeds the top line of the relevant SSAP No. 101, paragraph 11.b. Realization Threshold Limitation table (Ex. 3 years, 15%).

45. The basic facts above apply with the following additional information:
- a. For 20x3, the reporting entity exceeds the first line of the applicable realization threshold limitation in SSAP No. 101, paragraph 11.b. for use of a 3-year applicable period and the limitation of capital and surplus is 15%. Pursuant to paragraph 31 of this interpretation, the reporting entity would not have to take the CAMT into account in calculating the “with and without” tax liability for purposes of determining the amount expected to be realized under SSAP No. 101, paragraph 11.b.i.
 - b. The consolidated tax return group has assessed and determined that the CAMT credit DTA amounts after the valuation allowance of \$30x is expected to be utilized in 20x4 and 20x5 but \$15x of CAMT would be incurred in 20x6.

46. The reporting entity admits the \$30x adjusted gross DTA for its portion of the allocated CAMT credit DTA expected to be utilized within three years and admits the \$150x non-CAMT adjusted gross DTA after valuation allowance than can be utilized within three years. Therefore, the admitted non-CAMT DTA and admitted CAMT credit DTA would total \$180x (\$150 + \$30 = \$180).

47. Although the consolidated group is expecting to incur CAMT during the 3-year period, the reporting entity does not reduce its non-CAMT admitted DTAs by the \$15x the CAMT expected to be allocated under the tax allocation agreement to the reporting entity during the three years (pursuant to paragraph 31 of this Interpretation). Note that if the consolidated tax return group had assessed and determined that only a portion of the CAMT credit DTA after the valuation allowance was expected to be utilized in 20x4, 20x5 and 20x6 then the reporting would only admit its allocation (per its tax allocation agreement) of the amount of CAMT credit DTA that will be utilized by the consolidated group during the 3 years.

48. The \$180 is less than the \$300 15% of surplus limitation in paragraph 11.b.ii., so it is not a limiting factor. (However, if reporting entity’s 15% of surplus limitation under paragraph 11.b.ii. was \$175x, the reporting entity’s admitted adjusted gross DTA would be further reduced to \$175).

	DTA	Valuation Allowance	Not Recoverable Within 3 Years	DTA Admitted Standalone	Impact of Consol. DTA	Admitted DTA under 11bi	15% surplus limitation under 11bii	Nonadmitted DTAs
DTAs	240	-40	-50	150		150		50
CAMT credit DTA	50	-20	0		30	30	-	-
totals	290	-60	-50	150	30	180	300	50

Example 2. Applicable entity, that meets level 2 on the relevant SSAP No. 101, paragraph 11.b. Realization Threshold Limitation table (Ex.-1 year 10%).

49. The basic facts above apply with the following additional information:

- a. For 20x3, the reporting entity meets the second line of the applicable realization threshold limitation in SSAP No. 101, paragraph 11.b. for use of a 1-year applicable period and the limitation of capital and surplus is 10%. Pursuant to paragraph 32 of this interpretation, the reporting entity would have to also apply the with and without calculation of the determination of the impact of the CAMT on the realization of DTAs.
- b. The consolidated group of which the reporting entity is a member expects to incur CAMT in 20x4, of which \$10 is expected to be allocated under the tax allocation agreement to reporting entity. The reporting entity reduces its \$150x of non-CAMT admitted adjusted gross DTAs by its \$10x share of the consolidated CAMT expected to be incurred in 20x4.

50. The reporting entities admitted DTA would be \$140x. The result is an adjusted gross non-CAMT DTA of \$150x, minus the \$10 impact of the consolidated CAMT (with and without) equals 140 admitted DTA.

51. The resulting \$140x of DTA admitted under paragraph 11.b.i., which is less than the \$200x paragraph is less than the \$200 10% of surplus limitation in paragraph 11.b.ii., so it is not a limiting factor.

	DTA	Valuation Allowance	Not Recoverable Within 1 Year	DTA Admitted Standalone	Impact of Consol. DTA and VA	Admitted DTA under 11bi	10% surplus limitation under 11bii	Nonadmitted DTAs
DTAs	240	-40	-50	150	-10	140		60
CAMT credit DTA	<u>50</u>	<u>-20</u>	<u>-30</u>					<u>30</u>
totals	290	-60	-80	150	-10	140	200	90

Example 3 Applicable entity with qualifying tax allocation agreement exclusions

52. The basic facts situation applies.

- a. Similar to Example 1, the reporting entity meets the exceeds the first line of the applicable realization threshold limitation in SSAP No. 101, paragraph 11.b. for use of a 3-year applicable period and the limitation of capital and surplus is 15%.
- b. The reporting entity is excluded pursuant to the tax allocation agreement from any allocation of CAMT or CAMT credit utilization in a qualifying tax allocation agreement as described in paragraph 11 of this interpretation.

