

Date: 7/25/2023

2023 Summer National Meeting
Seattle, Washington

Statutory Accounting Principles (E) Working Group

Sunday, August 13, 2023

9:30 a.m. – 11:30 a.m. (PT)

OVERVIEW AGENDA

HEARING AGENDA

	<u>Hearing Page Number</u>	<u>Attachment</u>
1. SAPWG Hearing – Adoption of Minutes—Dale Bruggeman (OH)	1	1-6
2. SAPWG Hearing – Review and Adoption of Non-Contested Positions —Dale Bruggeman (OH)		
• Ref #2023-02: SSAP No. 43R – CLO Financial Modeling	2	7
• Ref #2023-05: ASU 2022-06, <i>Reference Rate Reform (Topic 848), Deferral of the Sunset Date of Topic 848</i>	2	8, 9
• Ref #2023-07: ASU 2019-08, Codification Improvements to Topic 718 and Topic 606	3	10
• Ref #2023-08: ASU 2019-07, Codification Updates to SEC Sections	3	11
• Ref #2023-09: ASU 2020-09, Codification Updates to SEC Sections	4	12
• Ref #2023-10: ASU 2022-05, Transition for Sold Contracts	4	13
• Ref #2023-13: PIK Interest Disclosure Clarification	5	14
3. SAPWG Hearing – Review of Comments on Exposed Items—Dale Bruggeman (OH)		
• Ref #2019-21: Principles-Based Bond Definition	7	15-20
• Ref #2022-01: Conceptual Framework - Updates	13	21, 22
• Ref #2022-11: Collateral for Loans	13	23
• Ref #2022-12: Review of INT 03-02: Modifications to an Existing Intercompany Pooling Arrangement	16	24, 25
• Ref #2022-14: New Market Tax Credits	19	26-28
• Ref #2022-19: Negative IMR	24	29, 30
• Ref #2023-01: Review Annual Statement Instructions for Accounting Guidance	26	31
• Ref #2023-04: INT 23-03: Corporate Alternative Minimum Tax Guidance	27	32, 33
• Ref #2023-06: Additional Updates on ASU 2021-10, Government Assistance	30	34
• Ref #2023-12: Residuals in SSAP No. 48 Investments	31	35
Comment Letters	33	36

OVERVIEW AGENDA

MEETING AGENDA

	<u>Meeting Page</u>	<u>Attachment</u>
	<u>Number</u>	
4. SAPWG Meeting – Maintenance Agenda – Pending List—Dale Bruggeman (OH)		
• Ref #2023-14: Asset Valuation Reserve and Interest Maintenance Reserve	1	A
• Ref #2023-15: IMR / AVR Specific Allocations	2	B
• Ref #2023-16: Schedule BA Reporting Categories	3	C
• Ref #2023-17: Short-Term Investments	4	D
• Ref #2023-18: ASU 2016-19, Technical Corrections and Improvements	6	E
• Ref #2023-19: ASU 2018-09, Codification Improvements	6	F
• Ref #2023-20: ASU 2020-10, Codification Improvements	7	G
• Ref #2023-21: Removal of Transition Guidance from SSAP No. 92 and SSAP No. 102	7	H
• Ref #INT 23-02: Third Quarter 2023 Inflation Reduction Act – CAMT	7	I
• Ref #2023-22: Actuarial Guideline 51 and Appendix A-010 Interaction	8	J
5. SAPWG Meeting – Any Other Matters Brought Before the Working Group—Dale Bruggeman (OH)		
• Review of U.S. GAAP Exposures	9	K
➤ Comment Deadline for Ref #2023-12 and INT 23-02 – Tuesday, September 12		
➤ Comment Deadline for all other items – Friday, September 29		

Hearing Agenda

**Statutory Accounting Principles (E) Working Group
Hearing Agenda
August 13, 2023**

ROLL CALL

Dale Bruggeman, Chair	Ohio	Judy Weaver	Michigan
Kevin Clark, Vice Chair	Iowa	Doug Bartlett	New Hampshire
Sheila Travis	Alabama	Bob Kasinow	New York
Kim Hudson	California	Diana Sherman	Pennsylvania
William Arfanis/Michael Estabrook	Connecticut	Jamie Walker	Texas
Rylynn Brown	Delaware	Doug Stolte/David Smith	Virginia
Cindy Andersen	Illinois	Amy Malm/Elena Vetrina	Wisconsin
Melissa Gibson/Stewart Guerin	Louisiana		

NAIC Support Staff: Julie Gann, Robin Marcotte, Jake Stultz, Jason Farr, Wil Oden

Note: This meeting will be recorded for subsequent use.

REVIEW AND ADOPTION OF MINUTES

- | | |
|----------------------------|-----------------------|
| 1. Spring National Meeting | (Attachment 1) |
| 2. April 10, 2023, E-Vote | (Attachment 2) |
| 3. April 12, 2023, E-Vote | (Attachment 3) |
| 4. May 16, 2023 | (Attachment 4) |
| 5. June 28, 2023 | (Attachment 5) |
| 6. July 5, 2023, E-Vote | (Attachment 6) |

REVIEW AND ADOPTION of NON-CONTESTED POSITIONS

The Working Group may individually discuss the following items, or may consider adoption in a single motion:

1. Ref #2023-02: SSAP No. 43R – CLO Financial Modeling
2. Ref #2023-05: ASU 2022-06, *Reference Rate Reform (Topic 848), Deferral of the Sunset Date of Topic 848*
3. Ref #2023-07: ASU 2019-08, Codification Improvements to Topic 718 and Topic 606
4. Ref #2023-08: ASU 2019-07, Codification Updates to SEC Sections
5. Ref #2023-09: ASU 2020-09, Codification Updates to SEC Sections
6. Ref #2023-10: ASU 2022-05, Transition for Sold Contracts
7. Ref #2023-13: PIK Interest Disclosure Clarification

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2023-02 (Julie)	SSAP No. 43R – CLO Financial Modeling	7 – Agenda Item	No Comments	IP-24

Summary:

During the Spring National Meeting, the Working Group exposed SAP clarifications 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.

Interested Parties' Comments:

Interested parties have no comments on this item.

Recommendation:

NAIC staff recommends that the Working Group adopt the exposed 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.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2023-05 (Jake)	<i>ASU 2022-06, Reference Rate Reform (Topic 848), Deferral of the Sunset Date of Topic 848</i>	8 – Agenda Item 9 – INT 20-01	Yes	IP-24

Summary:

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.

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.

Interested Parties' Comments:

Interested parties support the extension of the expiration date of INT 20-01 to December 31, 2024.

Recommendation:

NAIC staff recommends that the Working Group adopt the exposed 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.

Voting note: 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.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2023-07 (Wil)	<i>ASU 2019-08, Codification Improvements to Topic 718 and Topic 606</i>	10 – Agenda Item	No Comments	IP-25

Summary:

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 superseded guidance in Subtopic 505-50, Equity—Equity-Based Payments to Non-Employees. The changes to Topic 606 expand the scope to include share-based payment awards granted to a customer in conjunction with selling goods or services.

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.)

Interested Parties' Comments:

Interested parties have no comments on this item.

Recommendation:

Staff recommends that the Working Group adopt the exposed revisions to:

- *SSAP No. 104R—Share-Based Payments* 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.
- *SSAP No. 95—Nonmonetary Transactions* to update previously adopted U.S. GAAP guidance.
- *SSAP No. 47—Uninsured Plans*, reject Topic 606 guidance in ASU 2019-08.

These revisions add language to include share-based consideration payable to customers under SSAP No. 104R guidance in the same manner as U.S. GAAP. The proposed revisions to SSAP No. 95, SSAP No. 104R, and SSAP No. 47, are illustrated in Form A.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2023-08 (Wil)	<i>ASU 2019-07, Codification Updates to SEC Sections</i>	11 – Agenda Item	No Comments	IP-26

Summary:

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. Historically, SEC guidance from ASUs have been rejected as not applicable for statutory accounting in Appendix D.

Interested Parties' Comments:

Interested parties have no comments on this item.

Recommendation:

NAIC staff recommends that the Working Group adopt the exposed 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.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2023-09 (Wil)	<i>ASU 2020-09—Amendments to SEC Paragraphs Pursuant to SEC Release No. 33-10762—Debt (Topic 470)</i>	12 – Agenda Item	No Comments	IP-26

Summary:

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. SEC guidance from ASUs have generally been rejected as not applicable for statutory accounting in Appendix D, but all ASUs are reviewed for statutory accounting purposes to determine if the guidance should be considered for statutory accounting.

Interested Parties' Comments:

Interested parties have no comments on this item.

Recommendation:

NAIC staff recommends that the Working Group adopt the exposed 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 for 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.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2023-10 (Wil)	<i>ASU 2022-05, Transition for Sold Contracts</i>	13 – Agenda Item	Yes	IP-26

Summary:

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.

Interested Parties' Comments:

Interested parties support the conclusion reached for this guidance.

Recommendation:

NAIC staff recommends that the Working Group adopt the exposed 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.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2023-13 (Julie)	PIK Interest Disclosure Clarification	14 – Agenda Item	No Comments	IP-40

Summary:

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.

Interested Parties' Comments:

Interested parties have no comment on this item.

Recommendation:

NAIC staff recommend that the Working Group adopt 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 Working Group 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.

REVIEW of COMMENTS on EXPOSED ITEMS

The following items received comments during the exposure period that are open for discussion.

1. Ref #2019-21: Principles-Based Bond Definition
2. Ref #2022-01: Conceptual Framework – Updates
3. Ref #2022-11: Collateral for Loans
4. Ref #2022-12: Review of INT 03-02: Modification to an Existing Intercompany Pooling Arrangement
5. Ref #2022-14: New Market Tax Credits
6. Ref #2022-19: Net Negative (Disallowed) IMR
7. Ref #2023-01: Review Annual Statement Instructions for Accounting Guidance
8. Ref #2023-04: Corporate Alternative Minimum Tax Guidance
9. Ref #2023-06: Additional Updates on ASU 2021-10, Government Assistance
10. Ref #2023-12: Residuals in SSAP No. 48 Investments

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2019-21 SSAP No. 26R & 43R (Julie)	Principles-Based Bond Definition	15 – SSAP No. 26R 16 – SSAP No. 43R 17 – Other SSAPs 18 – SSAP No. 21R 19 – Issue Paper 20 – BA Concept	Comments Received	IP – 15 IP – 39

Summary:

During the 2023 Spring National Meeting, the Working Group exposed revisions, to reflect a majority of interested party comments, to the statutory accounting guidance that details the bond definition and the accounting and reporting guidance for bonds (including asset-backed securities), debt securities that do not qualify as bonds, and other SSAPs were also impacted (or that referenced) the prior bond guidance. These revisions were exposed for a comment period ending June 9, 2023. The SSAP guidance exposed for comment included the following documents:

- *SSAP No. 26R—Bonds*
- *SSAP No. 43R—Asset-Backed Securities*
- *SSAP No. 21R—Other Admitted Assets*
- Other SSAP Revisions

In addition to the documents proposing SSAP revisions, during the 2023 Spring National Meeting the Working Group exposed a concept proposal to revise the reporting lines on Schedule BA to encompass debt securities that do not qualify as bonds, as well as to consolidate existing reporting lines. This item was exposed until June 30 to correspond with the Blanks (E) Working Group exposure of the bond reporting revisions.

Interested Parties' June 9, 2023, Comments:

Interested parties' comments are shown below related to each of the five separate documents exposed for comment.

SSAP No. 26R, SSAP No. 43R, and Other SSAPs

Interested parties have no comments on these exposures and are appreciative of the changes made and the responsiveness to interested parties' previous comments.

SSAP No. 21R**Paragraphs 22 and 29**

Interested parties understand that proposed paragraph 22 of SSAP No. 21 requires that the underlying collateral in an asset-backed security that fails the bond definition must qualify as admitted assets for the security to be admitted.

Paragraph 22 also proposes to report these bonds at a value that does not exceed the fair value of the collateral with any amount above the fair value of the collateral being non-admitted. Interested parties have concerns with the proposal as this would be operationally very difficult to do since some asset-backed securities can have a large number of assets and the fair value of the underlying collateral in the asset-backed security may not be readily available. This is very different from collateral loans in SSAP No. 21 where there are generally fewer assets that compose the underlying collateral. In addition, this would be costly as currently the servicer/trustee reports do not usually include fair value of the collateral so this would be a new service for which we would have to pay. Interested parties believe that accounting for these securities at the lower of cost or market of the security owned by the insurer will consider the performance of the underlying collateral. The unit of account is the security owned by the insurer and not the underlying collateral for the asset-backed security. The fair value of the bond will consider the fair value of the collateral to a great extent, but it will also take into account other key characteristics of the bond itself that impact the bond's fair value and will better reflect the consideration expected to be received upon maturity or sale of the security. If the collateral is an admitted asset, the entire carrying balance of the security should be admitted without having to quantify collateral fair value given the cost and complexity in doing so. Interested parties propose changes to paragraph 22 as a result of the comments above.

Interested parties also have comments regarding the new paragraph 29 that was added to clarify the accounting for residual tranches. We believe that the intent of paragraph 29 is to require non-admission of a residual tranche only if another tranche from the same securitization owned by the insurer fails the bond definition and the collateral is not an admitted investment. Interested parties propose changes to paragraph 29 to further clarify what we believe to be the intent of the paragraph.

We proposed the following changes to paragraphs 22 and 29 to address the aforementioned comments:

22. Debt securities in scope of this standard that do not qualify as bonds under SSAP No. 26R and for which the primary source of repayment is derived through rights to underlying collateral, qualify as admitted assets only to the extent they are secured if the underlying collateral primarily qualify as admitted invested assets. Any residual tranches or first loss positions held from the same securitization that did not qualify as a bond under SSAP No. 26R also only qualify as admitted assets to the extent the underlying collateral primarily qualify as admitted invested assets. Any amounts in excess of the fair value of the underlying admitted invested assets shall be non-admitted.

29. As stated in paragraph 22, Residuals are permitted to be admitted if debt securities from the same securitization qualify as bonds under SSAP No. 26R as an issuer credit obligation or an asset backed security. For example, if a debt security from a securitization does not qualify as a bond, and the source of repayment is derived through rights to the underlying collateral, the debt security is only permitted to be admitted if the underlying assets qualify as admitted assets. If the debt security from a securitization is nonadmitted due to the requirements under paragraph 22, then any residual interests or first loss positions held from the same securitization also do not qualify as admitted assets and would be reported as nonadmitted assets.

Paragraph 25

Interested parties also note that the way paragraph 25 below was written implies that the only securities that can fail the definition are asset-backed securities. Since an issuer credit obligation could also fail the bond definition (i.e., does not reflect a creditor relationship in substance), we believe the changes recommended below are needed to reference the appropriate accounting guidance under either SSAP No. 26 for issuer credit obligations or SSAP No. 43R for asset-backed securities.

25. Debt securities that do not qualify as bonds are captured/included in the scope of this statement. Debt securities included in the scope of this statement shall follow the guidance in SSAP No. 43R—Asset-Backed Securities or SSAP No. 26R Bonds, depending on whether they would have been classified as asset-backed securities or issuer credit obligations, respectively, should they have qualified as bonds. This includes the guidance, for calculating amortized cost, for determining and recognizing other-than-temporary impairments and for allocating unrealized and realized gains and losses between the asset valuation reserve (AVR) and interest maintenance reserve (IMR).

Paragraphs 30 and 31

In paragraph 31 of the exposure, NAIC asks the following question:

Exposure Question: Industry is requested to provide information on how residual tranches have been amortized and how they have been assessed for OTTI as there are no contractual principal or interest payments.

Regarding the calculation of amortized cost and the assessment of OTTI for residuals, it has generally been industry practice to follow the SSAP No. 43R guidance for beneficial interests (i.e., paragraphs 21-25 of the bond definition proposal titled “Accretable Yield and Changes to Effective Yield for Application of Prospective Method”), which requires estimates of cash flows to be calculated quarterly with prospective yield adjustments. If there is an adverse change in estimated cash flows at the reporting date, an OTTI is recorded. Under those circumstances, the residual is written down to the current estimate of cash flows discounted at a rate equal to the current yield used to accrete the residual with the resulting change being recognized as a realized loss. If the cash flows increase from the prior period, the yield is adjusted upward. To require recognition of a loss for the entire amount of the residual would not be a reasonable accounting result. Also, for insurers who are US GAAP filers, they also apply the prospective method discussed above for their US GAAP financial statements, if they have not elected the fair value option. As a result, interested parties propose the edits below to paragraphs 30 and 31, which also include clarification on AVR treatment of residuals:

30. Residuals shall be initially reported at cost, or allocated cost (using proportional fair values) if acquired along with debt tranches from the securitization. Subsequent to initial acquisition, residuals shall be reported at the lower of amortized cost or fair value, with changes in fair value (or from amortized cost to fair value) reported as unrealized gains or losses. To determine amortized cost, the reporting entity should apply SSAP No. 43R, paragraphs 21-25 (i.e., prospective method). Unrealized and realized gains and losses on residuals are reported in the AVR.

31. Residuals shall be assessed for other-than-temporary impairment (OTTI) on an ongoing basis based on SSAP No. 43R. An OTT shall be considered to have occurred if it is probable that the reporting entity will not receive cash flows distributed to the residual tranche to cover the reported amortized cost basis. Upon identification of a probable OTTI, the reporting entity shall recognize a realized loss equal to the remaining amortized cost basis. Subsequent to the recognition of OTTI, the residual shall be reported with a zero book adjusted carrying value. Any subsequent cash flows received attributed to the residual tranche shall be reported as interest income.

Interested parties also note that the recent exposure by the Working Group that intends to expand the scope of what is considered a residual investment may require significant changes to the accounting laid out above. The accounting model for residuals issued in a securitization that we explain above is in line with the accounting for residuals that are more akin to a debt security. If the scope of a residual is expanded to include other types of residuals, this model may not fit those types of investments. Given this linkage, interested parties may have additional recommendations for the accounting discussed above as the residual investment definition is finalized.

Interested Parties’ June 30, 2023, Comments - Schedule BA:

Interested parties have the following observations and suggestions to the proposed changes to the categories within Schedule BA (Other Invested Assets):

- Ensure that all reporting categories reflect the related SSAP within the instructions.
- Recommend exposing changes to the columns.
- For investments tagged as ‘Debt Securities That Do Not Qualify as Bonds’ that are transferred from Schedule D, interested parties recommend that the investment will retain its’ NAIC Designation and its’ FE/ PLR status at the time of transfer.
- We believe the instructions for Tax Credit Investments (e.g., Guaranteed Low Income Housing Tax Credit Investments) are stale as the sentence ‘There must be an all-inclusive guarantee from a CRP-rated entity that guarantees the yield on the investment’ is no longer valid.