53. Accordingly, the reporting entity for 20x3, would be excluded from the CAMT calculations, and the reporting entity’s admitted adjusted gross DTA would be \$150x. which is the amount after the valuation allowance of \$40 and the \$50 reduction for the amount not recoverable within 3 years.

54. The \$150 is less than the \$300 15% of surplus limitation in paragraph 11.b.ii., so it is not a limiting factor.

	DTA	Valuation Allowance	Not Recoverable Within 3 Years	DTA Admitted Standalone	Impact of Consol. DTA and VA	Admitted DTA under 11bi	15% surplus limitation under 11bii	Nonadmitted DTAs
DTAs	240	-40	-50	150		150		50
CAMT credit DTA	0							
totals	240	-40	-50	150		150	300	50

[https://naiconline.sharepoint.com/teams/frsstatutoryaccounting/national meetings/a. national meeting materials/2023/9-21-23/adoptions/int 23-03 camt ref 23-04 final.docx](https://naiconline.sharepoint.com/teams/frsstatutoryaccounting/national%20meetings/a.%20national%20meeting%20materials/2023/9-21-23/adoptions/int%2023-03%20camt%20ref%2023-04%20final.docx)

**Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A**

Issue: Residuals in SSAP No. 48 Investments

Check (applicable entity):

	P/C	Life	Health
Modification of Existing SSAP	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
New Issue or SSAP	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Interpretation	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Description of Issue:

This agenda item proposes revisions to clarify the scope and reporting for investment structures that represent residual interests or a residual security tranche (collectively referred to as residuals) within statutory accounting principles. Previously, revisions have been incorporated in *SSAP No. 43R—Loan-Backed and Structured Securities* to address the reporting of residual interests within securitization structures. With these revisions, residual interests, as defined within SSAP No. 43R, were required to be reported on Schedule BA on designated reporting lines beginning year-end 2022. After reviewing the 2022 reporting results, it was identified that the information for residuals may be underrepresented as a result of the various legal forms that residual investments can take. For example, a reporting entity could hold investments that have the substance of residual interests in the form of limited partnerships, joint ventures, or other equity fund investments. To ensure collective and consistent reporting of all residual interests, this agenda item proposes guidance to clarify the reporting of in-substance residuals regardless of the structure of the investment vehicle.

The discussion of residual interests often compares those securities to equity interests. These two investment structures are not synonymous, and it should not be perceived that all equity interests reflect residuals. A residual interest or a residual security tranche exists in investment structures that are backed by a discrete pool of collateral assets. These designs could be backed directly or indirectly through a feeder fund. These collateral assets generate cash flows that provide interest and principal payments to debt holders, and once those contractual requirements are met, the resulting excess funds generated by (or with the sale of) the collateral assets are provided to the holder of the residual interest. When an asset within the discrete pool of assets does not perform as expected, it impacts the extent cash flows will be generated and distributed. The residual interest holder absorbs these losses (as it reduces what they could receive as a residual holder) while the holders of the debt securities continue to receive interest and principal, so long as there are enough collateral cash flows to cover them. The residual holder may ultimately receive nothing, a reduced amount from original projection, or large returns, based on how the underlying collateral assets perform.

The structural design of a residual interest or residual security tranche can vary, but the overall concept is that they receive ‘residual’ cash flows after all debt holders receive contractual interest and principal payments. The list below provides common characteristics in residuals, but with varying (and often changing structures), this list should not be used as rules governing whether a security reflects a residual interest. Determining whether a security reflects a residual interest or tranche for reporting purposes shall be based on the substance of the investment held rather than its legal form.

Common Characteristics of Residual Interests/Residual Security Tranches:

- Residuals often do not have contractual principal or interest.
- Residuals may have stated principal or interest, but with terms that result in receiving the residual cash flows of the underlying collateral. The terms allow for significant variation in the timing and amount of cash flows without triggering a default of the structure.

- Residuals do not have credit ratings or NAIC assigned designations. Rather, they provide the subordination to support the credit quality of the typically rated debt tranches.
- Residuals may provide payment throughout the investment duration (and not just at maturity), but the payments received continue to reflect the residual amount permitted after other tranche holders receive contractual principal and interest payments.
- Frequently, there are contractual triggers that divert cash flows from the residual tranche to the debt tranches if the structure becomes stressed.

Existing Authoritative Literature:

SSAP No. 43R—Loan-Backed and Structured Securities defines residuals specific to securitizations or beneficial interests and requires these securities to be reported on dedicated Schedule BA reporting lines. (This guidance was effective for year-end 2022 and detailed in agenda item 2022-15.)

26. Loan-backed and structured securities shall be valued and reported in accordance with this statement, the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual), and the designation assigned in the *NAIC Valuations of Securities* product prepared by the NAIC Securities Valuation Office or equivalent specified procedure. The carrying value method shall be determined as follows:
- For reporting entities that maintain an Asset Valuation Reserve (AVR), loan-backed and structured securities, excluding residual tranches or interests, shall be reported at amortized cost, except for those with an NAIC designation of 6, which shall be reported at the lower of amortized cost or fair value.
 - For reporting entities that do not maintain an AVR, loan-backed and structured securities designated highest-quality and high-quality (NAIC designations 1 and 2, respectively), excluding residual tranches or interests, shall be reported at amortized cost; loan-backed and structured securities that are designated medium quality, low quality, lowest quality and in or near default (NAIC designations 3 to 6, respectively) shall be reported at the lower of amortized cost or fair value.
 - For residual tranches or interests^{FN} captured in scope of this statement, all reporting entities shall report the item on Schedule BA: Other Long-Term Invested Assets at the lower of amortized cost or fair value. Changes in the reported value from the prior period shall be recorded as unrealized gains or losses. For reporting entities that maintain an AVR, the accounting for unrealized gains and losses shall be in accordance with *SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve*.

Footnote: Reference to “residual tranches or interests” intends to capture securitization tranches and beneficial interests as well as other structures captured in scope of this statement that reflect loss layers without any contractual payments, whether principal or interest, or both. Payments to holders of these investments occur after contractual interest and principal payments have been made to other tranches or interests and are based on the remaining available funds. Although payments to holders can occur throughout an investment’s duration (and not just at maturity), such instances still reflect the residual amount permitted to be distributed after other holders have received contractual interest and principal payments.

Annual Statement Instructions also detail specific reporting lines for residuals with instructions for reporting in Schedule BA:

Residual Tranches or Interests with Underlying Assets Having Characteristics of:

Fixed Income Instruments

Unaffiliated.....	4699999
Affiliated	4799999

Common Stock	
Unaffiliated.....	4899999
Affiliated.....	4999999
Preferred Stock	
Unaffiliated.....	5099999
Affiliated.....	5199999
Real Estate	
Unaffiliated.....	5299999
Affiliated.....	5399999
Mortgage Loans	
Unaffiliated.....	5499999
Affiliated.....	5599999
Other	
Unaffiliated.....	5699999
Affiliated.....	5799999

Residual Tranches or Interests with Underlying Assets Having Characteristics of:

Investment in Residual Tranches or Interests should be assigned to the subcategory with the highest underlying asset concentration. There shouldn't be any bifurcation of the underlying assets among the subcategories.

Include: Residual tranches or interests captures securitization tranches and beneficial interests as well as other structures captured in scope of *SSAP No. 43R – Loan-Backed and Structured Securities*, that reflect loss layers without any contractual payments, whether interest or principal, or both. Payments to holders of these investments occur after contractual interest and principal payments have been made to other tranches or interests and are based on the remaining available funds. See *SSAP No. 43R* for accounting guidance.

Fixed Income Instruments

Include: Investments with underlying collateral which, if held individually, would be reported on *Schedule D – Part 1 – Long-Term Bonds*

Common Stocks

Include: Investments with underlying collateral which, if held individually, would be reported on *Schedule D – Part 2 – Section 2 – Common Stocks*

Preferred Stocks

Include: Investments with underlying collateral which, if held individually, would be reported on *Schedule D – Part 2 – Section 1 – Preferred Stocks*

Real Estate

Include: Investments with underlying collateral which, if held individually, would be reported on *Schedule A – Real Estate Owned*

Mortgage Loans

Include: Investments with underlying collateral which, if held individually, would be reported on *Schedule B – Mortgage Loans*

Other

Include: Items that do not qualify for inclusion in the above subcategories.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups):

- Under the principles-based bond project, revisions have been proposed to incorporate guidance for residuals in *SSAP No. 21R—Other Admitted Assets*. With the Spring 2023 National Meeting exposure, information was requested from industry on how amortized cost for residuals was determined as well as how other-then-temporary assessments were completed.
- The Investment Risk and Evaluation (IRE) Risk Based-Capital (E) Working Group is considering a structural change and a potential factor change for residuals reported on Schedule BA. The year-end 2022 data was reviewed and was noted to underrepresent the full scope of residual tranche securities held by insurance reporting entities as the current guidance in SSAP No. 43R is specific to securitizations or beneficial interests.
- A March 31, 2023, Valuation of Securities (E) Task Force referral to the Statutory Accounting Principles (E) Working Group identified other structures that could contain residual tranche securities that may not be captured within the year-end 2022 Schedule BA dedicated residual reporting lines.

Information or issues (included in *Description of Issue*) not previously contemplated by the Working Group:
None

Convergence with International Financial Reporting Standards (IFRS): NA

Recommendation:

NAIC staff recommend that the Working Group move this item to the active listing, as a SAP clarification, and expose revisions to clarify that investments structures captured in scope of *SSAP No. 48—Joint Ventures, Partnerships, and Limited Liability Companies*, that represent residual interests or that predominantly hold residual interests, shall be reported on the dedicated residual reporting line on Schedule BA. As these investments are already reported on Schedule BA, this revision results in a reporting classification change within the same schedule. These investments are still considered to be in scope of SSAP No. 48 and they are only permitted to be admitted if they qualify as admitted assets pursuant to requirements of SSAP No. 48. (Under SSAP No. 48, investments in scope must be supported by an audit to qualify for admittance.)