- The various types of Tax Credit Investments (e.g., Low Income Housing; New Market; Renewable Energy) have different risks and should be evaluated accordingly and be reported according to their risks. Recommend a referral to the RBC Investment Risk & Evaluation Working Group to evaluate the various risk categories such that changes could be implemented for Annual 2025 reporting.
- Based on Ref #2022-14 (Tax Credits), interested parties will provide additional comments when this item is adopted by the Statutory Accounting Principles Working Group (SAPWG).
- Based on Ref #2023-12 (SSAP No. 48 - Residuals), interested parties will provide comments when this item is adopted by SAPWG.
- Please refer to the attached markup version of the exposure as there are several editorial revisions that we are suggesting that clarify the descriptions within the categories and language within the instructions.

Interested parties have attached a markup version of the exposure with our detailed suggested changes. (See Attachment 36)

Recommendation:

There are three separate recommendations below:

- 1) **Bond Definition:** NAIC staff is very pleased to recommend adoption of SSAP revisions to adopt 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. This adoption, with an effective date of Jan. 1, 2025, is recommended to allow insurance reporting entities to assess their investment portfolios in accordance with the adopted bond concepts and to allow training and education materials to be developed that reflects the adopted bond definition. NAIC staff appreciate all the work, collaboration and dedicated efforts of regulators and industry in developing the bond definition and the resulting guidance.

This recommendation is for the adoption of the following exposed documents for which no comments were received:

- *SSAP No. 26R—Bonds*
 - *SSAP No. 43R—Asset-Backed Securities*
 - Other SSAP Revisions - (Detail of all the SSAPs impacted and the edits are in the attachment.)
- 2) **SSAP No. 21R and Bond Issue Paper:** NAIC staff recommends that the Working Group expose a revised *SSAP No. 21R—Other Admitted Assets* to provide guidance for the accounting for debt securities that do not qualify as bonds as well as proposed measurement guidance for residuals. Additionally, NAIC staff recommends that the Working Group expose an updated issue paper that details the discussions / directions in developing the bond definition and resulting guidance.

With regards to SSAP No. 21R, the interested parties' comments have been considered and are reflected as follows in the revised draft:

- Paragraphs 22 & 29: Revisions predominantly reflect the interested parties' comments. These paragraphs address admittance for non-bond debt securities where the primary source of repayment is derived through underlying rights to collateral and residual interests if debt securities from the same securitization would (or would not) qualify as admitted assets.
- Paragraph 25: Revisions do not reflect interested parties' comments. These paragraphs point to the applicable SSAP guidance that should be followed as it pertains to IMR/AVR, OTTI, etc., for non-bond debt securities. After considering the interested parties' comments suggesting to refer to both SSAP No. 26R and SSAP No. 43R, it was noted that the provisions of SSAP No. 43R for the assessment of cash flows, bifurcation of IMR/AVR and the recognition of OTTI would be more appropriate for the less-traditional

investments that would be captured as debt securities that do not qualify as bonds. As such, the original guidance was retained, which points to SSAP No. 43R for these aspects of debt securities that do not qualify as bonds. Limiting to this one specific SSAP also eliminates potential inconsistencies based on differing company assessments on whether a debt instrument that did not qualify as a bond was more akin to an issuer credit obligation or an asset-backed security.

- Paragraphs 30-32: Revisions do not reflect interested parties' comments. These paragraphs propose measurement guidance for residual interests. After reviewing the reported book adjusted carrying value (BACV), as well as amounts for unrealized valuation changes and amortization for residuals as of Dec. 2022, it has been identified that there are inconsistencies across industry on measurement method for residual interests. Industry provided comments noting that it has been a general industry practice to follow the SSAP No. 43R effective yield method guidance for beneficial interests, and for estimates of cash flows to be calculated quarterly with prospective yield adjustments for changes in expected cashflows. As such, if a company has an expectation of 20% yield over the life of the residual, they would accrue interest (accretion) to the BACV at a rate of 20% unless and until that expectation changes, at which point it would revise the yield further upward (for a favorable change in expectation) or impair the asset (if unfavorable). Due to the inherent uncertainty in both the timing and amount of cash flows for residual tranches, it has been noted that using expected cash flows to accrete residual tranches may not be conducive to the conservatism principle under statutory accounting, therefore use of the effective yield method for residuals is likely not an appropriate fit for statutory accounting purposes. Instead NAIC staff has proposed guidance for exposure and feedback that requires a lower of 'adjusted cost' or fair value measurement method with no amortization or accretion and no changes based on changes in cash flow expectations other than OTTI. Rather, all cash flows received would be treated as a return of principal / investment until the residual BACV was zero. At that point, all cash flows would be treated as interest income. This proposed guidance intends to best suit how residuals work conceptually as previously described. Feedback is requested on the fit of this methodology for residual tranches in general, but also for individual types of residuals where the concepts described above may not be representative. Feedback is also requested on transition guidance to move to a different measurement approach for residuals (whether this approach or a revised approach.)

- 3) **Schedule BA Reporting:** NAIC staff recommends that the Working Group sponsor a blanks proposal to revise *Schedule BA: Other Long-Term Assets* in accordance with the bond project for debt securities that do not qualify as bonds, with formal notice to the Valuation of Securities (E) Task Force and the Capital Adequacy (E) Task Force on the proposal to allow life reporting entities the ability to use existing Schedule BA reporting provisions for SVO-Assigned designations in determining RBC for debt securities that do not qualify as bonds. (This exposure for new reporting lines does not encompass residuals as dedicated reporting lines for residuals are already captured in Schedule BA.) *(NAIC staff will work with the blanks staff in developing the blanks proposal for exposure subsequent to the National Meeting.)*

The Schedule BA reporting revisions are expected to encompass the following:

- Revised reporting lines, similar to what was exposed and considering the interested parties' comments, to capture debt securities that do not qualify as bonds as well as revisions to other Schedule BA reporting lines and descriptions. *(NAIC staff agrees with several of the industry comments on the need to revise the reporting lines that specifically address low-income housing tax credits but acknowledges those revisions may have to wait until the separate discussion on tax credits is complete.)*
- Potential revisions to Schedule BA columns (and/or instructions) to capture applicable information on debt securities that do not qualify as bonds.

NAIC staff notes that interested parties have requested that debt securities that do not qualify as bonds be permitted to retain a filing exempt (FE) or private letter rating (PLR) capability. As this distinction is not in the purview of the NAIC Statutory Accounting Principles (E) Working Group, the interested parties should redirect

this request to the Valuation of Securities (E) Task Force (for determination of FE / PLR eligibility) and to the Capital Adequacy (E) Task Force (for the impact of such designations on RBC.)

NAIC staff has provided the following overview of the proposed reporting for debt securities that do not qualify as bonds. As detailed above, **it is recommended that the Working Group explicitly inform the Valuation of Securities (E) Task Force and Capital Adequacy (E) Task Force of this proposal and request the Valuation of Securities (E) Task Force to assess whether additional guidance is needed within the Purposes and Procedures Manual to permit or govern the assignment of SVO-Assigned designations for debt securities that do not qualify as bonds. Overview of proposal:**

- Debt securities that do not qualify as bonds are proposed to be captured in separate Schedule BA reporting lines based on whether the debt security 1) does not reflect a creditor relationship in substance, 2) lacks substantive credit enhancement, or 3) does not qualify solely due to a lack of meaningful cash flows.
- The dedicated reporting lines are proposed to be separately divided between those that have SVO-Assigned NAIC Designation and those that do not have SVO-Assigned Designations. This split is consistent with the Schedule BA reporting lines for SSAP No. 48 investments that have underlying assets with characteristics of fixed-income instruments as those securities can also be filed with the SVO for a designation.
- NAIC staff has proposed the use of the “SVO-Assigned” and “Not-SVO Assigned” reporting lines as that provides the ability for life reporting entities to continue to have corresponding RBC for the items that have SVO-Assigned NAIC designations. **It should be noted that non-SVO assigned designations on Schedule BA do not qualify for corresponding RBC. As such, if this split is removed, then none of the debt securities that do not qualify as bonds will have corresponding RBC until / unless provisions are adopted by CATF that provides that capability. By using the existing approach, NAIC SAPWG staff is proposing to continue with the established guidelines to allow life companies with securities that have SVO-assigned designations to receive corresponding RBC charges. NAIC staff notes that the ability to have RBC charges impacted by SVO-assigned designations is currently only permitted for life companies. This line of business limitation is determined by the RBC Working Groups and the Capital Adequacy (E) Task Force and is not determined by the Statutory Accounting Principles (E) Working Group.**

(Staff Note: NAIC staff identifies that this is a source of confusion by industry, and some believe that CRP designations reported on the “Not SVO-Assigned” reporting lines impact RBC. This is inaccurate. With the way the mapping works, the items reported in the “SVO-Assigned” reporting lines go to the AVR categories that result with reduced RBC based on NAIC designation. The items in the “Not SVO-Assigned” reporting lines are linked to other AVR categories that do not receive RBC impacts from the reporting designation.)

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2022-01 (Robin)	Conceptual Framework – Updates	21 – Agenda Item 22 – Issue Paper	Comments Received	IP-18

Summary:

During the 2023 Spring National Meeting, the Working Group exposed additional revisions to *SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets* and *Issue Paper No. 168—Updates to the Definition of a Liability* related to the definition change of a liability. The revisions incorporate the definition of a liability from Financial Accounting Standards Boards (FASB) *Concepts Statement No. 8, Conceptual Framework for Financial Reporting—Chapter 7, Presentation*, and *Concepts Statement No. 8, Conceptual Framework for Financial Reporting—Chapter 4, Elements of Financial Statements*, which updates the definition of an asset and of a liability. For GAAP, the FASB Conceptual statements definitions are not authoritative, but rather are concepts to consider when developing and applying guidance.

The Spring exposure also included the following 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 paragraph 18 of the Issue Paper. 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. 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 (Ex. *SSAP No. 7—Asset Valuation Reserves and Interest Maintenance Reserves* and *SSAP No. 92—Post Retirement Benefits Other than Pensions*.)

Interested Parties' Comments:

Interested parties believe the proposed changes above are responsive to our previous comments and address the issue of having statutory accounting guidance in other authoritative sources, e.g., the *NAIC Annual Statement Instructions*.

Recommendation:

NAIC staff recommends adopting the exposed revisions to SSAP No. 5R and Issue Paper No. 168—Updates to the Definition of a Liability. These items were exposed as SAP clarifications and will be effective upon adoption.)

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2022-11 (Robin)	Collateral for Loans	23 – Agenda Item	IP – Yes SBL- Comments	IP – 19 SBLIC – 32

Summary:

During the Spring National Meeting, the Working Group re-exposed revisions to SSAP No. 21R to clarify that invested assets pledged as collateral for admitted collateral loans must qualify as admitted invested assets. The exposed revisions

Interested Parties' Comments:

Interested parties support the proposed changes.

Security Benefit Life Insurance Company Comments:

Security Benefit Life Insurance Company would like to thank the Statutory Accounting Principles Working Group (“SAPWG”) for the opportunity to provide comments for consideration on Reference No. 2022-11—Collateral for Loans (the “Exposure”) (FN1 - Dated March 22, 2023), which proposes revisions to Statements of Statutory Accounting principles (“SSAP”) No. 21R, *Other Admitted Assets* (“SSAP No. 21R”) as follows:

1. A joint venture, partnership, or limited liability company (“JV/LP/LLC”) or a subsidiary controlled or affiliated entity (“SCA”) that is pledged as collateral to support an outstanding collateral loan balance must each be audited annually to qualify as an admitted investment.
2. The audited net equity of a pledged JV/LP/LLC and/or SCA is the basis of measurement for comparison to an outstanding collateral loan balance. Any portion of the outstanding balance of a collateral loan that is greater than the audited net equity of a pledged JV/LP/LLC and/or SCA must be non-admitted.

Firstly, consistent with the separate and broader Interested Party comment letter dated February 10, 2023, we do not believe an audit is necessary. In addition, we believe considering book value as a measure of the adequacy of collateralization, or ability for a borrower to repay a collateral loan is not supportable. Book value of equity is not acknowledged to reflect the value of what an asset would be bought or sold for (*i.e.*, the ultimate source of repayment for the collateral loan). The concept of fair value (*vs.* book value) exists precisely to represent the price that would be received for the sale of an asset in an orderly transaction between market participants at the measurement date. This variance between book value and fair value is observed in markets every day, where trading and transaction prices vary significantly from the proportionate book value of equity (hence the concept of “price-to-book multiples”). Book value can be lower than or higher than fair value. Notably, for example, insurers often trade on public markets for less than one times price-to-book value ratio (*i.e.*, book value is greater than fair value).

Using the book value of equity in lieu of fair value when assessing collateralization for the admissibility of collateral loans will all but guarantee the carrying value of the collateral will differ from what it could ultimately be sold for to repay the collateral loan. This will create volatility for insurance companies and may lead borrowers to begin to manage to a metric in the short term that does not ultimately provide the highest proceeds to repay the collateral loan.

Please consider the following example: a borrower borrows \$100 on a collateral loan to make a \$100 equity investment in an equipment leasing business. The \$100 investment equates to 20% of the company upon investment, which implies that the total business is worth \$500. The total book value of the business is \$250 (equipment leasing businesses, for example, typically trade around 2x price/ book value). This means that, immediately upon making the \$100 investment, the borrower’s stake would be considered to have a collateral value of only \$50 (*i.e.*, 20% of the \$250 book value), resulting in an immediate loss of \$50 of collateral value. Further, this differs from the statutory accounting that would apply if the insurer had made the investment directly on its balance sheet (equity-method accounting). In accordance with SSAP No. 48, the insurer would record the initial investment in an investee at cost plus subsequent capital contributions to the investee. The carrying amount of the investment would then subsequently be adjusted for the amortization difference (difference between the cost and underlying GAAP equity) over a period of time as well as for the insurer’s pro-rata share of GAAP-basis earnings or losses and distributions of the investee. Therefore, under SSAP No. 48, the investment is worth its investment at cost (*i.e.*, \$100) on day one and subsequently amortized to the GAAP equity value of the investee over the period that the investing entity benefits economically rather than at a point in time as would occur under the proposed revisions in SSAP No. 21R.

We request consideration for the likely adverse effects to decision-making this exposed revision may cause, in addition to the operational disruptiveness of immediate adoption, as discussed further in this document.

Secondly, we believe the Exposure proposes substantive changes, not clarifications, and as a result, the process for a substantive change is not being followed. The Exposure will impose undue costs and efforts if adopted, as it

substantively causes a change to the application of SSAP No. 48, *Joint Ventures, Partnerships and Limited Liability Companies* (“SSAP No. 48”) and SSAP No. 97, *Investments in Subsidiary, Controlled and Affiliated Entities* (“SSAP No. 97”). The Accounting Practices and Procedures Manual provides that “[n]onsubstantive revisions are characterized as language clarifications which do not modify the original intent of a SSAP . . .” Utilization of fair value equity of pledged JV/LP/LLC and/or SCA investments has long been utilized as required by SSAP No. 21R and subject to both independent audits and state insurance department examinations, without this practice being raised as an issue nor requiring adjustments to financial statements. Accordingly, the Exposure modifies the original intent of SSAP Nos. 21R, 48 and 97. (FN2 - The same can be said of the Exposure’s requirement to perform audits of JV/LP/LLC and/or SCAs pledged in support of collateral loans. For years insurers have secured collateral loans with these types of interests and have been subject to both independent audit and state insurance department examinations without this practice being raised as an issue nor requiring adjustments to financial statements. We therefore believe requiring audits is a substantive change to SSAP No. 21R.)

The accelerated approach here is not supported by the analytical rigor that the SAPWG typically applies and denies affected parties the due process otherwise required when substantive changes are made. Should the Exposure be adopted with the proposed revisions to SSAP No. 21R to require audited net equity of pledged JV/LP/LLC and/or SCA investments, it would similarly be a material modification to an acceptable and supportable industry practice. It would also require insurers to disclose a change in accounting policy, which is further evidence that this is a substantive change. Furthermore, we would have to incur considerable cost and effort along with our borrowers (assuming that borrowers are willing to cooperate and, given that loan documentation was drafted prior to the changes being proposed here, there can be no assurance of such cooperation) to accurately determine the collateral value by applying the guidance prescribed in SSAP No. 48 with no assurance that we would be successful given the ability of borrowers to obtain the required information from their investees. Without the additional time typically afforded for a substantive modification, we find ourselves unable to consider effective alternative solutions in a timely manner and unable perform a full risk assessment of adoption impacts for both intended and potentially unintended consequences.

As a standard setting body (not a regulatory body), the NAIC has an obligation to adhere to proper processes and to base decisions on empirical data rather than hypotheses. Providing more process, rather than less, is critically important because decisions that the NAIC make can adversely affect competition in the industry; failing to do so can result in its decisions impermissibly choosing winners and losers in the marketplace. The Company believes that there have been other occasions where a proposed revision has been classified as “non-substantive” or a “SAP clarification,” despite the fact that the revisions have modified the intent of applicable SSAPs and thereby caused material changes in acceptable accounting practices. (FN3 - See, e.g., Exposure Ref No. 2019-24—Levelized and Persistency Commissions and Exposure Ref Nos. 2021-21—Related Party Reporting and 2022-15—Affiliate Reporting Clarification.)

Recommendation:

NAIC staff recommends revisions to SSAP No. 21R be adopted as exposed in the agenda item.

The interested parties support adoption and no changes have been proposed in their letter.

No changes have been proposed as a result of the SBL letter. NAIC staff reviewed the SBL comments and disagrees that the requirement to have audits for admittance is a new SAP concept. It is a long-standing SSAP provision that collateral loans need to be back by investments that qualify as admitted assets. SSAP No. 48 has audit requirements for investments in joint ventures, LLCs and partnerships to be admitted and that has not changed. The only change that was previously added was to address an industry request to recognize that audits do not provide fair value assurance, so for these types of collateral, the use of the audited equity value is permitted as a substitute to the fair value collateral / loan comparison in determining whether collateral is sufficient for admittance purposes.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2022-12 (Robin)	Review of INT 03-02: Modification to an Existing Intercompany Pooling Arrangement	24 – Agenda Item 25 – INT 03-02	Comments Received	IP-20

Summary:

On March 22, 2023, the Working Group re-exposed the intent to nullify INT 03-02, effective December 31, 2023. The nullification is proposed as INT 03-02 is inconsistent with SSAP No. 25 guidance regarding economic and non-economic transactions between related parties. The guidance in INT 03-02 can result with, in essence, unrecognized gains (dividends) or losses through the using the statutory book valuation when using assets (bonds) to make payments to affiliates for modifications to existing intercompany reinsurance pooling agreements. Treatment of transfers of assets between affiliates should be consistent for all intercompany transactions and there is not a compelling need to be different when valuing assets for intercompany reinsurance transactions.