Proposed revisions to SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies:

New header and paragraphs 18-20. All other paragraphs will be renumbered accordingly.

Residual Interests and Reporting

18. Investments in scope of this statement are reported on Schedule BA: Other Long-Term Assets. Schedule BA includes dedicated reporting categories for joint ventures, partnerships, and limited liability company investments as well as for residual interests, both with reporting lines in accordance with underlying asset characteristics. Investments within scope of this standard shall be divided within these reporting categories, with investments that reflect residual interests, or that predominantly hold residual interests, captured in the residual interest reporting category.

19. A residual interest or a residual security tranche (collectively referred to as residuals) exists in investment structures that are backed by a discrete pool of collateral assets. These designs could be backed directly or indirectly through a feeder fund. These collateral assets generate cash flows that provide interest and principal payments to debt holders, and once those contractual requirements are met, the resulting funds generated by (or with the sale of) the collateral assets are provided to the holder of the residual security / residual interest holder. When an asset within the discrete pool of assets does not perform as expected, it impacts the extent to which cash flows will be generated and distributed. The residual security holder absorbs these losses first (as it reduces what they could receive as a residual holder) while the holders of

the debt securities continue to receive interest and principal so long as there are enough collateral cash flows to cover them. The residual holder may ultimately receive nothing, a reduced amount from original projection, or large returns, based on how the underlying collateral assets perform.

20. The structural design of a residual interest or residual security tranche can vary, but the overall concept is that they receive ‘residual’ cash flows after all debt holders receive contractual interest and principal payments. Determining whether a security reflects a residual interest or tranche shall be based on the substance of the investment held rather than its legal form. Common characteristics of residual interests/residual security tranches include the items noted below, but the presence or absence of any of these factors should not be definitive in determination. Classification as a residual should be based on the substance of the investment and how cash flows to the holder are determined.

- a. Residuals often do not have contractual principal or interest.
- b. Residuals may have stated principal or interest, but with terms that result in receiving the residual cash flows of the underlying collateral. The terms allow for significant variation in the timing and amount of cash flows without triggering a default of the structure.
- c. Residuals do not have credit ratings or NAIC assigned designations. Rather, they provide the subordination to support the credit quality of the typically rated debt tranches.
- d. Residuals may provide payment throughout the investment duration (and not just at maturity), but the payments received continue to reflect the residual amount permitted after other tranche holders receive contractual principal and interest payments.
- e. Frequently, there are contractual triggers that divert cash flows from the residual tranche to the debt tranches if the structure becomes stressed.

Corresponding revisions are also proposed to SSAP No. 43R—Loan-Backed and Structured Securities:

Revisions are proposed to pull the residual guidance into a new section, after paragraph 26, rather than a footnote. Remaining paragraphs will be renumbered accordingly.

Reporting Guidance for All Loan-Backed and Structured Securities

26. Loan-backed and structured securities shall be valued and reported in accordance with this statement, the Purposes and Procedures Manual of the NAIC Investment Analysis Office (P&P Manual), and the designation assigned in the NAIC Valuations of Securities product prepared by the NAIC Securities Valuation Office or equivalent specified procedure. The carrying value method shall be determined as follows:

- a. For reporting entities that maintain an Asset Valuation Reserve (AVR), loan-backed and structured securities, excluding residual tranches or interests, shall be reported at amortized cost, except for those with an NAIC designation of 6, which shall be reported at the lower of amortized cost or fair value.
- b. For reporting entities that do not maintain an AVR, loan-backed and structured securities designated highest-quality and high-quality (NAIC designations 1 and 2, respectively), excluding residual tranches or interests, shall be reported at amortized cost; loan-backed and structured securities that are designated medium quality, low quality, lowest quality and in or near default (NAIC designations 3 to 6, respectively) shall be reported at the lower of amortized cost or fair value.

- c. For residual tranches or interests⁺ captured in scope of this statement, all reporting entities shall report the item on Schedule BA: Other Long-Term Invested Assets at the lower of amortized cost or fair value. Changes in the reported value from the prior period shall be recorded as unrealized gains or losses. For reporting entities that maintain an AVR, the accounting for unrealized gains and losses shall be in accordance with *SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve*.