Interested Parties' Comments:

Interested parties note that there are several issues associated with nullifying INT 03-02 and transferring the assets that support the insurance liabilities at fair value versus book value as provided in the current guidance in the INT including the following:

- Inconsistent accounting among affiliates for a modification of the intercompany pooling agreement when some of the transfers generate a realized gain and others do not, depending on the assets transferred;
- The transfer of a bond in an intercompany pooling transaction that generates a realized gain would cause the intercompany pooling modification to be accounted for as retroactive reinsurance, which would violate the accounting guidance currently contained in SSAP No. 63;
- The use of retroactive reinsurance contradicts the basis of presentation in Schedule P for business subject to intercompany pooling agreements;
- Inconsistent presentation of underwriting assets and liabilities among participants in the pooling agreement; and
- Inconsistent accounting for intercompany transactions, as some gains would be deferred while other gains will be realized at the parent level, depending on the insurer's corporate ownership structure.

Depending on market interest rates at the time of a pooling modification, a gain or loss will result from the transfer of bonds at fair value. In times of declining interest rates, the fair value of bonds generally increase. During these times, if a bond with a fair value in excess of book value is transferred as part of a pooling modification and the transfer is accounted for at fair value, the transferor will recognize a gain. This gain will disqualify the transferor and transferee from accounting for the pooling modification as prospective reinsurance based on the accounting guidance in SSAP No. 62R paragraph 36d. However, the same pooling modification can have other participants qualify for prospective reinsurance due to no gain on transfer of the assets.

Prospective reinsurance versus retroactive reinsurance

The transferors, i.e., the ceding pool entities, that qualify for prospective reinsurance will record the premium and loss accounts as prospective reinsurance (i.e., the cedent's participation share of the total intercompany pool written and earned premium, reserves and losses are reported in the cedent's financial statements).

The transferors, i.e., the ceding pool entities, that do not qualify for prospective reinsurance will report written premiums, earned premiums, loss and loss adjustment reserves and losses and loss adjustment expenses without recognition of the retroactive reinsurance. Therefore, insurance accounts subject to pooling will not be reduced for cessions to the lead company of the pool or retrocessions by the lead company to the pool participants. Similarly, any transferees that do not qualify for prospective reinsurance, i.e., the assuming pool entities, will exclude the

retroactive reinsurance from loss and loss expense reserves and all schedules and exhibits. SSAP No. 62R requires the following for retroactive reinsurance:

- The ceding entity and the assuming entity shall report by write-in item on the balance sheet, the total amount of all retroactive reinsurance, identified as retroactive reinsurance reserve ceded or assumed, recorded as a contra-liability by the ceding entity and as a liability by the assuming entity;
- The ceding entity shall, by write-in item on the balance sheet, restrict surplus resulting from any retroactive reinsurance as a special surplus fund, designated as special surplus from retroactive reinsurance account;
- The surplus gain from any retroactive reinsurance shall not be classified as unassigned funds (surplus) until the actual retroactive reinsurance recovered exceeds the consideration paid;
- The special surplus from retroactive reinsurance account for each respective retroactive reinsurance agreement shall be reduced at the time the ceding entity begins to recover funds from the assuming entity in amounts exceeding the consideration paid by the ceding entity.

As a result of the inconsistent accounting between pool entities that are required to account for the intercompany pooling as prospective reinsurance and the pool entities that are required to use retroactive reinsurance, the financial statements of the pool will be extremely confusing and lack useful financial information. The stand-alone financial statements of the legal entities of the pool will not be consistent and the combined audited financial statements of the pool will reflect insurance accounts that are accounted for and reported using different accounting methodologies for the same underlying transactions.

As a practical matter, it would be nearly impossible for an insurer to report intercompany pooling results and balances using both prospective and retroactive reinsurance. Premium, claim, and loss systems are not built to handle such inconsistent accounting for the same underlying transactions.

SSAP No. 62R versus SSAP No. 63

The application of retroactive reinsurance as a result of the nullification of INT 03-02 would also result in a conflict with the guidance in SSAP No. 63, *Underwriting Pools*. The highlighted wording in paragraphs 8 and 9 of SSAP No. 63 instructs the preparer to record the premiums and losses based on the legal entity's participation in the pool. The use of retroactive reinsurance would violate that guidance. Regarding the last sentence of paragraph 7, the use of retroactive reinsurance would also result in timing differences between entities in the pool as a result of certain entities deferring gains in surplus.

7. Intercompany pooling arrangements involve establishment of a conventional quota share reinsurance agreement under which all of the pooled business is ceded to the lead entity and then retroceded back to the pool participants in accordance with their stipulated shares. Arrangements whereby there is one lead company that retains 100% of the pooled business and all or some of the affiliated companies have a 0% net share of the pool may qualify as intercompany pooling. In these arrangements, only the policy issuing entity has direct liability to its policyholders or claimants; other pool participants are liable as reinsurers for their share of the issuing entity's obligations. Although participants may use different assumptions (e.g., discount rates) in recording transactions, the timing of recording transactions shall be consistently applied by all participants.

8. Underwriting results relating to voluntary and involuntary pools shall be accounted for on a gross basis whereby the participant's portion of premiums, losses, expenses, and other operations of the pools are recorded separately in the financial statements rather than netted against each other. Premiums and losses shall be recorded as direct, assumed, and/or ceded as applicable. If the reporting entity is a direct writer of the business, premiums shall be recorded as directly written and accounted for in the same manner as other business which is directly written by the entity. To the extent that premium is ceded to a pool, premiums and losses shall be recorded in the same manner as any other reinsurance arrangement. A reporting entity who is a member of a pool shall record its participation in the pool as assumed business as in any other reinsurance arrangement.

9. Underwriting results relating to intercompany pools shall be accounted for and reported as described in paragraph 8. While it is acceptable that intercompany pooling transactions be settled through

intercompany arrangements and accounts, intercompany pooling transactions shall be reported on a gross basis in the appropriate reinsurance accounts consistent with other direct, assumed and ceded business.

Schedule P

Data reported in Schedule P is required to be reported net of intercompany pooling (i.e., only the reporting entity's share of the pool business is reported in Schedule P). This includes data related to premiums, losses and loss adjustment expenses, and claim counts.

Additionally, the *NAIC Annual Statement Instructions* for Schedule P require that when changes to pooling agreements impact prior accident years, historical data values in Schedule P must be restated based on the new pooling percentages. This instruction effectively recognizes that Schedule F only provides useful information related to changes in intercompany pooling agreements if such changes are treated as prospective reinsurance.

Because intercompany pooling data would not be reflected in the Schedule P of the pool entities that are required to use retroactive reinsurance accounting, distorted data would result because only a portion of the intercompany pool's loss, premium, and claim count data would be reported on Schedule P (i.e., the only pooled data reported in Schedule P would be of the pool participants that qualify for using prospective reinsurance). Note that the use of retroactive reinsurance will apply until all of the claims subject to retroactive reinsurance are settled; therefore, the distortion of Schedule P for the pool entities will likely occur for decades depending on the underlying business. As a result, the Schedule P data for the intercompany pool used by actuaries, analysts, regulators, and the NAIC (including analysis used to update RBC factors) will not be useful or meaningful.

Other intercompany pooling issues

Because intercompany pooling agreements subject certain insurance assets (e.g., agents balances) to pooling, a mismatch would occur in the financial statements of pool participants that are required to use retroactive reinsurance accounting versus the participants that are not. For the ceding entities, insurance assets would reflect the reporting entity's share of the pool business, but premiums and losses will reflect the entity's business excluding the pooling. This would occur because insurance assets such as agents balances are not subject to retroactive reinsurance accounting.

Consistency of accounting

The NAIC has noted concerns that the "guidance in INT 03-02 can result with in essence, unrecognized gains (dividends) or losses through the using the statutory book valuation when using assets (bonds) to make payments to affiliates for modifications to existing intercompany reinsurance pooling agreements." The NAIC also notes that the "treatment of transfers of assets between affiliates should be consistent for all intercompany transactions and there is not a compelling need to be different when valuing assets for intercompany reinsurance transactions." Interested parties note the following:

- As our examples illustrate, the transfer of assets using fair value in an intercompany pooling modification can result in reported realized gains reflected in certain pool participants' financial statements, as well as the combined audited statutory financial statements of the intercompany pool even though the assets remain in the pool.
- The transfer of assets at fair value in an intercompany pooling modification can also result in inconsistent accounting for intercompany transactions, as some gains would be deferred while other gains will be realized at the parent level, depending on the ownership structure of the entities in the intercompany pool.

SSAP No. 63

SSAP No. 63 has limited accounting guidance related to intercompany pooling agreements and instead primarily provides a discussion of what an intercompany pooling agreement is and contains a reference to INT 03-02 in paragraph 5. We believe that a more effective approach to addressing the concerns over moving invested assets at book value in a modification of an intercompany agreement would be to incorporate portions of INT 03-02 into SSAP No. 63, require that insurers settle the movement of assets and liabilities on a net basis (i.e., the net of pool

assets less pool liabilities) to minimize the movement of assets, require disclosure if assets with fair values that differ from cost or amortized cost are transferred as part of the modification, and include a cross reference in SSAP No. 25 to the updated guidance in SSAP No. 63 for transfers of assets associated with a modification of an intercompany pooling agreement. This approach would also provide guidance on such modification where none would exist in the absence of INT 03-02. Please see recommended changes to SSAP No. 63 in the attached.

Since the guidance regarding the transfers of assets associated with modifications of intercompany agreements would be located in SSAP No. 63, we recommend that SSAP No. 25 include a new paragraph 4 to direct the reader to the guidance in SSAP No. 63 as follows:

4. If a company transfers assets or liabilities to effectuate a modification to an existing intercompany pooling arrangement, the transaction, including the transfer of assets, shall be accounted for in accordance with the guidance in SSAP No. 63 – Underwriting Pools.

Recommendation:

NAIC staff continues to recommend nullification of INT 03-02 and does not recommend incorporation of the interested parties proposed revisions in SSAP No. 25 and SSAP No. 63. NAIC staff believes that the existing guidance in the SSAP No. 62R implementation guide provides useful guidance regarding some of the issues raised by interested parties regarding measurement of gains under the reinsurance contract versus gains on sales of investments. At a high level, NAIC staff believe these are separate evaluations under SSAP No. 62R and would like the opportunity to further discuss this with regulators and interested parties. For the Summer National Meeting, NAIC staff recommend that the Working Group defer action, to allow NAIC staff to work with interested parties to develop additional recommendations for future Working Group discussion.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2022-14 (Wil)	New Market Tax Credits	26 – Agenda Item 27 – SSAP No. 93R 28 – SSAP No. 94R	Comments Received	IP – 34

Summary:

On May 16, the Statutory Accounting Principles (E) Working Group exposed revisions to *SSAP No. 93—Low-Income Housing Tax Credit Property Investments* and *SSAP No. 94R—Transferable and Non-Transferable State Tax Credits*. The following are significant revisions detailed in the exposure of SSAP No. 93 and 94R:

- SSAP No. 93—Investments in Tax Credit Structures – In response to comments received from interested parties, the scope of the SSAP has been expanded to include tax credit investments irrespective of structure which is a departure from GAAP guidance which is only applicable to tax equity investments. Additionally, SSAP No. 93 has been revised so that it provides guidance on the investment structure whereas SSAP No. 94R provides guidance on state and federal tax credits, which would include tax credits allocated from tax credit investments. This statement applies the proportional amortization method in *2023-02, Accounting for Investments in Tax Credit Structures Using the Proportional Amortization Method*.
- SSAP No. 94R—State and Federal Tax Credits – The scope of the SSAP has been expanded to include all state and federal tax credits which have been allocated to or purchased by the reporting entity. The previous version of SSAP No. 94R required tax credits which were purchased at a discount to be recorded at cost which effectively deferred the gain on purchase by creating an off-balance sheet asset that could not be recognized until the cost basis was utilized by the reporting entity. The revised version of SSAP No. 94R eliminates the off-balance sheet asset requirement and instead requires tax credits to be recorded at face value; acquisitions at a premium require the loss to be immediately recognized whereas acquisitions at a

discount require the gain be deferred as an “other liability” until the reporting entity has utilized tax credits in excess of the acquisition cost.

Interested Parties’ Comments:

Interested Parties appreciate the opportunity to comment on the substantive revisions exposed by the Working Group to SSAP No. 93 - *Low Income Housing Tax Credit Property Investments* and SSAP No. 94 *Transferable and Non-Transferable State Tax Credits*. As stated in our prior comment letter on this topic, interested parties agree with having uniformity in accounting and reporting for equity and debt investments for which the return is earned primarily through tax credits. Interested parties also agree that the proportional amortization method is an appropriate method to use for any type of investment (debt or equity) where the return is primarily earned through tax credits. We have a few comments on the exposure to make sure the guidance is clear and insurers know how to apply it.

SSAP No. 93

- 1) Paragraph 2 and 3– Paragraph 2 includes the criteria for investments in tax credit structures to apply the proportional amortization method. If an investment does not meet the criteria, then paragraph 3 states that the investment should follow the applicable statutory accounting statement. For equity investments, that means that SSAP No. 48 should be followed, which would require the use of equity method of accounting. For bonds in tax credit structures that do not meet the definition, interested parties believe that the bond needs to be analyzed under the new proposed principles-based bond definition to determine if bond reporting or other-invested asset reporting is required. Interested parties recommend clarifying this in the standard if that is the case.
- 2) Paragraph 14 (a) –This paragraph states that tax credits under the SSAP No. 93 accounting guidance are to be recorded and assessed for admittance in accordance with SSAP No. 94. Interested parties found this confusing and subject to many different interpretations. There is a key difference between SSAP No. 93 and SSAP No. 94 tax credits in that SSAP No. 93 tax credits are only earned as part of the return on the investment so the only asset recorded on the insurer’s books is related to the investment itself. The tax credits are only recorded upon becoming available for use on a reporting entity’s tax return. Therefore, there is no tax credit to non-admit per se. In the rare case that the tax credit cannot be utilized in the year that it is allowed to be utilized due to the insurer not having enough income from operations in the case of federal tax credits or premium income in the case of state programs, the insurer would record a Deferred Tax Asset (DTA). Any DTA set up would be subject to the admissibility requirements under SSAP No. 101 - *Income Taxes*. For these reasons, interested parties recommend that paragraph 14 (a) be removed.
- 3) Paragraph 18 (a) and (b) and (c) - These paragraphs are intended to address admissibility considerations. Paragraph (c) states that if the tax credits cannot be utilized in the next three years, they will be non-admitted, while paragraphs (a) and (b) are intended to address instances when the credits cannot be utilized by the insurer, but the insurer has the ability to sell them to third parties or get a refund for the credits. We understand from discussions with the Working Group that the intent of this guidance is for an insurer to first start with the assessment in (c) to determine if it will be able to utilize the tax credits in the next three years. If not, then the insurer can consider whether the tax credits can be sold or whether the insurer can be reimbursed for the credits if unable to utilize them. Under the former, the insurer can admit the credits up to their fair value as the insurer would recover the fair value in a sale. Under the latter, the insurer can admit up to the amount of the expected refund.

Similar to our comments under #1 above, it is not clear to us what exactly we are non-admitting. As explained above, the only item that gets recorded on the balance sheet as an actual asset is the investment itself. The cost of the investment is amortized in proportion to the tax credits earned every year regardless of whether the credits are utilized or not. Admissibility requirements are already addressed for the investment itself in the proposal (i.e., the tax opinion and audited financial statements). As the tax credits are allocated to the insurer, they either reduce federal income taxes, or state/premium taxes. If the tax credits cannot be utilized in a given year, a DTA would be established. Any admissibility rules on the DTA itself are already addressed in SSAP No. 101 - *Income Taxes*.

If the DTA admissibility is what is being addressed in paragraph 18, interested parties recommend that be clarified. We understand that this may have been one of the reasons why the SSAP No. 93 proposal references SSAP No. 94. As stated above, to avoid any confusion regarding the accounting for the tax credits earned in a SSAP No. 93 investment, we suggest including all guidance in SSAP 93 (i.e., no reference to SSAP 94) regarding the credits earned in a SSAP No. 93 investment. Interested parties also have the following suggested edits to make the admissibility rules on the tax credits themselves clear.

~~Paragraph 18 – If tax credits allocated to the reporting entity cannot be utilized in the year they have been allocated to the entity, a deferred tax asset (DTA) would be established. Under those circumstances, the reporting entity would follow the requirements under SSAP No. 101 *Income Taxes* regarding admissibility rules on DTAs. A reporting entity is required to assess the realization of tax credits against tax liability for both the tax year in which the credit can be initially utilized as well as in accordance with carry-forward and/or carryback periods to determine the extent the investments can be admitted:~~

~~a. — Tax credit investments which allocate tax credits which are transferable in accordance with permitted IRS or state tax provisions are admitted up to the lesser of the proportional amortized cost, or fair value of the tax credits.~~

~~b. — Tax credit investments which allocate tax credits eligible for direct payment are admitted up to the lesser of the proportional amortized cost, or the estimated proceeds.~~

~~c. — For all other tax credits, if a reporting entity does not expect to fully utilize investment tax credits in the upcoming tax year or for a carryback year, the reporting entity shall perform an assessment to determine the extent it will be able to utilize the tax credits over the life of the investment. If assessment projections identify that the tax credits from investments in tax credit programs will exceed what can be utilized under IRS or state tax provisions (current and other applicable tax periods), the reporting entity shall nonadmit investments as necessary so that investments in scope of this statement (in aggregate) are only admitted to the extent tax credits are expected to be utilized. Additionally]. In making this assessment, the reporting entity is not permitted to assume increased operations (e.g., expanded product sales) beyond actual experience to conclude that additional federal or state tax liability will exist that would allow additional utilization of tax credits. A reporting entity can subsequently admit a previously nonadmitted tax credit investment, based on subsequent assessments in which the reporting entity determines that they will be able to utilize the tax credits.~~

- 4) Paragraph 34 - The SSAP No. 93 exposure states that reporting entities shall prospectively modify the recognition, accounting and reporting of tax credit investment structures to follow the guidance under SSAP No. 3. We believe this means that on day of adoption, the SSAP No. 93 investment's book value is the starting value of the investment and the prospective method will be applied using that book value and amortizing the book value at the date of adoption based on the future tax credits to be earned. If that is the case, some clarification on the application of the prospective method would be helpful. Those companies that are US GAAP reporters are to apply the FASB ASU on a retrospective basis and thus there will continue to be differences between US GAAP and Statutory proportional method results for already existing tax credit investments. We believe further clarification of how the prospective method is to be applied for Statutory reporting should be clarified to avoid inconsistent interpretation of the intent.