Residual Tranches or Interests

27. A residual interest or a residual security tranche (collectively referred to as residuals) exists in investment structures (including securitizations, beneficial interests and other structures captured in scope of this statement) that are backed by a discrete pool of collateral assets. These collateral assets generate cash flows that provide interest and principal payments to debt holders, and once those contractual requirements are met, the resulting funds generated by (or with the sale of) the collateral assets are provided to the holder of the residual security / residual interest holder. When an asset within the discrete pool of assets does not perform as expected, it impacts the extent to which cash flows will be generated and distributed. The residual security holder absorbs these losses first (as it reduces what they could receive as a residual holder) while the holders of the debt securities continue to receive interest and principal so long as there are enough collateral cash flows to cover them. The residual holder may ultimately receive nothing, a reduced amount from original projection, or large returns, based on how the underlying collateral assets perform.

28. The structural design of a residual interest or residual security tranche can vary, but the overall concept is that they receive ‘residual’ cash flows after all debt holders receive contractual interest and principal payments. Determining whether a security reflects a residual interest or tranche for reporting purposes shall be based on the substance of the investment held rather than its legal form. Common characteristics of residual interests/residual security tranches include the items noted below, but the presence of absence of any of these factors should not be definitive in determination. Classification as a residual should be based on the substance of the investment and how cash flows to the holder are determined.

- a. Residuals often do not have contractual principal or interest.
- b. Residuals may have stated principal or interest, but with terms that result in receiving the residual cash flows of the underlying collateral. The terms allow for significant variation in the timing and amount of cash flows without triggering a default of the structure.
- c. Residuals do not have credit ratings or NAIC assigned designations. Rather, they provide the subordination to support the credit quality of the typically rated debt tranches.
- d. Residuals may provide payment throughout the investment duration (and not just at maturity), but the payments received continue to reflect the residual amount permitted after other tranche holders receive contractual principal and interest payments.
- e. Frequently, there are contractual triggers that divert cash flows from the residual tranche to the debt tranches if the structure becomes stressed.

Proposed revisions to Annual Statement Instructions:

Residual Tranches or Interests with Underlying Assets Having Characteristics of:

Investment in Residual Tranches or Interests should be assigned to the subcategory with the highest underlying asset concentration. There shouldn't be any bifurcation of the underlying assets among the subcategories.

Include: Residual tranches or interests ~~captures from~~ securitization tranches and beneficial interests as well as other structures captured in scope of SSAP No. 43R – *Loan-Backed and Structured Securities*, ~~that reflect loss layers without any contractual payments, whether interest or principal, or both. Payments to holders of these investments occur after contractual interest and principal payments have been made to other tranches or interests and are based on the remaining available funds. See SSAP No. 43R for accounting guidance.~~

Investments in joint ventures, partnerships and limited liability companies captured in scope of SSAP No. 48—*Joint Ventures, Partnerships and Limited Liability Companies* that represent residual interests, or that predominantly hold residual interests.

This category shall also include residual interests or residual security tranches within investment structures that are not captured in scope of SSAP No. 43R or SSAP No. 48 but that reflect, in substance, residual interests or residual security tranches.

The structural design of a residual interest or residual security tranche can vary, but the overall concept is that they receive 'residual' cash flows after all debt holders receive contractual interest and principal payments. Determining whether a security reflects a residual interest or tranche shall be based on the substance of the investment held rather than its legal form. Common characteristics of residual interests/residual security tranches include the items noted below, but the presence of absence of any of these factors should not be definitive in determination. Classification as a residual should be based on the substance of the investment and how cash flows to the holder are determined.

- a. Residuals often do not have contractual principal or interest.
- b. Residuals may have stated principal or interest, but with terms that result in receiving the residual cash flows of the underlying collateral. The terms allow for significant variation in the timing and amount of cash flows without triggering a default of the structure.
- c. Residuals do not have credit ratings or NAIC assigned designations. Rather, they provide the subordination to support the credit quality of the typically rated debt tranches.
- d. Residuals may provide payment throughout the investment duration (and not just at maturity), but the payments received continue to reflect the residual amount permitted after other tranche holders receive contractual principal and interest payments.

e. Frequently, there are contractual triggers that divert cash flows from the residual tranche to the debt tranches if the structure becomes stressed.

Staff Note: With adoption of guidance to define a residual, corresponding revisions will also be proposed to the SSAPs proposed to be updated under the principles-based bond definition (e.g., *SSAP No. 43R—Asset-Backed Securities* and *SSAP No. 21R—Other Admitted Assets*.)

Staff Review Completed by: Julie Gann - NAIC Staff, April 2023

Status:

On May 16, 2023, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a SAP clarification, and exposed revisions to SSAP No. 48 which clarify that investments structures captured in scope of SSAP No. 48 that represent residual interests or that predominantly hold residual interests, shall be reported on the dedicated residual reporting line on Schedule BA. Corresponding edits to ensure consistent language in SSAP No. 43R and revisions to the Schedule BA Annual Statement Instructions were also exposed.

On August 13, 2023, the Statutory Accounting Principles (E) Working Group exposed revisions as shown below in the updated July 2023 recommendation with a shortened comment deadline ending September 12, 2023. The updated recommendation was based on interim discussions and coordination with industry representatives.