SSAP No. 94

- 1) Paragraph 1 – This paragraph explains the scope of the types of tax credits that fall within the SSAP No. 94 guidance. Interested parties believe that the key difference between SSAP No. 93 and SSAP No. 94 is that SSAP No. 93 relates to tax credits that are earned as a result of being an investor (i.e., an equity investor) in the entity earning the credits and SSAP No. 94 relates to tax credit certificates that are purchased outright without being an investor in the entity. To make sure that is clear, interested parties propose the following changes to paragraph 1

Paragraph 1 – This statement establishes statutory accounting principles for state and federal tax credits certificates that are purchased by the reporting entity without being an investor in the entity

~~from which the tax credit certificates were purchased. that are consistent with the Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy (Statement of Concepts)~~

- 2) Paragraph 2 - The last sentence in this paragraph states that the tax credits received from SSAP No. 93 tax credit investments are within the scope of SSAP No. 94. For the reasons stated above in the SSAP No. 93 section of this comment letter, we do not think that SSAP No. 94 and SSAP No. 93 should be linked. As stated above, there are two very different assets that are recorded upon purchasing an investment under SSAP No. 93 versus SSAP No. 94. The only similarity in accounting for the tax credits relates to instances when the credits earned under a SSAP No. 93 investment cannot be utilized in the current year. Under that scenario, a DTA would be recorded, which would be subject to the admissibility rules under SSAP No. 101. For that reason, interested parties recommend removing the last sentence in paragraph 2 as suggested below.

Paragraph 2 - Investments in tax credits as discussed in SSAP No. 93R - *Investments in Tax Credit Structures*, which involve investments in projects or programs that generate general business federal tax credits or state tax credits, are not within the scope of this statement. ~~However, the tax credits received from tax credit investments are within the scope of this statement.~~

- 3) Paragraph 9 - This paragraph states that federal and state tax credits that can be utilized in the year allocated or purchased shall be reported in the income statement as an offset to federal taxes in accordance with SSAP No. 101 or state premium tax, respectively. Interested parties note that most tax certificates reduce a reporting entity's tax liability and do not directly impact the income statement at the time they are used. In addition, interested parties believe that upon purchase, the tax credits should be reported as an other-than-invested asset since the asset represents a right to receive future benefits. As the tax credits become available for use, a reduction to the insurer's income tax payable or premium/state taxes payable should take place. Based on that, we propose the following changes:

Paragraph 9 – Tax credits shall be recognized in the period that they are purchased or allocated to the reporting entity for tax purposes:

- a. ~~Federal and state tax credits are recorded as other-than-invested assets upon purchase. As the tax credits are redeemed, the carrying value of the tax credits is reduced dollar for dollar by the amount of tax credits applied toward the reporting entity's federal or state/premium tax liability, as applicable, that can be utilized in the year allocated or purchased shall be reported in the income statement as an offset to federal taxes in accordance with SSAP No. 101 *Income Taxes*. Federal tax credits that cannot be utilized in the year allocated or purchased and are carried forward to a future tax year shall be reported net of deferred tax asset (DTA) in accordance with SSAP No. 101.~~
- b. ~~Federal and Sstate tax credits that can be utilized in the year allocated or purchased shall be reported in the income statement as an offset to state premium tax or state income tax, whichever is applicable, in the tax reporting year in which the credit is utilized. State tax credits that cannot be utilized in the year they are available for use allocated or purchased and are carried forward to a future tax year shall be reported as a deferred tax asset (DTA). gross of any related state tax liabilities and reported in the category of other than invested assets (not reported net).~~

We have updated the illustration that was included in Exhibit B below to reflect this as well.

- 4) Paragraph 7 - The accounting for purchased tax credits under the SSAP No. 94 exposure is different from the current guidance in that the credits will be recorded at face value instead of at cost. Interested parties do not have an issue with this accounting treatment per se, but we would like to point out that this is not consistent with the accounting treatment for other types of assets that are purchased at a premium or discount such as bonds and mortgage loans.
- 5) Exhibit B – Accounting for Non-Transferable Tax Credits

Interested parties recommend some edits to the illustration under Exhibit B to reflect the changes described in item 2) above. In addition, the edits below include other edits that we believe are necessary to show the appropriate flow of transactions and to add clarity to the accounting for federal tax credit certificates.

On 7/1/X1 LJW Insurance Company purchased non-transferable federal tax credits for a cost of \$100,000. The federal tax credits are redeemable for \$110,000 and expire on, April 1, 20x2. LJW expects to utilize the tax credits before expiration in the amount of \$110,000. The credits are earned pro-rata every quarter from acquisition date to expiration date. Therefore, the credits earned quarterly are about \$36,666. The illustration below assumes that LJW Insurance Company's quarterly income tax liability equals the amount of credits that were purchased.

7/1/x1	Federal tax credits	110,000	
	Deferred gains on acquired tax credits		10,000
	Cash		100,000
	<i>To record the purchase of the tax credits</i>		
9/30/x1	Income Premium tax expense	36,666	
	Income Premium taxes payable to		36,666
	<i>To record quarterly income tax liability.</i>		
10/1/x1	Income taxes payable	36,666	
	Federal tax credits		36,666
	<i>To record the use of tax credits in the quarter</i>		
12/31/x1	Income tax expense	36,666	
	Income taxes payable		36,666
	<i>To record quarterly income tax liability</i>		
1/1/x2	Income taxes payable	36,666	
	Federal tax credits		36,666
	<i>To record the use of tax credits in the quarter</i>		
3/31/x2	Income tax expense	36,666	
	Income taxes payable		36,666
	<i>To record quarterly income tax liability</i>		
4/1/x2	Income taxes payable	36,666	
	Deferred gains on acquired tax credits	10,000	
	Other Income		10,000
	Federal tax credits		36,666
	<i>To record the use of income tax credits in excess of cost and recognize a gain on premium tax credits in other income.</i>		

Recommendation:

NAIC staff recommend that the Working Group expose additional revisions described below to SSAP No. 93 and SSAP No. 94R. Additionally, NAIC staff recognizes that revisions to the annual statement Schedule BA reporting lines will need to be considered, as well as how those reporting lines flow through to the AVR. NAIC staff recommends that the Working Group direct staff to work with interested parties throughout the interim to discuss to allow subsequent (or interim) exposure.

Based on the review of the interested parties June 30, 2023, comment letter, NAIC Staff has proposed the following additional edits for exposure:

- SSAP No. 93 was revised so that accounting guidance for allocated tax credits was contained within instead of directing readers to refer to SSAP No. 94R.

- The admittance criteria detailed in paragraphs 18(a)-(c) is unchanged. This is because the admittance criteria detailed pertains to the tax credit investments rather than the tax credits allocated.
- SSAP No. 94R was revised to exclude SSAP No. 93 allocated tax credits.
- The interested parties’ proposed revisions which would allow purchased federal tax credits to be initially reported as other than invested assets and then transferred to deferred tax assets if not utilized in the same period it was purchased were not incorporated. In practice this would require a transfer between reporting lines simply because the tax credit was utilized within a year.

Further discussion details are in the status section in agenda item 2022-14. NAIC staff appreciates the interested parties’ comments and would like to continue discussions on these proposed revisions in the interim period.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2022-19 (Julie)	Net Negative (Disallowed) IMR	29 – Agenda Item 30 – INT 23-01T	Comments Received	IP – 14

Summary:

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. Discussion of this topic began after receipt of an ACLI comment letter dated Oct. 31, 2022, that included the following two positions:

- 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.

Since the receipt of the ACLI letter, the Working Group has discussed this issue and directed various actions. Most recently, on June 28, 2023, the Working Group met to hear comments on an interpretation (INT) exposed to permit limited admittance of net negative (disallowed) IMR. As a result of that meeting, the Working Group directed NAIC staff to incorporate several revisions to the proposed INT to reflect 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.

The revised INT was exposed via evote on July 5, 2023, for a shortened comment period ending July 21, 2023.

Interested Parties' Comments:

The American Council of Life Insurers (ACLI) appreciates the thoughtful and timely attention the Statutory Accounting Principles Working Group (SAPWG) and NAIC Staff have dedicated to this important topic. We also appreciate regulators' recognition for the need of an interim solution for negative Interest Maintenance Reserves (IMR), while a longer-term solution is pursued and ultimately finalized.

ACLI supports the adoption of the Interpretation at the Summer National Meeting and has no substantive comments, as it reflects what was agreed upon to by SAPWG at the June 28, 2023 meeting. However, ACLI has shared with NAIC Staff three minor editorial comments that we understand will be part of the Summer National Meeting materials and proposed as friendly amendments.

ACLI also proposes the consideration of an Ad Hoc Technical Working Group, perhaps comprised of regulators from both SAPWG and LATF, as well as industry and the American Academy of Actuaries, to address the many complexities of IMR in the development of the long-term solution.

The interim solution is not designed to permanently address this complex issue and we hope that such a Working Group can take a holistic view of all the data to construct a measured, effective and sustainable permanent solution.

Recommendation:

NAIC Staff recommends adopting the exposed tentative INT 23-01 with the three editorial revisions noted below. NAIC staff has worked with industry in identifying these proposed changes. As detailed within the INT, it will be effective until Dec. 31, 2025, and automatically nullified on Jan. 1, 2026, but the effective date can be adjusted (nullified earlier or extended) in response to the Statutory Accounting Principles (E) Working Group actions to establish statutory accounting guidance specific to net negative (disallowed) IMR.

Upon adoption of the INT, NAIC staff will provide the Blanks (E) Working Group a disclosure memo for posting on their website for year-end 2023. Additionally, a blanks proposal will be sponsored to incorporate the disclosures and attestation requirements into the notes and general interrogatories for year-end 2024.

NAIC staff requests feedback from the Working Group on the formation of an Ad Hoc Technical Group as requested by the ACLI.

Editorial Revisions:

1) Reference authorized control level (ACL) when identifying the 300% RBC requirement. (Paragraph 9b)

9.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 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.

2) Add reference to clarify that the focus on the disclosures is for asset sales that were generating admitted negative IMR. (paragraph 13.c.iv)

13.c.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).

3) Missing the word “account” in the application guidance. (Paragraph 6 of S/A Application Guidance)

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.

Voting note: The proposed INT 23-01 overrides existing SSAP and A/S instructions, 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 INT for adoption.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2023-01 (Julie)	Review Annual Statement Instructions for Accounting Guidance	31 – Agenda Item	Comments Received	IP – 24

Summary:

This agenda item was developed to establish a project to review the annual and quarterly statement instructions to ensure that all accounting guidance is properly reflected within the Statements of Statutory Accounting Principles (SSAPs). Although duplication or reference of accounting guidance may occur for ease of application the reporting guidance, the focus of this project is to ensure that the annual or quarterly statement instructions are not the source of statutory accounting guidance. For purposes of this agenda item, accounting guidance is intended to refer to measurement, valuation, admittance / nonadmittance, as well as when assets and liabilities should be recognized or derecognized within the statutory financial statements.

This agenda item and project was proposed due to limited situations in which the annual statement instructions have been identified to reflect more detailed accounting guidance than the SSAPs. Under the Statutory Hierarchy, the SSAPs are Level 1 and are the authoritative source for accounting provisions. If guidance does not exist in the SSAPs, then other sources of guidance can be considered based on the statutory hierarchy, but it is not intended that guidance be captured in the annual statement instructions (which are level 3) in lieu of the inclusion of guidance in the SSAPs.

Interested Parties’ Comments:

Interested parties are aware of Annual Statement guidance on IMR /AVR and Schedule F penalties that should be considered for inclusion in SSAP’s as well as the guidance related to intercompany pooling arrangements discussed above. If additional items come to our attention, we will inform the Working Group.

Informal Comments:

The following comments were also received informally regarding health reporting:

1) Presentation of Co-payments and Deductibles: The instructions for the Statement of Revenue and Expenses, Line 9 *hospital and medical benefits expense*, state that expenses should be shown net of coordination of benefits, copayments and deductibles. However, this guidance is not present in the SSAPs. For HMO’s that provide medical services, the copayments and deductibles are paid directly to the reporting entity.

- 2) Presentation of Fee-for-Service Revenue: The statement instructions for Line 4 - *Fee-for-service* of the Statement of Revenue and Expenses state that the fee-for-service revenue should be reported net of expenses incurred. However, this guidance is not present in the SSAPs.
- 3) Presentation of Gains/Loss on Fixed Assets: The statement instructions for Line 7 - *Aggregate Write-Ins for Other Health Care Related Revenues* of the Statement of Revenue and Expenses states that gains/loss on fixed assets should be reported in this section as part of the underwriting gain/loss. Our understanding from previous correspondence with NAIC staff is that this is limited to non-Real Estate property assets such as equipment, furniture etc. Can a reference be made in SSAP No. 19R—*Furniture, Equipment and Leasehold Improvements* or SSAP No. 73—*Health Care Delivery Assets and Leasehold Improvements in Health Care Facilities*. Gains/loss from real estate investments would be reported in Line 26 *Net Realized Capital Gains/Loss* as mentioned in SSAP No. 90R—*Impairment or Disposal of Real Estate Investments*, paragraph 31.

Recommendation:

NAIC staff recommends that the Working Group direct NAIC staff to proceed with a broad project to review the annual statement instructions and ensure accounting guidance is included within the SSAPs. NAIC staff plans to proceed with separate agenda items for the specific topics, but to reference this broad Working Group direction as the source for the various proposals.

NAIC staff has drafted preliminary agenda item, which is presented under the meeting agenda, to begin on a long-term project to update SSAP No. 7—*Asset Valuation Reserve and Interest Maintenance Reserve*. NAIC staff will review the informal comments for consideration in potential subsequent agenda items.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2023-04 (Robin)	Corporate Alternative Minimum Tax Guidance	32 – Agenda item 33 – INT 23-03	Comments Received	IP – 1

Summary:

This agenda item proposes an *Interpretation INT 23-03: Inflation Reduction Act - Corporate Alternative Minimum Tax* to provide guidance regarding the CAMT for periods on and after the year-end 2023. The CAMT is more complex than the prior alternative minimum tax and it is assessed at the consolidated return level using book income.

Interested parties of the SAPWG have submitted a draft INT (in the comment letters) to assist with addressing many technical aspects of the guidance. While the INT that is proposed for exposure has some departures from the industry proposal, the Working Group appreciates the cooperation and input provided by the industry technical experts in addressing the guidance.

Background: The Inflation Reduction Act (Act) was enacted on August 16, 2022, and included a new corporate alternative minimum tax (CAMT) which goes into effect for 2023 tax years. The CAMT applies only to corporations (determined on a tax-controlled group basis as defined for federal income tax purposes) 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. The tax liability is the higher amount.

Payment of the CAMT results in a tax credit which does not expire. However, the tax credit can only be used to pay “non CAMT” federal taxes which are above the CAMT amount (that is the CAMT credit cannot be used to pay CAMT taxes.) Therefore, as long as the consolidated group is a CAMT payor, the CAMT tax credit cannot be used.

The Working Group has previously 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 guidance will expire on August 16, 2023. The meeting agenda has a separate proposed Interpretation for third quarter 2023 CAMT reporting (See INT 23-02).

Interested Parties’ Comments:

Interested parties are now providing a draft of suggested language for a recommended Interpretation addressing the statutory accounting for the CAMT. This draft is intended to aid the SAPWG staff by providing the interested parties’ proposal in direct language suitable for an Interpretation. The draft Interpretation is more detailed than the previously provided material and also includes transitional guidance, as well as suggested disclosures. We believe this detailed language should help prevent different interpretations among the industry and the accounting firms.

In drafting this proposal, interested parties followed the guiding principles that you previously communicated. First, given that CAMT only applies to a limited number of large and profitable companies, SSAP No. 101 – Income Taxes does not need to, and should not, be opened and rewritten. Although guidance is necessary to address how the consolidated tax should be accounted for under statutory accounting, revising SAAP No. 101 is not necessary as this draft clarifies the existing guidance in SSAP No. 101. Following this guiding principle, interested parties drafted guidance through an Interpretation, leaving SSAP No. 101 intact. Next, given that the CAMT is calculated based on consolidated book income and not taxable income, you suggested the use of the tax sharing agreement to bridge the CAMT calculation to the separate company statutory statements. As such, the proposed Interpretation relies on tax sharing agreements to allocate the consolidated CAMT for purposes of the admittance calculation. In addition, all insurance companies will have different organizational structures, various book income starting points (U.S. GAAP, STAT or IFRS), and other facts and circumstances that will lead to unique situations under the CAMT. To avoid situational guidance, you indicated the solution should be principles-based and cover all insurance companies. By using a hierarchy of filers, the proposal covers all insurance companies without the need to address company specific issues. Finally, you suggested the solution should be developed between the working group and the industry, not external audit firms. Utilizing industry and working group representatives to develop the guidance prevents external audit firms from deviating in how they require insurance companies to account for the CAMT.

Recommendation:

NAIC staff recommends that the Working Group move this item to the active listing, categorized as a SAP clarification and expose INT 23-03: Inflation Reduction Act - Corporate Alternative Minimum Tax for comment with a proposed effective date of year-end 2023. NAIC staff requests Working Group input regarding the SSAP No. 101 paragraph 11c admissibility test noted below, prior to the exposure. (Expose one of the two options below to paragraph 34 of the INT or direct some other action.) During the comment period, input is requested regarding whether references to the INT should be added to SSAP No. 101 scope and disclosure section.

The industry technical draft was very helpful in noting technical concerns and is much appreciated. Key points of the proposed in INT 23-03 guidance include the following:

1. The guidance is for the following categories of entities:
 - nonapplicable (not doing the calculation);
 - applicable (has to do the CAMT calculation and may or may not have to pay) and
 - applicable but has a tax sharing agreement which exclude them from paying the CAMT,
2. Follows existing guidance in SSAP No. 101 to the extent practicable for the CAMT including:

- The reporting entity receives / uses the **statutory valuation allowance (SVA)** assessment from the group for CAMT. The entity continues to complete the SVA separately for all other non-CAMT DTAs. (An entity that is not part of the group assesses SVA for all DTAs themselves.)
 - Utilizes the Realization Threshold Limitations Tables in SSAP No. 101, paragraph 11.b. as applicable. Most entities will be above 300% RBC ex DTA RBC and will admit the CAMT tax credits in that can be utilized within 3 years along with other DTAs in this admissibility step up to 15% of statutory capital and surplus as required to be shown on the statutory balance sheet of the reporting entity for the current reporting period's statement filed with the domiciliary state commissioner adjusted to exclude any net DTAs, EDP equipment and operating system software and any net positive goodwill.
 - Provides an exception to SSAP No. 101 in that entities in top line of the realization tables (3years/ 15%) will not have to do the with and without calculation to determine the impact of the CAMT on realization of DTAs in the admissibility test. (Industry requested that these entities not have to apply with and without).
 - Relying on the tax allocation agreements for the treatment of the CAMT
3. Requires disclosures.
 4. Provides transition guidance including allowing reliance on unapproved TSA agreements filed by year end, with domiciliary DOI consent.

Working Group Input Requested on SSAP No. 101, paragraph 11 c.

Working Group direction is requested on paragraph 34 of the INT (shown below). Two paragraph choices are provided.

Yes, full paragraph 11c offset – Proposed to admit CAMT credits under paragraph 11c. This would treat the CAMT credit similar to other DTAs.

34. The adjusted gross DTA for any CAMT tax credit carryforward which does not qualify for admission under SSAP No. 101, paragraph 11. a. or 11. b. is permitted to be recognized as an offset against applicable deferred tax liabilities (DTLs) in accordance with SSAP No. 101, paragraph 11.c. The 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.

No, paragraph 11c offset - Proposes not to admit any CAMT \ credits under paragraph 11c which is the third step of the DTA admissibility test. This is a departure from SSAP No. 101, paragraph 11c.:

34. The adjusted gross DTA for any CAMT tax credit carryforward which does not qualify for admission under SSAP No. 101, paragraph 11. a. or 11. b. is not permitted to be recognized as an offset against applicable deferred tax liabilities (DTLs) in SSAP No. 101, paragraph 11.c. This restriction is consistent with the noted elements of CAMT tax credits and their restrictions on utilization. It is not permissible to reduce DTLs for a tax credit that the reporting is not eligible to use.

SSAP No. 101, paragraph 11.c admits the amount of adjusted gross DTAs, after application of paragraphs 11.a. and 11.b. that can be offset against existing gross DTLs. Under paragraph 11.c the reporting entity has to 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. For example, an adjusted gross DTA related to unrealized capital losses could not be offset against an ordinary income DTL. Whereas ordinary DTAs can be

admitted by offset with ordinary DTLs and/or capital DTLs. Initial information indicates that the CAMT credit will be available to be used against “ordinary taxes.”

The CAMT credit carryforward does not expire. However, it has additional contingencies that make the utility of offsetting the CAMT credit fully against DTLs more questionable as noted below.

- The CAMT tax credit can’t directly offset other DTLs. The CAMT credit only gets utilized to the extent 21% of regular taxable income exceeds 15% of adjusted financial statement income.
- Because the CAMT credit cannot be used for CAMT liabilities it cannot be used as long as the group is a CAMT Payor. This would be beyond the regular analysis of valuation allowance, which for CAMT is done at the group level.
- While having more DTLs that reverse would generally increase the likelihood that 21% of regular taxable income will exceed 15% of adjusted financial statement income, this is not guaranteed.
- DTLs help determine regular taxable income which is just one component of determining whether the CAMT credit carryforward gets utilized (the other component is 15% of adjusted financial statement income).
- The CAMT DTA is a credit, similar to a Net Operating Loss carryforward, which does not have a reversal pattern. The entity must be eligible to use it for future filings.

The Working Group can direct the following actions 1) yes, expose with paragraph 11c offset (allows the CAMT tax credits which can be offset against DTLs to be admitted) or 2) expose with no paragraph 11c offset above (excludes admissibility of the CAMT credit under SSAP No. 101, paragraph 11c), or 3) some other action such as applying a haircut of some type to the CAMT tax credits admissible under SSAP No. 101, paragraph 11.c.

Voting note: The proposed INT 23-XX for year-end 2023 provides overrides to SSAP No. 4, SSAP No. 9 and SSAP No. 101 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.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2023-06 (Robin)	Additional Updates on ASU 2021-10, Government Assistance	34 – Agenda Item	Comments Received	IP – 25

Summary:

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.

Interested Parties’ Comments:

Interested parties agree with the proposed revisions to SSAP No. 24, as exposed in Ref 2023-06, subject to the following comments.

Interested parties noted that the Working Group’s discussion of Ref #2023-06 in the Spring 2023 Working Group meeting agenda, indicated that use of a grant or contribution model was not intended to be permitted when accounting for government assistance under statutory accounting principles. The discussion did not indicate what accounting model should be applied. Interested parties are not aware of specific statutory guidance addressing the accounting for government assistance transactions, and believe, in the absence of specific guidance, companies may look to industry practice and other nonauthoritative GAAP guidance, which supports the use of a grant or contribution model, to determine appropriate statutory accounting treatment. Additionally, interested parties believe the disclosure requirements in SSAP No. 24 provide sufficient detail to allow a user of the financial statements to adequately understand the impact of any government assistance received by an insurer on its results regardless of the accounting model used to recognize and measure the assistance. Given these considerations and the relative infrequent occurrence of such items, interested parties suggest that the Working Group clarify that the intent of the exposed revisions in Ref #2023-06 are to require disclosure of unusual or infrequent government assistance transactions regardless of how such transactions are accounted for, and are not intended to prohibit entities from accounting for government assistance transactions through the use of a grant or contribution model.

Recommendation:

NAIC staff recommends that the Working Group adopt the exposed revisions to SSAP No. 24 as exposed. NAIC staff does not recommend any additional revisions are needed as ASU 2021-10 is rejected and the remaining disclosure is about government assistance, not the form of accounting for such assistance. If preferred, the disclosures could be wholly rejected.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2023-12 (Julie)	Residuals in SSAP No. 48 Investments	35 – Agenda Item	Comments Received	IP – 40

Summary:

This agenda item proposes revisions to clarify the scope and reporting for investment structures that represent residual interests 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 designed 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 directly, or indirectly through a feeder fund, 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 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.

Interested Parties' Comments:

Interested parties has been working with NAIC staff to clarify the definition in order to facilitate consistent interpretation by the industry and auditors, to avoid unintended consequences of certain equity investments being scoped into the definition of a residual when they were not intended to be in scope. We appreciate NAIC staff working with us on these clarifications and look forward to reviewing the next exposure. In addition to the redrafted exposure draft, we offer the following comments.

In reviewing the exposure, we understand that the residual definition is related to investment structures that issue debt securities created for the primary purpose of raising debt capital backed by collateral assets (ABS issuers as defined in paragraph 8 of the current bond exposure in SSAP Nos. 26R). As a result, interested parties do not believe the intent was to include the following types of investment structures:

- Private Funds (e.g., equity, debt, hedge)- that issued debt for liquidity / operating purposes rather than to raise capital backed by a discrete pool of collateral assets.
- Real Estate Funds (including REITs and JVs) (i.e., considered Issuer Credit Obligations, or "ICOs", in the proposed bond standard)
- Non-US registered Funds (i.e., considered ICOs in the proposed bond standard)
- Other ICOs in the proposed bond definition, such as 40 Act Funds, Business Development Company, Operating Entities, and Holding Companies supported by operating companies.

The exposure currently addresses changes to *SSAP No. 48—Joint Ventures, Partnerships and Limited liability Companies*, but we also believe the definition is relevant to SSAP Nos. 26R, 43R, and 21R and should be included in those other SSAPs. Also, consideration should be given to whether the definition should also be added to SSAPs where residuals may currently be in scope, such as SSAP No. 30R (e.g., from securitizations in legal form of a corporation).

Upon adoption of the Form A, interested parties believe the guidance would be effective immediately. Interested parties will need time to consider the guidance, develop accounting policies, and identify the residuals under the new definition. As a result, we recommend an effective date of six months after the adoption by Executive (Ex) Committee.

Recommendation:

NAIC staff has been working with regulators and industry on the proposed revisions to ensure consistent reporting classification for residuals. NAIC staff recommends that the Working Group expose this agenda item, which has been expanded with an updated proposal to reflect revisions from the interim discussions and coordination. (It is NAIC staff's assessment that the intent of the definition is consistent, but the language has been clarified to ensure consistent interpretation and application.) This item is proposed to have a shortened comment deadline ending September 12.

NAIC staff does not support the industry proposal for a 6-month delay for adoption as that would go beyond year-end 2023. NAIC staff believe that having all residuals reported on the Schedule BA designated reporting line for year-end 2023 is vital to ensure that the adopted RBC sensitivity test can properly reflected. NAIC staff notes that the current focus should only move those items that were previously on Schedule BA, so it is only a reporting line change on the existing schedule. Revisions previously adopted to SSAP No. 43R specified that residuals previously captured in scope in that standard, perhaps as beneficial interests, had to be reported on the Schedule BA designated reporting lines. The shortened comment deadline intends to allow for adoption and implementation for year-end 2023.

The comment letters are included in Attachment 36 (50 pages).

[https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2023/8-13-23 Summer National Meeting/Hearing/00 - 08-2023 - SAPWG Hearing Agenda.docx](https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National%20Meetings/A.%20National%20Meeting%20Materials/2023/8-13-23%20Summer%20National%20Meeting/Hearing/00-08-2023-SAPWG%20Hearing%20Agenda.docx)

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Attachment 1

Accounting Practices and Procedures (E) Task Force

3/23/23

Draft: 4/11/23

Statutory Accounting Principles (E) Working Group
Louisville, Kentucky
March 22, 2023

The Statutory Accounting Principles (E) Working Group of the Accounting Practices and Procedures (E) Task Force met in Louisville, KY, March 22, 2023. The following Working Group members participated: Dale Bruggeman, Chair (OH); Kevin Clark, Vice Chair (IA); Sheila Travis (AL); Kim Hudson (CA); William Arfanis (CT); Rylynn Brown (DE); Cindy Andersen (IL); Stewart Guerin (LA); Judy Weaver (MI); Doug Bartlett (NH); Bob Kasinow (NY); Diana Sherman and Matt Milford (PA); Jamie Walker (TX); Doug Stolte and David Smith (VA); and Amy Malm (WI). Also participating were: Blase Abreo and Todrick Burks (AL); Michael Shanahan (CT); Bill Carmello (NY); Tom Botsko (OH); Doug Hartz (OR); and Rachel Hemphill (TX).

1. Adopted its 2022 Fall National Meeting Minutes

The Working Group met March 16, Feb. 22, Jan. 20, and Jan. 17 in regulator-to-regulator session, pursuant to paragraph 3 (specific companies, entities or individuals) and paragraph 6 (consultations with NAIC staff related to NAIC technical guidance) of the NAIC Policy Statement on Open Meetings. No actions were taken during these meetings, as the discussion previewed the Spring National Meeting agendas and discussed other items with NAIC staff pursuant to the NAIC Policy Statement on Open Meetings.

Malm made a motion, seconded by Sherman, to adopt the Working Group's Dec. 13, 2022, minutes (*see NAIC Proceedings – Fall 2022, Accounting Practices and Procedures (E) Task Force, Attachment One*). The motion passed unanimously.

2. Adopted Non-Contested Positions

The Working Group held a public hearing to review comments (**Attachment One-A**) on previously exposed items.

Walker made a motion, seconded by Weaver, to adopt the revisions detailed below as non-contested statutory accounting revisions. The motion passed unanimously.

a. Agenda Item 2017-33

Bruggeman directed the Working Group to agenda item 2017-33: ASU 2022-01, *Issue Paper No. 167—Derivatives and Hedging* (**Attachment One-B**). Julie Gann (NAIC) stated that this agenda item is for an issue paper that provides historical documentation of the revisions adopted to *Statement of Statutory Accounting Principles (SSAP) No. 86—Derivatives* from the review of *Accounting Standards Update (ASU) 2017-22, Derivatives and Hedging* and *ASU 2022-01, Fair Value Hedging – Portfolio Layer Method*. Interested parties had no comments on the exposure.

b. Agenda Item 2022-15

Bruggeman directed the Working Group to agenda item 2022-15: *Affiliate Reporting Clarification* (**Attachment One-C**). Jake Stultz (NAIC) stated that during the 2022 Fall National Meeting, the Working Group exposed statutory accounting principle (SAP) clarifications to *SSAP No. 25—Affiliates and Other Related Parties* to clarify that any

Draft Pending Adoption

Attachment 1

Accounting Practices and Procedures (E) Task Force

3/23/23

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. Interested parties had no comments on the exposure.

c. Agenda Item 2022-16

Bruggeman directed the Working Group to agenda item 2022-16: *ASU 2022-03, Fair Value Measurement of Restricted Securities* (Attachment One-D). Stultz stated that revisions to *SSAP No. 100R—Fair Value* were exposed for adoption with modifications to ASU 2022-03 to be consistent with existing statutory accounting guidance, but the revisions do not incorporate the new ASU disclosures on sales restrictions. He noted that the items restricted as to sale would be captured as restricted assets per *SSAP No. 1—Accounting Policies, Risks & Uncertainties and Other Disclosures*. He noted that ASU 2022-03 provides updated guidance for two specific scenarios: 1) the restriction is based on the entity holding the equity security; and 2) the restriction is a characteristic of equity security. Interested parties had no comments on the exposure.

d. Agenda Item 2022-18

Bruggeman directed the Working Group to agenda item 2022-18: *ASU 2022-04, Disclosure of Supplier Finance Program Obligations* (Attachment One-E). Robin Marcotte (NAIC) stated that this agenda item is a clarification to *SSAP No. 105R—Working Capital Finance Investments* to reject ASU 2022-04 for statutory accounting, as these disclosures are for borrowers in these programs and, as such, are not relevant for insurance reporting entities that may invest in these programs. Interested parties had no comments on the exposure.

3. Reviewed Comments on Exposed Items

a. Agenda Item 2019-21

Bruggeman directed the Working Group to agenda item 2019-21: Principles-Based Bond Definition. Gann stated that in November 2022 and at the 2022 Fall National Meeting, the Working Group exposed revisions to *SSAP No. 26R—Bonds*, *SSAP No. 43R—Loan-Backed and Structured Securities*, and other SSAPs, as necessary, to update statutory accounting guidance for the principles-based bond project. These revisions also included edits to *SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments* to restrict asset-backed securities (ABS) from being captured in scope and *SSAP No. 21R—Other Admitted Assets* to include new guidance for the debt securities that do not qualify within the bond definition. In addition to the revisions, an updated issue paper detailing the discussions and revisions, as well as proposed reporting changes, were also exposed.

Gann stated that interested parties provided detailed comment letters included in the meeting materials. She stated that NAIC staff reviewed the comments and made several changes to the proposed guidance. She stated that one change pertains to nominal interest rate adjustments in the prior guidance. Under the prior exposure, if the principal or interest can fluctuate based on non-bond related variables, it would preclude the security from being a bond. Gann stated that NAIC staff included guidance to have a very limited exception for nominal interest rate related adjustments, mostly pertaining to sustainability type bonds, but not limited in scope to that specific instance. Also included was guidance in *SSAP No. 21R* for residual tranche securities. Gann stated that interested parties highlighted that the guidance for residual tranche securities was still in *SSAP No. 26R* and *SSAP No. 43R*, but residual tranche securities do not technically qualify as bonds. Gann stated that *SSAP No. 21R* also reflects additional revisions to the guidance proposed for non-bond debt securities. She stated that there are questions for interested parties regarding the method that is being used to amortize residual tranche securities, as well as for the assessments of other-than-temporary impairment (OTTI) and how that has occurred historically. She stated

Draft Pending Adoption

Attachment 1

Accounting Practices and Procedures (E) Task Force

3/23/23

that NAIC staff recommend that the Working Group expose the revised SSAPS. She stated that SSAP No. 21R has been broken out so that it is its own stand-alone document, so the documents for exposure include SSAP No. 26R, SSAP No. 43R, SSAP No. 21R, and the other SSAP revisions. In addition to the SSAP guidance revisions, NAIC staff also proposed Schedule BA reporting line changes very similar to what was done in the past for the broader bond changes. Gann stated that NAIC staff recommended exposing the proposed reporting changes as a conceptual change at the Working Group, and after considering comments, a blanks proposal could then be submitted to the Blanks (E) Working Group.

Michael Reis (Northwestern Mutual), representing interested parties, expressed his appreciation of the dialogue with NAIC staff and state insurance regulators, as well as support for the nominal interest rate adjustment that Gann discussed. He stated that interested parties continue to look forward to working with the NAIC staff and state insurance regulators on this project.

Gann stated that there were two additional items to highlight: 1) the issue paper detailing discussions and decisions for the principles-based bond project will be updated after this meeting for subsequent exposure; and 2) the Blanks (E) Working Group exposed the broad bond reporting changes (2023-06BWG) with a public comment period ending June 30.

Clark made a motion, seconded by Walker, to expose the above agenda items. The motion passed unanimously. After the Spring National Meeting, the chair agreed to extend the exposure deadline for the Schedule BA reporting changes to June 30 to mirror the exposure deadline for the blanks reporting changes. The SSAP exposures were not extended and have a public comment period ending June 9.

b. Agenda Item 2022-01

Bruggeman directed the Working Group to agenda item 2022-01: Conceptual Framework – Updates. Marcotte stated that during the 2022 Fall National Meeting, the Working Group re-exposed revisions to *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets* and *Issue Paper No. 16X—Updates to the Definition of a Liability*. The revisions incorporate the definition of a liability from Financial Accounting Standards Boards (FASB) *Concepts Statement No. 8, Conceptual Framework for Financial Reporting—Chapter 7, Presentation and Concepts Statement No. 8, Conceptual Framework for Financial Reporting—Chapter 4, Elements of Financial Statements*, which updates the definition of an asset and definition of a liability.

Marcotte stated that NAIC staff recommend exposure of additional clarifications, deferring to SSAP guidance, which provides topic-specific variations from the definition of a liability and SSAP No. 5R, and the related issue paper, as illustrated in the proposed revisions in the meeting materials. These clarifications are recommended because of the authoritative treatment that statutory accounting provides to the definition of an asset and liability in *SSAP No. 4—Assets and Nonadmitted Assets* and SSAP No. 5R. Marcotte stated that for U.S. generally accepted accounting principles (GAAP), the FASB conceptual framework definitions are not authoritative, but they are concepts to consider when developing and applying guidance. Particularly for liabilities, this is needed because of the existing variations in SSAPs, such as asset valuation reserve (AVR) and interest maintenance reserve (IMR) and the provision for reinsurance and other post-retirement benefits. Marcotte stated that the proposed footnote defers to other topic-specific guidance in other SSAPs when appropriate. She stated that due to prior interested parties' comments, NAIC staff have also prepared a new agenda item 2023-01: Review Annual Statement Instructions for Accounting Guidance—which proposes a project to ensure that accounting guidance from the annual statement instructions are incorporated in the SSAPs, as needed.