Updated Recommendation - July 12, 2023

NAIC staff has been working directly with regulators and industry on the proposed revisions to ensure consistent reporting classification for residuals. As a result of this coordination, updated revisions are proposed. Changes from the prior proposal are shaded:

SSAP No. 48 - New header and paragraphs 18-20. All other paragraphs will be renumbered accordingly.

Residual Interests and Reporting

18. Investments in scope of this statement are reported on *Schedule BA: Other Long-Term Assets*. Schedule BA includes dedicated reporting categories for joint ventures, partnerships, and limited liability company investments as well as for residual interests, both with reporting lines in accordance with underlying asset characteristics. Investments within scope of this standard shall be divided within these reporting categories, with investments that reflect residual interests, or that predominantly hold residual interests, captured in the residual interest reporting category.

19. A residual interest or a residual security tranche (collectively referred to as residuals) exists in investment structures that issue one or more classes of debt securities created for the primary purpose of raising debt capital backed by collateral assets. The primary source of debt repayment is derived through rights to the cash flows of ~~are backed by~~ a discrete pool of collateral assets. These designs could be backed directly or indirectly through a feeder fund. These collateral assets generate cash flows that provide interest and principal payments to debt holders through a contractually prescribed distribution methodology (e.g., waterfall dictating the order and application of all collateral cash flows). ~~and~~ Once those contractual requirements are met, the ~~resulting funds~~ remaining cash flows generated by (or with the sale of) the collateral assets are provided to the holder of the residual security/residual interest holder. When an asset within the discrete pool of assets does not perform as expected, it impacts the extent to which cash flows will be generated and distributed. The residual holders in the structure continue to receive payments from the collateral so long as there are cash flows in excess of the debt obligations. ~~security holder absorbs these losses first (as it reduces what they could receive as a residual holder) while the holders of the debt securities continue to receive interest and principal so long as there are enough collateral cash flows in excess of the debt obligations to cover them. The residual holder may ultimately receive nothing, a reduced amount from~~

original projection, or large returns, based on how the underlying collateral assets perform. The payments to the residual holder may vary significantly, both in timing and amount, based on the underlying collateral performance.

20. The structural design of a residual interest or residual security tranche can vary, but the overall concept is that they receive ~~residual~~ the remaining cash flows after all debt holders receive contractual interest and principal payments. Determining whether an investment in a structure ~~a security~~ reflects a residual interest or tranche shall be based on the substance of the investment held rather than its legal form. Common characteristics of residual interests/residual security tranches include the items noted below, but the presence or absence of any of these factors should not be definitive in determination. Classification as a residual should be based on the substance of the investment and how cash flows to the holder are determined.

- a. Residuals often do not have contractual principal or interest.
- b. Residuals may be structured with terms that appear to be ~~have~~ stated principal or interest but that lack substance, and ~~with terms that~~ result in receiving the residual cash flows of the underlying collateral. The terms allow for significant variation in the timing and amount of cash flows without triggering a default of the structure.
- c. Residuals do not have credit ratings or NAIC assigned designations. Rather, they are first loss positions that provide ~~the~~ subordination to support the credit quality of the typically rated debt tranches.
- d. Residuals may provide payment throughout the investment duration (and not just at maturity), but the payments received continue to reflect the residual amount permitted after ~~other debt~~ tranche holders receive contractual principal and interest payments.
- e. Frequently, there are contractual triggers that divert cash flows from the residual ~~tranche holders~~ to the debt tranches if the structure becomes stressed.

Corresponding revisions are then proposed to SSAP No. 43R and the Schedule BA Annual Statement Instructions:

SSAP No 43R:

Residual Tranches or Interests

27. A residual interest or a residual security tranche (collectively referred to as residuals) exists in investment structures that issue one or more classes of debt securities created for the primary purpose of raising debt capital backed by collateral assets. The primary source of debt repayment is derived through rights to the cash flows of ~~are backed by~~ a discrete pool of collateral assets. These designs could be backed directly or indirectly through a feeder fund. These collateral assets generate cash flows that provide interest and principal payments to debt holders through a contractually prescribed distribution methodology (e.g., waterfall dictating the order and application of all collateral cash flows). ~~and~~ Once those contractual requirements are met, the ~~resulting funds~~ remaining cash flows generated by (or with the sale of) the collateral assets are provided to the holder of the residual security/residual interest holder. When an asset within the discrete pool of assets does not perform as expected, it impacts the extent to which cash flows will be generated and distributed. The residual holders in the structure continue to receive payments from the collateral so long as there are cash flows in excess of the debt obligations. ~~security holder absorbs these losses first (as it reduces what they could receive as a residual holder) while the holders of the debt securities continue to receive interest and principal so long as there are enough collateral cash flows in excess of the debt obligations to cover them. The residual holder may ultimately receive nothing, a reduced amount from original projection, or large returns, based on how the underlying collateral assets perform.~~ The payments to the residual holder may vary significantly, both in timing and amount, based on the underlying collateral performance.