Draft Pending Adoption

Attachment 1

Accounting Practices and Procedures (E) Task Force

3/23/23

Walker made a motion, seconded by Malm, to expose the additional clarifications deferring to SSAP guidance. The motion passed unanimously.

c. Agenda Item 2022-11

Bruggeman directed the Working Group to agenda item 2022-11: Collateral for Loans. Marcotte stated that during the 2022 Fall National Meeting, the Working Group re-exposed revisions to SSAP No. 21R to clarify that assets pledged as collateral for admitted collateral loans must qualify as admitted invested assets. She stated that interested parties proposed a footnote on audit requirements allowing a third-party-determined fair value to be used in the place of an audited valuation.

NAIC staff recommended revisions to SSAP No. 21R, illustrated in the agenda item, proposing the clarification of guidance, along with the addition of a new footnote. This footnote, originating from state insurance regulators, noted that it was imperative to uphold and maintain audit requirements of joint ventures, limited liability companies (LLCs), or investments that would qualify as a subsidiary controlled entity if they were pledged as collateral for a loan. State insurance regulators had concerns that allowing these investments to qualify as acceptable collateral without an audit would lower the collateral requirement standard and allow for potential arbitrage within risk-based capital (RBC) and the admissibility of assets.

Marcotte stated that NAIC staff's recommendation is to continue to require audits for joint ventures, limited LLCs, and partnerships, as well as investments that would qualify as subsidiary, controlled, and affiliated (SCA) entities if these items are pledged as collateral to support the admittance of a collateral loan. Furthermore, the recommendation proposes to revise the standard to note that a fair value comparison is required unless the collateral is an *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies* or *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities* investment, in which case the comparison to the loan is to the audited net equity value of the pledged collateral. Marcotte stated that this is closer to what the day two value would be in the event that the loan defaulted and the collateral was assumed by the insurance reporting entity. In addition, NAIC staff are recommending that the words “admitted” and “investment” be inserted into paragraph 4.b. of *SSAP No. 20—Nonadmitted Assets* for consistency. Marcotte recommended exposing the proposed edits to SSAP No. 21R and SSAP No. 20.

Bruggeman stated that the concept that nonadmitted assets cannot find their way into an admitted asset balance sheet came up several years ago. He stated there are some fair value considerations, but with SSAP No. 48 and SSAP No. 97 entities that almost always require an audit, and if that audit is the support to admit the loan receivable, the Working Group must ensure that if there are nonadmitted assets being pledged as collateral, they are not being moved up to the regulated entity balance sheet in a different way.

Andrew Morse (Global Atlantic Financial Group), representing interested parties, stated his appreciation of the collaborative and clear process on this topic. He stated that interested parties made a comment at the 2022 Fall National Meeting on this topic and have read the proposed exposure, and they believe it is significantly clearer in terms of what is needed. He added that interested parties' ability to comment and engage in dialogue with state insurance regulators is appreciated.

Clark made a motion, seconded by Weaver, to expose the revisions to SSAP No. 21R proposing the addition of a new footnote and minor consistency edits to SSAP No. 20. The motion passed unanimously.

Draft Pending Adoption

Attachment 1

Accounting Practices and Procedures (E) Task Force

3/23/23

d. Agenda Item 2022-12

Bruggeman directed the Working Group to agenda item 2022-12: Review of INT 03-02: Modifications to an Existing Intercompany Pooling Arrangement. Marcotte stated that during the 2022 Fall National Meeting, the Working Group re-exposed the intent to nullify *Interpretation (INT) 03-02: Modification to an Existing Intercompany Pooling Arrangement*. With this re-exposure, the Working Group requested industry provide comments on specific instances in which the interpretation was being applied and specific staff-identified items were noted in the agenda.

Marcotte stated that interested parties provided comments that were included in the meeting materials. She stated that NAIC staff continue to recommend nullification of INT 03-02, as it is inconsistent with SSAP No. 25 guidance regarding economic and non-economic transactions between related parties. She stated that after speaking with interested parties, NAIC staff do not believe there is a compelling need to be different when valuing these types of intercompany transactions. She stated that the recommendation is exposure with an effective nullification date of Dec. 31, 2023. She stated that interested parties requested another exposure to allow for further discussion.

Bruggeman stated that there may be a need to review the guidance in *SSAP No. 62R—Property and Casualty Reinsurance* transactions, particularly with pooling and netting arrangements as part of this exposure and discussion to ensure SSAP No. 62R is not in conflict, and requested comments from state insurance regulators and industry on this dynamic during the exposure period.

Keith Bell (Travelers), representing interested parties, commented that while INT 03-02 is in conflict with SSAP No. 25, there is consistency and comparability of accounting because of the interpretation. He stated that there is concern that the nullification of INT 03-02 is going to cause a high risk of inconsistency of interpretation by companies, state insurance regulators, and auditors on the issue of economic versus non-economic transactions. He also stated that the nullification will end up with different reinsurance accounting depending on whether interest rates are going up or going down and for bonds with an unrealized gain versus unrealized loss position. He stated that there is also going to be inconsistency within an intercompany pooling arrangement depending on whether investments are in an unrealized gain or loss position. For example, the same company group could trigger both gains and losses, meaning some companies would end up with prospective reinsurance because of the change, and other companies within the same group would end up with retroactive reinsurance. Bell noted that there is going to be some inconsistency within a group based on the ownership chain of companies. If there is a single insurer at the top of the ownership chain, there will be a different set of rules on the economic distinction, versus having multiple companies at the top of the ownership chain. Bell stated that interested parties will look at the re-exposure, and they may present language that could narrow this down even further to be included in SSAP No. 62R as permanent guidance rather than be part of an INT.

Bruggeman requested that interested parties include specific wording or economic versus non-economic situations, as well as the unrealized gain/loss scenario he discussed for bonds. He stated that specificity or examples that could be provided, rather than a theoretical discussion, would help the Working Group understand how to incorporate necessary guidance within SSAP No. 62R. Bell stated that the response will include these details.

Malm made a motion, seconded by Walker, to re-expose INT 03-02 with an effective nullification date of Dec. 31, 2023. The motion passed unanimously.

Draft Pending Adoption

Attachment 1

Accounting Practices and Procedures (E) Task Force

3/23/23

e. Agenda Item 2022-14

Bruggeman directed the Working Group to agenda item 2022-14: New Market Tax Credits. Gann stated that this agenda item addresses new market tax credits, but more broadly, overall tax credit accounting. She stated that at the 2022 Fall National Meeting, the Working Group exposed both the agenda item and a discussion document that walked through proposed SSAP changes, and it requested feedback from state insurance regulators and interested parties. The Working Group received a very detailed comment letter from interested parties that addressed all the discussion document questions. Interested parties also provided two general key theme comments. One comment asked for a reconsideration of the existing guidance to have both the amortization of the investments and the use of the tax credits go through the same income statement line, consistent with U.S. GAAP. Gann stated that statutory accounting intentionally took a different approach when the guidance was originally adopted. NAIC staff will research this to understand why the divergence from U.S. GAAP was undertaken and determine if there is a reason to change to be consistent with U.S. GAAP. The second comment pertained to the classification of tax credit investments that are in the form of debt on Schedule D and not Schedule BA. Gann stated that NAIC staff have received comments from state insurance regulators that they are more appropriate to be on Schedule BA and should not be reported as bonds. She stated that NAIC staff are requesting feedback from state insurance regulators if that is an incorrect assessment. She stated that NAIC staff are recommending that the Working Group direct NAIC staff to continue moving forward with drafting SSAP guidance, noting that the FASB has a pending issuance regarding the proportional amortization method. NAIC staff will also review comments received from interested parties, as well as the new U.S. GAAP ASU once it has been issued, and move forward with proposing SSAP revisions for exposure at a later date. She stated that NAIC staff also recommend direction to work with interested parties directly during the interim.

Bruggeman stated that there are currently only line items for low-income housing tax credits in Schedule BA of the financial statements and RBC calculations. He stated that there may come a time that if there are differentiations, the Working Group will inform interested state insurance regulators and interested parties of those and will pass that information along to the Capital Adequacy (E) Task Force.

Gann stated that it is anticipated that this project will continue to sponsor blanks and RBC reporting changes since current reporting is specific to low-income housing tax credits, and the project is expanding to encompass more types of tax credits.

Bruggeman stated that the Working Group does not need to make a motion for this agenda item, and NAIC staff have been directed based on these recommendations.

f. Agenda Item 2022-17

Bruggeman directed the Working Group to agenda item 2022-17: Interest Income Disclosure Update. Stultz stated that this agenda item came from the larger principles-based bond project. He stated that during one of the earlier exposures, interested parties suggested revisions to further enhance reporting for interest income. He stated that there are two distinct items that came from the original interested parties' comments addressed in this agenda item. First, interested parties suggest data-capturing the gross nonadmitted and admitted amounts of interest income due and accrued. Second, interested parties suggested that a data element for paid-in-kind (PIK) interest mirror the definition included in the bond proposal project and reflect the cumulative amount of PIK interest included in the current principal balance. Stultz stated that from the original exposure of this agenda item, interested parties provided some revisions that are shown in the agenda. Interested parties also asked to have an effective date that is consistent with the bond project. He stated that because this disclosure is unrelated to that

Draft Pending Adoption

Attachment 1

Accounting Practices and Procedures (E) Task Force

3/23/23

project overall, NAIC staff recommend that this be adopted for 2023 year-end reporting. He stated that NAIC staff's recommendation is to adopt the agenda item with the interested parties' suggested revisions but keep the 2023 year-end date. He stated that there is a corresponding Blanks (E) Working Group proposal that will be exposed, and NAIC staff will work closely with the interested parties to ensure that the language in the proposal is consistent with their suggested revisions.

Tip Tipton (Thrivent), representing interested parties, stated that they are appreciative of the changes made. He stated that these are just aggregate total amounts of deferred interest and PIK interest. He noted that beginning in 2025 with the bond project, the expectation is these will be identified separately for each investment, but for now, at least for 2023 and 2024, this will be just a total aggregate amount. He stated that is interested parties' understanding, and they support this effort. He stated interested parties look forward to the opportunity to comment on the Blanks (E) Working Group proposal.

Clark made a motion, seconded by Walker, to adopt the agenda item with the interested parties' suggested revisions but keep the 2023 year-end effective date (Attachment One-F). The motion passed unanimously.

g. Agenda Item 2022-19

Bruggeman directed the Working Group to agenda item 2022-19: Negative IMR. Gann stated during the 2022 Fall National Meeting, the Working Group exposed the agenda item as a new SAP concept. She stated that it detailed the current guidance and the history of negative IMR, but there were no actual recommendations included. She stated that the Working Group also had regulator-only discussions in January and February to hear company presentations regarding negative IMR. She stated that the Working Group also received a comment letter from the American Council of Life Insurers (ACLI) during the exposure period, which was included in the meeting materials. She stated that NAIC staff are requesting the Working Group to provide feedback and direction.

Brown stated that it is important to help state insurance regulators understand the impact of negative IMR and to have special reporting so it can be easily identified. She expressed support for a referral to the Capital Adequacy (E) Task Force in regard to RBC. She suggested an admittance limitation of 1% of capital and surplus. She stated that there are a variety of things for the Working Group to consider and discuss.

Hudson stated that the Working Group has a number of items that should be directed to NAIC staff. First, he suggested a referral to the Life Actuarial (A) Task Force on the asset adequacy implications of negative IMR, and he directed NAIC staff to help with the template for reporting asset adequacy. Secondly, he reiterated Brown's comments for a referral to the Capital Adequacy (E) Task Force to consider the elimination of any net negative IMR from total adjusted capital (TAC) and consideration of sensitivity testing with and without negative IMR. Thirdly, he said he supports separate surplus reporting for the admitted negative IMR. Fourth, he recommended a cap on admitted negative IMR as a percentage of surplus, such as what exists for goodwill, and consideration of a downward adjustment when RBC reaches below 300%. Fifth, he suggested the consideration of an update to the instructions for excess withdrawal and related capital gains and loss to ensure that it is clear on the division between AVR and IMR. Sixth, he said there should be additional footnote disclosure.

Walker agreed with Hudson and emphasized that the Working Group is trying to find a solution quickly on this topic. She stated that the prior discussion of negative IMR was a multi-year long discussion that got nowhere. So, the Working Group may have to do an interim solution until feedback is received in response to the referrals to the task forces and other groups involved in this issue get a permanent solution. She stated that the Working

Draft Pending Adoption

Attachment 1

Accounting Practices and Procedures (E) Task Force

3/23/23

Group should try to address the current issue while also establishing a robust and well-thought-out overall policy related to negative IMR.

Malm agreed with Walker, and she stated that the Working Group should not close the issue until a solution is reached to prevent this dynamic from reoccurring after another 10 years. She stated that the issues should be well documented, with full understanding of the pros and cons, and a conclusion reached.

Clark stated support for the comments that Walker and Malm made and the direction that Hudson laid out. He stated that he would add one element, which is one of the things that interested parties recommended in their comment letter, to include an opt-in approach that would come with documentation around asset-liability matching (ALM) policies. He stated that having an approach where there might be differences between companies may not be desirable, but he noted that there are elements of the opt-in idea that could be applied across the board. He stated that he is not sure that the current guidance specifies that sales of assets for other than reinvestment purposes cannot be deferred; therefore, that could be the presumption for why negative IMR should be admitted. He stated that explicitly spelling out what is permitted for IMR might be needed, as well as potentially some form of attestation from the company that any deferred losses were in fact for reinvestment purposes and not for non-reinvestment purposes.

Bruggeman stated the need to ensure the discussion and conclusions, with the final accounting guidance fully documented. He stated that this is one topic where there are instructions in the NAIC *Annual Statement Instructions* and generic instructions in *SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve*. He stated the Working Group needs to ensure that those are consistent with the hierarchy, so statutory accounting comes first. He stated that blanks instructions cannot change the accounting guidance. He stated that the Working Group needs to ensure that the language between the instructions, SSAP No. 7, and SSAP No. 86 are lined up as best as possible when discussing types of assets, such as bonds and interest rate-related impacts, especially with derivatives that have yet to be discussed. He stated that the whole idea with bonds is they are being carried at amortized cost. With amortized cost measurement, there is no recording of an unrealized gain or loss fluctuation during the life of the asset, and that is why IMR was established. He stated that where there are already assets, whether they are bonds or derivatives that are recorded at fair value, those items should probably not end up in IMR. He stated that there are instructional elements that are not laid out exactly right that should be addressed as part of this project.

Reis stated that the ACLI would like to thank the NAIC for picking up this issue with urgency. He stated that the ACLI would like to acknowledge that there was a prior Working Group discussion, a regulator-to-regulator session with the Life Actuarial (A) Task Force, a discussion at the Financial Condition (E) Committee, a discussion here today, and many state insurance regulator discussions with individual ACLI companies, and all of those efforts are very much appreciated. He stated that he wants to start with maybe the main thrust of the ACLI letter and try to address a few key points. He stated that the ACLI brought forth the opt-in approach in its letter because it believed it was something that would best address state insurance regulator concerns. He stated that it would be intended to be a very structured process that had many potential appropriate safeguards, such as proving reinvestments, ALM objectives being met, a recommendation of asset adequacy testing (AAT) tightening attestation, potentially tethering to RBC, and significant transparency. He stated that throughout state insurance regulator and individual member company discussions, the ACLI has been hearing a lot of different thoughts. Some participants really like the opt-in approach; some, perhaps Delaware, may want segregating surplus through a special surplus account, and they appreciate the detailed consideration that has been going into this. He stated that he believes the ACLI would support, maybe along the lines of what Clark suggested, either of those approaches or some combination of these approaches, certainly with the requisite safeguards mentioned. He stated that one common theme that

Draft Pending Adoption

Attachment 1

Accounting Practices and Procedures (E) Task Force

3/23/23

the ACLI has heard from state insurance regulators is that they do not want to disincentivize prudent behavior transactions. At the same time, the ACLI has heard that state insurance regulators do not want to incentivize imprudent behavior or transactions. He stated that the ACLI certainly shares those objectives and welcomes any specific concerns that state insurance regulators have so they can help to address those. He stated that higher interest rates are generally positive for life insurance companies, and for all the reasons that IMR was developed, ACLI companies believe that it is important that financial strength be accurately reflected. Current interest rates, or even higher rates, will only exacerbate the negative IMR issue as companies look to make decisions throughout 2023 and beyond and likely many years down the road. Therefore, ACLI companies are hopeful that they can work with state insurance regulators and NAIC staff toward a year-end resolution if possible, and they are here to support that effort in any way they can. He stated that the ACLI is thankful for all the consideration, and it is certainly willing to discuss or take questions as well.

Bruggeman asked if there were any questions for Reis, and he stated that the options hint at incorporating governance within accounting, but there are, as Clark described, ways to do that. Bruggeman stated that he agrees with Clark that an opt-in is probably not the best way to get consistency; therefore, if something like that is supported by the Working Group, it would have to be across the board. He stated that asset adequacy testing is done through the Life Actuarial (A) Task Force, and with the actuarial assumptions, there are certain things that perhaps do not have as many guardrails. There are a lot of cash flow assessments to consider, and there is a bigger picture for the whole industry and the Financial Stability (E) Task Force on liquidity stress testing (LST). He stated that he does not know if that is part of AAT testing, and that it is kind of indirect. However, because these are deferred losses, if there is a liquidity stress within one company, which may not be in the whole industry, those create different kinds of issues, going to the heart of reinvestment.

Bruggeman stated that there is already a requirement for excess withdrawals, and if there are excess withdrawals and a company is forced to sell bonds, the loss that happens in that situation does not currently go through IMR. If the Working Group needs to tighten up that language, it may help ensure that reinvestment occurs. Bruggeman stated that in situations where losses go to IMR and reinvestment does not occur, then the Working Group and state insurance regulators need to understand to verify that it was because of the excess withdrawal. He stated that the state insurance regulators want to prevent any gamesmanship going on with that scenario.

Bruggeman stated that he is trying to ensure that the Working Group is addressing all components of this topic, and at the end of the discussion, the intent is to give directions to NAIC staff to move forward. He stated that he heard a percentage of surplus admittance limitation from Brown at 1%. He stated that NAIC staff have done an overall analysis by company, which was shared with state insurance regulators, on the percentage of net negative IMR that is currently nonadmitted compared to capital and surplus. He also noted that state insurance regulators received a five-year history of net negative IMR by reporting entity. He stated that there are individual circumstances where companies go from positive to negative, but there are several reporting entities that have been in a net negative IMR position for all five years. He stated there could be a lot of reasons why those companies have been in a net negative position, but recognizing this dynamic goes back to the key components of the original ACLI letter and what guardrails should exist before permitting an admitted asset for net negative IMR.

Reis stated that the ACLI letter does not oppose looking at the excess withdrawal guidance. He identified that certain liabilities with market value adjustments are believed to be excluded from the excess withdrawal guidance, and there are questions on why those were excluded. Regarding the data that details ongoing years of negative IMR by some reporting entities, he stated that the economy has been in a 30-year period of declining interest

Draft Pending Adoption

Attachment 1

Accounting Practices and Procedures (E) Task Force

3/23/23

rates; therefore, the five-year historical data may not be the most useful assessment. He stated the results for net negative IMR could go back for an extended period.

Reis stated that an admittance limit of 1% of surplus is a small number compared to what companies are anticipating. He stated that the ACLI's position is that an arbitrary safeguard of 1% is too low. He also stated concern with the view that IMR creates an intangible asset of prior realized losses that cannot be used to pay claims. He stated it is very important to understand the presence of the intangible asset with the current reporting of bonds at amortized cost, and he provided an example, noting that it is an oversimplification of the theory behind IMR. He stated that if a reporting entity has a bond that was bought for \$100 on the balance sheet and because of rising interest rates, the fair value of the bond is \$80, a reporting entity effectively has \$80 of claims paying ability or liquidity, on the balance sheet has an intangible asset on the balance sheet of \$20. This is because the bond is reporting at amortized cost (100), so there is an intangible asset reported with the bond, which is the difference between the fair value and the amortized cost. Reis stated that if a reporting entity was to sell the bond at fair value, predicated on reinvestment, the reporting entity would acquire a new bond for \$80. As such, the reporting entity still has the same \$80 liquid asset, and with the allocation to IMR for the \$20 loss from the sale—\$100 to \$80—the reporting entity still has the same \$20 in intangible assets they had when the bond was reported at \$100. As such, in terms of financial position and a reporting entity's claims paying ability from liquidity, a reporting entity would be in the same position pre- and post-bond sale with reinvestment. Reis stated that he has been asked why reporting entities do these transactions, and he noted that there are many reasons. He stated that a reporting entity could be doing it to shorten or lengthen portfolios to either affect disintermediation risk or ensure that guarantees do not get hit in the long term. He stated that the duration of the sold bond and reinvested bond could be different, but that change does not affect claims paying ability or liquidity, and it could put reporting entities in a better spot in the long term. He stated that it has also been inquired as to whether the reporting entities reinvest with different credit-rated bonds, and he advised that entities do not necessarily think linearly, and if they are going to sell a AAA bond, then they are going to reinvest in another AAA bond. He noted that if the credit rating were different, higher or lower, that would be picked up in RBC. In conclusion, he stated that he wanted to be sure to make the point that liquidity and claims paying ability is not affected, as that is an important point.

Bruggeman requested discussion on how to direct NAIC staff to prepare guidance for exposure, and he opened the floor to begin with the admittance limit as a percentage of surplus. He stated that Brown has proposed a 1% limit, and goodwill is limited to 10% of surplus, noting that could be perceived as a large range between limits. Brown stated that it is a compromise to allow the admittance of even a small amount, but the 1% proposal is open to negotiation. She stated some think it should be 10%, but she believes it should be 1%, so perhaps somewhere in the middle would be a good place to start.

Bruggeman stated that he had heard potential support closer to the 15% used for the deferred tax asset (DTA), but he noted that there is a secondary guardrail there with the three-year limit, so that is why he believes maybe closer to the goodwill 10% limit may be more appropriate.

Brown stated that some states use 5% of capital and surplus in determining materiality, and if the amount is considered material, it is a big deal. However, she said she is certainly willing to hear what everyone else has to say.

Bruggeman suggested starting at 5% of capital and surplus as an admittance limit with an elimination of admittance if RBC goes below 300%. He asked if anyone objects to the 5% limit as the initial direction to staff. Reis asked if it makes sense to focus on the broader conceptual direction that seemingly makes sense and is without

Draft Pending Adoption

Attachment 1

Accounting Practices and Procedures (E) Task Force

3/23/23

controversy and leave open a specific percentage in the exposure as something to debate further. Bruggeman stated his preference to have a percentage limit in the exposure. He stated that he is not aware of the support for the 10% goodwill limit, and he requested NAIC staff research that historical discussion. He stated support for 10%, but he is sensitive to Brown's comments that materiality assessments are at 5%, noting that there could be a secondary guardrail where asset adequacy testing is the primary guardrail.

Clark stated that he is not opposed to an admittance limit for exposure, as the point of the exposure is to get comments before having additional discussion, and getting industry feedback will be important. He stated that the desire for an admittance limit makes logical sense from a conservatism perspective. But given the size of insurers' balance sheets in comparison to surplus and the size of their fixed income portfolios, even a 10% allowance is going to be very small in comparison to what interest rates have done to some reporting entity's fixed income portfolios. He stated that is an issue the Working Group should explore, but he believes it is going to be kind of a difficult one to meaningfully address the IMR impact of the significant rise in interest rates and what that has done to asset values with a 5% limit.

Malm stated that the analysis needs to be done before a percentage is set. She stated that industry should do an analysis as well because they know their investment portfolios and their surplus, and it would be beneficial for them to provide the Working Group with what they are projecting. Bruggeman stated that individual company analysis is key to understanding the potential impact if sales are planned for investments held at amortized cost.

Hartz stated that getting input from industry and considering the type of transaction that is giving rise to the negative IMR might be more important than a target rate or target percentage of surplus.

Walker stated that if the Working Group takes too much time for analysis, they will not arrive at a solution by year-end. As such, there is a give and take from a short-term solution versus a long-term solution. If there is a desire to have the long-term solution conversation, then it will likely take more time than what is available to have a solution this year. She stated that although it is only the first quarter, the Working Group already has a limited amount of time for a year-end solution. Bruggeman agreed with these comments.

Hudson stated support for a numerical cap even if it ends up not being the perfect solution. The Working Group needs to get something in place, and the initial limit can always be changed. He stated the Working Group should start off with the cap, if it is 5% of surplus, to start the discussion process. Weaver agreed to put in a percentage limitation, also acknowledging that it is under negotiation. Walker and Weaver both stated support for a 5% admittance limit to capital and surplus. Hartz also noted that 5% is between the 1% and 10% options being considered, so it is a good place to begin as an initial direction to NAIC staff.

Brown stated that once other safeguards are in place, the Working Group could consider raising the admittance limit. Bruggeman and Walker agreed with these comments.

Reis stated that the admittance limit is important and supports the idea that it will be subject to additional discussion.

Bruggeman then discussed providing direction to NAIC staff to provide referrals to both the Life Actuarial (A) Task Force and the Capital Adequacy (E) Task Force. For the referral to the Life Actuarial (A) Task Force, he requested further consideration of asset adequacy implications of negative IMR. He directed NAIC staff to assist in developing a template for AAT disclosures, noting that he is aware of the current initiative for an *Actuarial Guideline LIII—Application of the Valuation Manual for Testing the Adequacy of Life Insurer Reserves* (AG 53) documentation

Draft Pending Adoption

Attachment 1

Accounting Practices and Procedures (E) Task Force

3/23/23

enhancement. He stated that it is important to consider the actual amount of admitted negative IMR that is being used within the asset adequacy testing, because the higher the negative IMR, the more potential there is for an AAT liability. He requested the referral also address the considerations of cash flows within AAT with liquidity stress testing considerations to ensure that excessive withdrawal considerations are consistent with the actual data. He stated that it is important for the assumptions of cash flows and liquidity stress testing to be consistent, and he referred to the existing guidance for tax planning strategies, where it is noted that tax planning strategies cannot be inconsistent with other company assertions. He stated that the referral should request guardrails within AAT that are reasonable and consistent with other aspects.

Bruggeman stated that for the referral to the Capital Adequacy (E) Task Force, he requested consideration to remove any admitted net negative IMR from total adjusted capital (TAC) with inclusion of any other sensitivity testing that may be needed for IMR. He stated that RBC is supposed to be a weakness indicator and is a state insurance regulator tool, not a strength indicator for other uses. He stated that he knows it gets used for other things, but the state insurance regulator use and tool is the first priority. Brown and Walker agreed with this recommended referral.

In response to an inquiry from Reis asking whether the referral will remove admitted negative IMR from TAC for the RBC calculation, or just for sensitivity testing, Bruggeman confirmed that the referral is to remove admitted negative IMR from TAC in determining the RBC percentage. Bruggeman noted that the discussion on this aspect will occur at the Capital Adequacy (E) Task Force. He stated that this change may not be viable for year-end, so that is why other points and guardrails need to be considered.

Bruggeman directed NAIC staff to proceed with guidance to allocate the admitted negative IMR to special surplus. He stated that this allocation will make it easier to identify in the quarterly financials, as the IMR schedule is only completed for the annual reporting.

Bruggeman requested that NAIC staff review the annual statement instructions for excess withdrawals and for bonds and derivatives reported at fair value to ensure those gains and losses are not going through IMR. He also noted a need to review the AVR guidance, which is intended for credit losses, to ensure that the division between IMR and AVR is clear. He requested NAIC staff to also consider additional disclosure reporting that would help state insurance regulators identify or summarize aggregate activity, especially with quarterly reporting.

Bruggeman reiterated that the Working Group is trying to provide guidance quickly as an interim step, but it needs to have a long-term solution so that this is not a pending issue in another 10 years. Although it is unlikely to be fully done by year-end, he would like to work towards June 30 for the interim solution, as that allows the other affected groups to receive the interim guidance in a timely manner before it is applicable for year-end.

In response to an inquiry from Brown on a potential blanks referral, Bruggeman stated that the Working Group would consider a disclosure first as part of the interim discussion and then sponsor a blanks proposal.

In response to Weaver's comments on the lengthy list of action items, items to consider, and the time that may be needed, Bruggeman stated he already had several of these identified, and he has given NAIC staff a preview, contingent on the discussion of the Working Group from this meeting. He stated that NAIC staff will move forward on this quickly as directed by the Working Group. He stated that the approach is trying to identify a good solution for industry but also ensure appropriate financial reporting and regulatory tools. Bruggeman stated that it would have been easier if a resolution to this topic had been established 20 years ago, but there were other urgent issues. He stated when interest rates increase more than 4% in a year, some weird circumstances happen.

Draft Pending Adoption

Attachment 1

Accounting Practices and Procedures (E) Task Force

3/23/23

Carmello asked for clarity on the referral to the Life Actuarial (A) Task Force, specifically on the topic of reasonable guardrails. He stated that there are no guardrails now on AAT other than in New York. He asked whether the Working Group will ask for guardrails to be established on a national basis. Bruggeman responded that the request to the Task Force is to look at the guardrails in place in New York, as well as other options, to see if there are any that can be incorporated. Carmello stated that Minnesota made a proposal for AG 53 guardrails last year, and it was voted down. As such, he does not believe the Working Group should be relying on AAT.

Hemphill stated that the question of whether there is a need for AAT guardrails dovetails with other work the Life Actuarial (A) Task Force and the Valuation Analysis (E) Working Group is going to be doing with AG 53. She stated that it might be a heavy change to make, but they may indeed find that there are guardrails needed, and if those changes are made, then that would provide actuaries more comfort with applying AAT to a greater extent. She stated that without guardrails, she would also be uncomfortable in relying on AAT, and it makes sense for the Life Actuarial (A) Task Force to review what could be established.

Walker stated that her message to industry is that there are going to be three groups that will be working on this negative IMR issue. While the Statutory Accounting Principles (E) Working Group is going to consider an interim solution, the longer-term resolution may be contingent on what the other groups decide. Walker stated that the solutions of those other groups may allow the state insurance regulators of the Working Group to decide whether to allow a higher admitted asset on the balance sheet. As such, it is going to be a balancing act, and there may be tough discussions on a long-term solution if there are no guardrails on AAT or changes to TAC, or other RBC calculation revisions. Without those revisions, the long-term solution may have a far less admitted amount than what industry might prefer.

Smith stated that the Working Group keeps talking about a long-term solution, but he believes it is important to highlight that this will be a new long-term solution. He stated the long-term solution that has been in place for 31 years is that negative IMR is nonadmitted. He stated that the recent discussion has implied that the Working Group did not address this issue, and that is incorrect. He reiterated that since 1992, negative IMR has been required to be nonadmitted, and that long-term process should speak for itself.

Hartz stated that the long-term solution may be to leave the existing guidance as it is, as nonadmittance is more conservative. He stated not allowing negative IMR and leaving it nonadmitted is consistent with statutory accounting, but even in that circumstance, there may be special circumstances that state insurance regulators may need to consider.

Smith stated that he does not disagree with the discussion or the proposed actions, but he wants to be clear that the admittance of negative IMR will be a change to the long-time existing guidance. He noted that the existing guidance was an intentional decision.

Bruggeman expressed appreciation for the detailed discussion, and he requested that NAIC staff have the minutes explicitly detailed for historical purposes. He stated that the Working Group does not generally take a vote to direct NAIC staff, but for this topic, he would like to have a vote.

Malm made a motion, seconded by Walker, to direct NAIC staff to work on both a 2023 solution and a long-term solution as follows:

Draft Pending Adoption

Attachment 1

Accounting Practices and Procedures (E) Task Force

3/23/23

- i. Recommend 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 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 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.
- ii. Recommend a referral to the Capital Adequacy (E) Task Force for the consideration of eliminating any admitted net negative IMR from TAC and the consideration of sensitivity testing with and without negative IMR.
- iii. Develop guidance for future Working Group consideration that would allow for 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 the RBC ratio is less than 300%.
- iv. Review and provide updates on any annual statement instructions for excess withdrawals, related bond gains/losses, and non-effective hedge gains/losses to clarify that those related gains/losses are through AVR, not IMR.
- v. Develop accounting and reporting guidance to require the use of a special surplus—account or line—for net negative IMR.
- vi. Develop governance-related documentation to ensure sales of bonds are reinvested in other bonds.
- vii. Develop a footnote disclosure for quarterly and annual reporting.

The motion passed unanimously.

4. Considered Maintenance Agenda – Active Listing

Walker made a motion, seconded by Weaver, to expose the following agenda items for a public comment period ending June 9, except for agenda item 2023-03: New C-2 Mortality Risk Note and agenda item 2023-11-EP: AP&P Manual Editorial Updates, which will be exposed for a public comment period ending May 5. The motion passed unanimously.

a. Agenda Item 2023-01

Bruggeman directed the Working Group to agenda item 2023-01: Review Annual Statement Instructions for Accounting Guidance. Gann stated that this agenda item has been developed to establish a project to review the annual and quarterly statement instructions to ensure that primary accounting guidance is reflected within the SSAPs. Although the duplication or reference of accounting guidance may occur for ease in applying the reporting guidance, the focus of this project is to ensure that the annual or quarterly statement instructions are not the primary source of statutory accounting guidance. For the purposes of this agenda item, accounting guidance is intended to refer to measurement, valuation, admittance/nonadmittance, as well as when assets and liabilities should be recognized or derecognized within the statutory financial statements.

Draft Pending Adoption

Attachment 1

Accounting Practices and Procedures (E) Task Force

3/23/23

This agenda item and project is proposed to address limited situations in which the annual statement instructions have been identified to reflect more detailed accounting guidance than the SSAPs. Under the statutory hierarchy, the SSAPs are Level 1 and the authoritative source for accounting provisions. If guidance does not exist in the SSAPs, then other sources of guidance can be considered based on the statutory hierarchy, but it is not intended that guidance purposely be captured in the annual statement instructions (which are level 3,) in lieu of the inclusion of guidance in the SSAPs.

Although it is anticipated that only limited situations will be identified, this agenda item proposes a broad project to review the instructions and identify where accounting guidance may need to be captured in the SSAPs.

b. Agenda Item 2023-02

Bruggeman directed the Working Group to agenda item 2023-02: SSAP No. 43R – CLO Financial Modeling. Gann stated that this agenda item proposes revisions to SSAP No. 43R to incorporate edits to reflect changes adopted by the Valuation of Securities (E) Task Force on Feb. 21 to include collateralized loan obligations (CLOs) in the Securities Valuation Office (SVO) financial modeling process.

This agenda item has been drafted to ensure the financial modeling guidance summarized in SSAP No. 43R reflects the practices, as directed by the *Purposes and Procedures Manual of the NAIC Investment Analysis Office (P&P Manual)*. The *Accounting Practices and Procedures Manual (AP&P Manual)* is higher in the statutory hierarchy than the P&P Manual, but 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.

c. Agenda Item 2023-03

Bruggeman directed the Working Group to agenda item 2023-03: New C-2 Mortality Risk Note. Marcotte stated that the Life Risk-Based Capital (E) Working Group is working on a project to modify its C-2 mortality risk charges. The Life Risk-Based Capital (E) Working Group, in cooperation with the C-2 Mortality Work Group of the American Academy of Actuaries (Academy), developed structural updates to the life RBC treatment of group permanent life and miscellaneous other instruction updates. The proposal assigns the same factors to group permanent life as individual permanent life for policies with and without pricing flexibility.

A new financial statement note will provide the development of net amounts at risk in the categories needed for the Life C-2 mortality risk charges. These categories are designed to create a direct link to a financial statement source and accompanying life RBC C-2 mortality risk updates.

As the notes to the financial statements are maintained by the Statutory Accounting Principles (E) Working Group, this agenda item is to add the requirement for the new proposed note into the *Accounting Practices and Procedures Manual*. An annual statement blanks proposal is being simultaneously exposed at the Life Risk-Based Capital (E) Working Group, which has requested year-end 2023 as the effective date for the note.

Draft Pending Adoption

Attachment 1

Accounting Practices and Procedures (E) Task Force

3/23/23

d. Agenda Item 2023-04

Bruggeman directed the Working Group to agenda item 2023-04: Corporate Alternative Minimum Tax Guidance. Marcotte stated that the Inflation Reduction Act (IRA) was enacted on Aug. 16, 2022, and it included a new corporate alternative minimum tax (CAMT), which goes into effect for the 2023 tax year. 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 of 2023. Interested parties have submitted initial informal recommendations to assist with preparing the guidance. The CAMT is more complex than the prior alternative minimum tax, and it is assessed at the consolidated return level using book income. She noted that the Working Group will need to have interim small group discussions and may also need to consider extending INT 22-02.

e. Agenda Item 2023-05

Bruggeman directed the Working Group to agenda item 2023-05: ASU 2022-06, Reference Rate Reform (Topic 848), Deferral of the Sunset Date of Topic 848. Stultz stated that the FASB issued ASU 2022-06 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*.