28. The structural design of a residual interest or residual security tranche can vary, but the overall concept is that they receive 'residual' the remaining cash flows after all debt holders receive contractual interest and principal payments. Determining whether an investment in a structure a security reflects a residual interest or tranche shall be based on the substance of the investment held rather than its legal form. Common characteristics of residual interests/residual security tranches include the items noted below, but the presence or absence of any of these factors should not be definitive in determination. Classification as a residual should be based on the substance of the investment and how cash flows to the holder are determined.

- a. Residuals often do not have contractual principal or interest.
- b. Residuals may be structured with terms that appear to be have-stated principal or interest but that lack substance, and with terms that result in receiving the residual cash flows of the underlying collateral. The terms allow for significant variation in the timing and amount of cash flows without triggering a default of the structure.
- c. Residuals do not have credit ratings or NAIC assigned designations. Rather, they are first loss positions that provide the subordination to support the credit quality of the typically rated debt tranches.
- d. Residuals may provide payment throughout the investment duration (and not just at maturity), but the payments received continue to reflect the residual amount permitted after other debt tranche holders receive contractual principal and interest payments.
- e. Frequently, there are contractual triggers that divert cash flows from the residual tranche holders to the debt tranches if the structure becomes stressed.

Schedule BA Annual Statement Instructions:

Residual Tranches or Interests with Underlying Assets Having Characteristics of:

Investment in Residual Tranches or Interests, as defined within SSAP No. 43R—Loan-Backed and Structured Securities or SSAP No. 48—Joint Ventures, Partnerships and Limited Liabilities Companies, should be assigned to the subcategory with the highest underlying asset concentration. There shouldn't be any bifurcation of the underlying assets among the subcategories.

Include: Residual tranches or interests ~~captures from~~ securitization tranches and beneficial interests as well as other structures captured in scope of SSAP No. 43R – *Loan-Backed and Structured Securities*, ~~that reflect loss layers without any contractual payments, whether interest or principal, or both. Payments to holders of these investments occur after contractual interest and principal payments have been made to other tranches or interests and are based on the remaining available funds. See SSAP No. 43R for accounting guidance.~~

Investments in joint ventures, partnerships and limited liability companies captured in scope of SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies that represent residual interests, or that predominantly hold residual interests.

This category shall also include residual interests or residual security tranches within investment structures that are not captured in scope of SSAP No. 43R or SSAP No. 48 but that reflect, in substance, residual interests or residual security tranches.

The structural design of a residual interest or residual security tranche can vary, but the overall concept is that they receive 'residual' the remaining cash flows after all debt holders receive contractual interest and principal

~~payments. Determining whether an investment in a structure a security reflects a residual interest or tranche shall be based on the substance of the investment held rather than its legal form. Common characteristics of residual interests / residual security tranches include the items noted below, but the presence of absence of any of these factors should not be definitive in determination. Classification as a residual should be based on the substance of the investment and how cash flows to the holder are determined.~~

- a. ~~Residuals often do not have contractual principal or interest.~~
- b. ~~Residuals may be structured with terms that appear to be have stated principal or interest but that lack substance, and with terms that result in receiving the residual cash flows of the underlying collateral. The terms allow for significant variation in the timing and amount of cash flows without triggering a default of the structure.~~
- c. ~~Residuals do not have credit ratings or NAIC assigned designations. Rather, they are first loss positions that provide the subordination to support the credit quality of the typically rated debt tranches.~~
- d. ~~Residuals may provide payment throughout the investment duration (and not just at maturity), but the payments received continue to reflect the residual amount permitted after other debt tranche holders receive contractual principal and interest payments.~~
- e. ~~Frequently, there are contractual triggers that divert cash flows from the residual tranche holders to the debt tranches if the structure becomes stressed.~~

On September 21, 2023, the Statutory Accounting Principles (E) Working Group adopted the revisions as exposed on August 13, 2023, to *SSAP No. 43R—Loan-Backed and Structured Securities* and *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*, and adopted revisions to the Annual Statement Instructions modified from the exposure to reflect industry comments. As clarification revisions for the reporting of residual interests, so that all residuals are captured on the dedicated Schedule BA reporting lines, the revisions are effective for year-end December 31, 2023. The revisions to the Annual Statement Instructions will be forwarded to the Blanks (E) Working Group in the year-end memo and for a future blanks proposal. The adopted statutory accounting revisions and annual statement instructions are shown below:

SSAP No. 48 - New header and paragraphs 18-20. All other paragraphs will be renumbered accordingly.

Residual Interests and Reporting

18. Investments in scope of this statement are reported on *Schedule BA: Other Long-Term Assets*. Schedule BA includes dedicated reporting categories for joint ventures, partnerships, and limited liability company investments as well as for residual interests, both with reporting lines in accordance with underlying asset characteristics. Investments within scope of this standard shall be divided within these reporting categories, with investments that reflect residual interests, or that predominantly hold residual interests captured in the residual interest reporting category.

19. A residual interest or a residual security tranche (collectively referred to as residuals) exists in investment structures that issue one or more classes of debt securities created for the primary purpose of raising debt capital backed by collateral assets. The primary source of debt repayment is derived through rights to the cash flows of a discrete pool of collateral assets. These designs could be backed directly or indirectly through a feeder fund. The collateral assets generate cash flows that provide interest and principal payments to debt holders through a contractually prescribed distribution methodology (e.g., waterfall dictating the order and application of all collateral cash flows). Once those contractual requirements are

met, the remaining cash flows generated by (or with the sale of) the collateral assets are provided to the holder of the residual security/residual interest holder. When an asset within the discrete pool of assets does not perform as expected, it impacts the extent to which cash flows will be generated and distributed. The residual holders in the structure continue to receive payments from the collateral so long as there are cash flows in excess of the debt obligations. The payments to the residual holder may vary significantly, both in timing and amount, based on the underlying collateral performance.

20. The structural design of a residual interest or residual security tranche can vary, but the overall concept is that they receive the remaining cash flows after all debt holders receive contractual interest and principal payments. Determining whether an investment in a structure reflects a residual interest or tranche shall be based on the substance of the investment held rather than its legal form. Common characteristics of residual interests/residual security tranches include the items noted below, but the presence or absence of any of these factors should not be definitive in determination. Classification as a residual should be based on the substance of the investment and how cash flows to the holder are determined.

- a. Residuals often do not have contractual principal or interest.
- b. Residuals may be structured with terms that appear to be stated principal or interest but that lack substance and result in receiving the residual cash flows of the underlying collateral. The terms allow for significant variation in the timing and amount of cash flows without triggering a default of the structure.
- c. Residuals do not have credit ratings or NAIC assigned designations. Rather, they are first loss positions that provide subordination to support the credit quality of the typically rated debt tranches.
- d. Residuals may provide payment throughout the investment duration (and not just at maturity), but the payments received continue to reflect the residual amount permitted after debt tranche holders receive contractual principal and interest payments.
- e. Frequently, there are contractual triggers that divert cash flows from the residual holders to the debt tranches if the structure becomes stressed.

SSAP No 43R: New Header and paragraphs 27-28. All other paragraphs will be renumbered accordingly.

Residual Tranches or Interests

27. A residual interest or a residual security tranche (collectively referred to as residuals) exists in investment structures that issue one or more classes of debt securities created for the primary purpose of raising debt capital backed by collateral assets. The primary source of debt repayment is derived through rights to the cash flows of a discrete pool of collateral assets. These designs could be backed directly or indirectly through a feeder fund. The collateral assets generate cash flows that provide interest and principal payments to debt holders through a contractually prescribed distribution methodology (e.g., waterfall dictating the order and application of all collateral cash flows). Once those contractual requirements are met, the remaining cash flows generated by (or with the sale of) the collateral assets are provided to the holder of the residual security/residual interest holder. When an asset within the discrete pool of assets does not perform as expected, it impacts the extent to which cash flows will be generated and distributed. The residual holders in the structure continue to receive payments from the collateral so long as there are cash flows in excess of the debt obligations. The payments to the residual holder may vary significantly, both in timing and amount, based on the underlying collateral performance.

28. The structural design of a residual interest or residual security tranche can vary, but the overall concept is that they receive the remaining cash flows after all debt holders receive contractual interest and principal payments. Determining whether an investment in a structure reflects a residual interest or tranche shall be based on the substance of the investment held rather than its legal form. Common characteristics

of residual interests/residual security tranches include the items noted below, but the presence or absence of any of these factors should not be definitive in determination. Classification as a residual should be based on the substance of the investment and how cash flows to the holder are determined.

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Schedule BA Annual Statement Instructions:

Residual Tranches or Interests with Underlying Assets Having Characteristics of:

Investment in Residual Tranches or Interests should be assigned to the subcategory with the highest underlying asset concentration. There shouldn't be any bifurcation of the underlying assets among the subcategories.

Include: Residual tranches or interests ~~captures from~~ securitization tranches and beneficial interests as well as other structures captured in scope of SSAP No. 43R – *Loan-Backed and Structured Securities*, ~~that reflect loss layers without any contractual payments, whether interest or principal, or both. Payments to holders of these investments occur after contractual interest and principal payments have been made to other tranches or interests and are based on the remaining available funds. See SSAP No. 43R for accounting guidance.~~

Investments in joint ventures, partnerships and limited liability companies captured in scope of SSAP No. 48—*Joint Ventures, Partnerships and Limited Liability Companies* that represent residual interests, or that predominantly hold residual interests.

This category shall also include residual interests or residual security tranches within investment structures that are not captured in scope of SSAP No. 43R or SSAP No. 48 but that reflect, in substance, residual interests or residual security tranches.