Stultz stated that 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 IBOR, 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 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 IBORs 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 and 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 the remeasurement of the contract, or in the case of a hedging relationship, a redesignation of the transaction.

To address ASU 2020-04, the Working Group issued *INT 20-01: ASU 2020-04 – Reference Rate Reform*, and this interpretation was then revised to incorporate guidance from ASU 2021-01. This agenda item recommends revisions to INT 20-01 to include the updated sunset date of Dec. 31, 2024.

Draft Pending Adoption

Attachment 1

Accounting Practices and Procedures (E) Task Force

3/23/23

f. Agenda Item 2023-06

Bruggeman directed the Working Group to agenda item 2023-06: Additional Updates on *ASU 2021-10, Government Assistance*. Marcotte stated that on Aug. 10, 2022, the 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 these disclosures would be required. Because NAIC staff understanding is that the grant and contribution model was not intended to be permitted for statutory accounting, additional modifications to clarify this point have been proposed that reject *ASU 2021-10* but still incorporate when the government assistance disclosures from *ASU 2021-10* were adopted.

g. Agenda Item 2023-07

Bruggeman directed the Working Group to agenda item 2023-07: *ASU 2019-08, Codification Improvements to Topic 718 and Topic 606*. Stultz stated that in November 2019, the 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 non-employees, 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 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.

h. Agenda Item 2023-08

Bruggeman directed the Working Group to agenda item 2023-08: *ASU 2019-07, Codification Updates to SEC Sections*. Stultz stated that the 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 amends and supersedes certain U.S. Securities and Exchange Commission (SEC) sections in Topic 942, 944, and

Draft Pending Adoption

Attachment 1

Accounting Practices and Procedures (E) Task Force

3/23/23

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. SEC guidance from ASUs have generally been rejected as not applicable for statutory accounting in Appendix D, but all ASUs are reviewed for statutory accounting purposes to determine if the guidance should be considered for statutory accounting.

i. Agenda Item 2023-09

Bruggeman directed the Working Group to agenda item 2023-09: ASU 2020-09, Amendments to SEC Paragraphs. Stultz stated that the FASB issued *ASU 2020-09, Amendments to SEC Paragraphs Pursuant to SEC Release No. 33-10762—Debt (Topic 470)*, which amends and supersedes certain SEC sections in Topic 470 to align codification guidance with SEC Release No. 33-10762, which 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. SEC guidance from ASUs have generally been rejected as not applicable for statutory accounting in Appendix D, but all ASUs are reviewed for statutory accounting purposes to determine if the guidance should be considered for statutory accounting.

j. Agenda Item 2023-10

Bruggeman directed the Working Group to agenda item 2023-10: ASU 2022-05, Transition for Sold Contracts. Stultz stated that this agenda item has been drafted to consider *ASU 2022-05, Transition for Sold Contracts* for statutory accounting. He noted that the FASB issued the ASU in December 2022 to amend specific sections of *ASU 2018-12, Targeted Improvements for Long-Durations Contracts*. The amendments made by the ASU are intended to reduce the implementation costs and complexity associated with the adoption of long-duration contracts (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.

k. Agenda Item 2023-11EP

Bruggeman directed the Working Group to agenda item 2023-11EP: AP&P Manual Editorial Updates. Gann stated that this agenda item details editorial updates for the *Accounting Practices and Procedures Manual*. These revisions are captured in three broad categories:

- SSAP No. 86: Change a disclosure category from “intrinsic value” to “volatility value.”
- Various – Streamline references to the P&P Manual.
- Various – Changes to consistently reference percent (with % sign and not “percent”) throughout SSAPs.

Draft Pending Adoption

Attachment 1

Accounting Practices and Procedures (E) Task Force

3/23/23

5. Discussed Other Matters

a. Received and Discussed Valuation of Securities (E) Task Force Referral

Gann stated that the Working Group was one of several groups that received a referral from the Valuation of Securities (E) Task Force (**Attachment One-G**) to inquire about the NAIC SVO obtaining the ability to calculate analytical information by utilizing commercially available data sources and investment models instead of requesting individual insurance companies to incur the costs to implement system changes. The referral identifies that if the SVO had the capabilities, it could calculate for state insurance regulators various measures, including key rate duration, sensitivity to interest rate volatility, principal and interest cash flow projections for any security or portfolio for any given interest rate projection, loss estimates, and many other measurements. The referral asks each group to respond to the following questions by May 15:

1. Indicate if your group is supportive of creating this capability within the SVO.
2. List the investment analytical measures and projections that would be most helpful to support the work performed by your respective group.
3. Describe how your group would utilize the data and why it would be of value.
4. Are there other investment data or projection capabilities that would be useful to your group that could be provided by commercially available data sources or investment models? And if so, please list them.
5. Any other thoughts you may have on this initiative.

Bruggeman requested that the Working Group provide comments to NAIC staff by April 15 so a referral response could be submitted to the Valuation of Securities (E) Task Force.

b. 2023 NAIC Accounting Practices and Procedures Manual

Gann stated that on Jan. 9, interested parties provided comments to the NAIC Chief Executive Officer and the Chief Operating Officer/Chief Legal Officer on the Bookshelf product limitations and the need for industry to have a searchable and printable portable document format (PDF) of the AP&P Manual (**Attachment One-H**).

On Feb. 6, a response letter was provided (**Attachment One-I**) informing that for the 2023 AP&P Manual, the NAIC is proud to announce that a copyrighted PDF will be made available, at no additional charge, to those who purchase a subscription to the AP&P Manual. Similar to the current subscription process, access will be restricted to the individual level; however, the PDF will be searchable and printable like any other PDF document. This process is specific to the 2023 AP&P Manual only, and for the 2024 AP&P Manual, the NAIC is dedicated to finding an amicable, long-term solution that will result in ease of access for industry users.

The process to obtain the PDF is anticipated to be automatic upon purchase of the 2023 AP&P Bookshelf subscription through Account Manager. Acquiring it through Account Manager is key to obtaining the PDF download, and manual processing will not be available.

c. American Academy of Actuaries Request

Marcotte stated that on Feb. 23, the Financial Reporting and Solvency Committee of the Health Practice Council of the American Academy of Actuaries, submitted a request to the Long-Term Care Actuarial (B) Working Group and the Statutory Accounting Principles (E) Working Group that requests clarifications regarding some observed

Draft Pending Adoption

Attachment 1

Accounting Practices and Procedures (E) Task Force

3/23/23

diversity in practice across issuers of long-term care insurance (LCTI) regarding how the new guidance in *Actuarial Guideline LI—The Application of Asset Adequacy Testing to Long Term Care Insurance Reserves* (AG 51), and specifically Section 4C, on determining when additional reserves may be necessary, interacts with existing guidance on accident and health (A&H) insurance reserve adequacy, as found in paragraph 24 of *SSAP No. 54R—Individual and Group Accident and Health Contracts* and paragraph 26 of *Appendix A-010—Minimum Reserve Standards for Individual and Group Accident and Health Insurance Contracts* (Attachment One-J). NAIC staff will work with the American Academy of Actuaries representatives and NAIC support staff of the Long-Term Care Actuarial (B) Working Group and the Valuation Analysis (E) Working Group to develop an agenda item for future Statutory Accounting Principles (E) Working Group discussion.

d. Update on International Activity – IAIS AAWG

Gann stated that she participates on behalf of the NAIC in the International Association of Insurance Supervisors (IAIS) Accounting and Auditing Working Group (AAWG). The AAWG focuses on developing, or providing input on, IAIS high-level principles-based supervisory and supporting material related to the accounting, auditing, valuation, reporting, and public disclosures of insurers. The AAWG monitors international developments and prepares comments letters and other papers in relation to the above focus, as deemed appropriate.

Recent discussions of the AAWG have focused on updates to Insurance Core Principle (ICP) 14: Valuation. Gann advised that public consultation of the draft revised ICP 14, as well as ICP 17: Capital Adequacy, is expected to occur in July 2023.

Other discussions of the AAWG have focused on the implementation of International Financial Reporting Standard (IFRS) 17: Insurance Contracts by other jurisdictions, and future discussions are expected to review the International Auditing and Assurance Standards Board (IAASB) proposed strategy and work plan for 2024–2027, as well as the proposed International Standard on Auditing (ISA) 500: Audit Evidence. NAIC staff are monitoring these discussions and requesting comments from state insurance regulators or industry if there are positions or concerns that should be communicated to the AAWG. NAIC staff anticipate including regular updates as any other matter within national meeting agendas.

e. Review of U.S. GAAP Exposures

Stultz identified two items with disclosure deadlines from January to February that will be reviewed by the Working Group in the normal maintenance process (Attachment One-K).

Having no further business, the Statutory Accounting Principles (E) Working Group adjourned.

[https://naiconline.sharepoint.com/teams/frsstatutoryaccounting/national meetings/a. national meeting materials/2023/3-22-23 - spring/summary and minutes/sapwg minutes 03.22.23.docx](https://naiconline.sharepoint.com/teams/frsstatutoryaccounting/national%20meetings/a.%20national%20meeting%20materials/2023/3-22-23-spring/summary%20and%20minutes/sapwg%20minutes%2003.22.23.docx)

Draft: 4/25/23

Statutory Accounting Principles (E) Working Group
E-Vote
April 10, 2023

The Statutory Accounting Principles (E) Working Group of the Accounting Practices and Procedures (E) Task Force conducted an e-vote that concluded April 10, 2023. The following Working Group members participated: Dale Bruggeman, Chair (OH); Kevin Clark, Vice Chair (IA); Sheila Travis (AL); Kim Hudson (CA); Rylynn Brown (DE); Stewart Guerin (LA); Judy Weaver (MI); Doug Bartlett (NH); Bob Kasinow (NY); Jamie Walker (TX); David Smith (VA); and Amy Malm (WI).

1. Exposed INT 23-01

The Working Group considered an e-vote exposure of *Interpretation (INT) 23-01: Net Negative (Disallowed) Interest Maintenance Reserve*. This INT proposes a limited-time, optional exception to statutory accounting to admit net negative (disallowed) interest maintenance reserve (IMR) in the general account up to 5% of adjusted capital and surplus. The tentative INT includes limitations on the negative IMR permitted to be admitted, with an explicit exclusion for losses captured in the IMR from derivatives that were reported at fair value prior to termination/settlement. It also specifically excludes separate account negative (disallowed) IMR from the admittance provisions. The INT details reporting requirements, which include an allocation to special surplus for the admitted net negative (disallowed) IMR, as well as disclosures on the derivative losses removed from IMR in determining the amount that could be admitted and disclosures on the overall IMR admittance calculation and the percentage of adjusted capital and surplus.

Hudson made a motion, seconded by Walker, to expose INT 23-01 for a public comment period ending May 5. The motion passed with 11 Working Group members responding with affirmative votes, meeting the NAIC Policy Statement on Statutory Accounting Principles Maintenance Agenda Process requirement for a 2/3 vote of the membership for INTs that conflict with existing statutory accounting.

Having no further business, the Statutory Accounting Principles (E) Working Group adjourned.

Subsequent to the e-vote, the comment period for this exposure was extended to June 9.

<https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/NationalMeetings/A.NationalMeetingMaterials/2023/8-13-23SummerNationalMeeting/Hearing/02-April10,2023,E-Vote.docx>

Draft: 4/25/23

Statutory Accounting Principles (E) Working Group
E-Vote
April 12, 2023

The Statutory Accounting Principles (E) Working Group of the Accounting Practices and Procedures (E) Task Force conducted an e-vote that concluded April 12, 2023. The following Working Group members participated: Dale Bruggeman, Chair (OH); Kevin Clark, Vice Chair (IA); Sheila Travis (AL); Kim Hudson (CA); William Arfanis (CT); Rylynn Brown (DE); Stewart Guerin (LA); Judy Weaver (MI); Doug Bartlett (NH); Bob Kasinow (NY); Doug Stolte and David Smith (VA); and Amy Malm (WI).

1. Exposed INT 22-02

The Working Group considered exposure of *Interpretation (INT) 22-02: Third Quarter 2022 through Second Quarter 2023 Reporting of the Inflation Reduction Act – Corporate Alternative Minimum Tax*. This proposes to extend the existing INT 22-02 from June 15 to July 1 so that the Interpretation can be used through the second quarter of 2023.

Key elements of INT 22-02 are that it does not require accrual of the Corporate Alternative Minimum Tax (CAMT), it requires disclosures. INT 22-02 provides overrides to existing guidance in *Statement of Statutory Accounting Principles (SSAP) No. 9—Subsequent Events* and *SSAP No. 101—Income Taxes*. The Working Group anticipates having calls this quarter to address accounting for the CAMT.

Arfanis made a motion, seconded by Clark, to expose INT 22-02 with a comment deadline of May 5. The motion passed unanimously. This meets the NAIC Policy Statement on Statutory Accounting Principles Maintenance Agenda Process requirement for a 2/3 vote of the membership for INTs that conflict with existing statutory accounting.

Having no further business, the Statutory Accounting Principles (E) Working Group adjourned.

<https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/NationalMeetings/A.NationalMeetingMaterials/2023/8-13-23SummerNationalMeeting/Hearing/03-April12,2023,E-Vote.docx>

Draft: 5/25/23

Statutory Accounting Principles (E) Working Group
Virtual Meeting
May 16, 2023

The Statutory Accounting Principles (E) Working Group of the Accounting Practices and Procedures (E) Task Force met May 16, 2023. The following Working Group members participated: Dale Bruggeman, Chair (OH); Kevin Clark, Vice Chair (IA); Sheila Travis (AL); Kim Hudson (CA); William Arfanis and Michael Estabrook (CT); Rylynn Brown (DE); Stewart Guerin and Melissa Gibson (LA); Judy Weaver (MI); Doug Bartlett (NH); Bob Kasinow (NY); Diana Sherman and Matt Milford (PA); Jamie Walker (TX); and Doug Stolte and David Smith (VA).

1. Reviewed Comments on Exposed Items

a. INT 22-02

Bruggeman directed the Working Group to *Interpretation (INT) 22-02: Extension of INT 22-02 Through Second Quarter 2023*. Robin Marcotte (NAIC) stated that on April 12, the Working Group conducted an e-vote to expose *INT 22-02: Third Quarter 2022 through Second Quarter 2023 Reporting of the Inflation Reduction Act - Corporate Alternative Minimum Tax*. The exposure proposed to extend INT 22-02 from June 15 to July 1 to allow it to be applied to the second quarter of 2023 financial statements. Disclosures continue to be required. Marcotte stated that interested parties support the extension of INT 22-02, but they recommend that it be extended to Aug. 16, the day after the quarterly statements are due to be filed. She stated that NAIC staff recommend that the Working Group adopt the exposed INT 22-02 with a minor modification to incorporate the Aug. 16 extension date suggested by interested parties.

Hudson made a motion, seconded by Walker, to adopt INT 22-02 (Attachment 1) and its proposed extension from June 15 to Aug. 16. The motion passed unanimously.

b. Agenda Item 2023-03

Bruggeman directed the Working Group to agenda item 2023-03: C-2 Mortality Risk Note. Marcotte stated that the exposure proposes the addition of new financial statement notes that calculate the net amount at risk, which is used in the C-2 mortality risk charge calculation. She stated that the Blanks (E) Working Group proposal 2023-09BWG is being simultaneously exposed, and the Life Risk-Based Capital (E) Working Group is working on a project to modify its C-2 mortality risk charges. She stated that the purpose of the note was to provide the development of the net amount at risk and have financial statement links to the elements used in the risk-based capital (RBC) charge. She stated that comments from Connie Jasper Woodroof (CJW Associates) focused on possible redundancy issues in the proposed note because some items in the disclosure could currently be directly referenced from Exhibit 5 – Aggregate Reserve for Life Contracts or the similar Exhibit 3 – Aggregate Reserve of Life, Annuity and Accident and Health Contracts in the separate account statement. She stated that Woodroof recommended removing these elements from the proposal and noted that some of the elements in the exposure were not needed for the C-2 mortality risk charge. She stated that the interested parties' comments were focused on moving the proposed information out of the footnotes and to another location. She stated that NAIC staff reached out to the Life Risk-Based Capital (E) Working Group chair and its NAIC support staff, who confirmed that the annual statement notes for the 2023 year-end would be helpful, but they were not strictly necessary for the planned update to the C-2 mortality risk charges. She stated that NAIC staff recommend that the Statutory Accounting Principles (E) Working Group defer action on this agenda item and refer the comments received to the Life Risk-Based Capital (E) Working Group.

Rose Albrizio (Equitable) stated that interested parties believe this is something that should not be in Statements of Statutory Accounting Principles (SSAPs) or the annual statement footnotes because it is a data capture for the net amount of risk needed for the C-2 mortality risk. She stated that maybe it should be in the interrogatories if it is not currently available. She stated that interested parties reached the same conclusion that this would not impede their ability to do the C-2 mortality this year because the current format can be used to deliver the data.

Bruggeman stated that he does not have an issue with deferring this agenda item. In response to his inquiry, no other Statutory Accounting Principles (E) Working Group members noted a concern with deferral.

c. Agenda Item 2023-11EP

Bruggeman directed the Working Group to agenda item 2023-11-EP: AP&P Manual Editorial Updates. Julie Gann (NAIC) stated that at its March 23 meeting, the Working Group voted to expose various maintenance updates providing revisions to the *Accounting Practices and Procedures Manual* (AP&P Manual), such as editorial corrections, reference changes, and formatting. She stated that the primary revision to note was to SSAP No. 86—*Derivatives*. She stated that the change in the disclosure category from intrinsic value to volatility value was done because of a corresponding comment made to the Blanks (E) Working Group to improve that disclosure category. She stated that other editorial changes are to streamline references to the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual), as well as to address inconsistencies with how percentages are referenced—using a symbol (%) versus spelling out “percent.” She stated that interested parties support the changes. She stated that NAIC staff recommend that the Statutory Accounting Principles (E) Working Group adopt the exposed maintenance updates providing revisions to the AP&P Manual.

Weaver made a motion, seconded by Hudson, to adopt agenda item 2023-11EP (Attachment 3). The motion passed unanimously.

2. Exposed its Maintenance Agenda

Clark made a motion, seconded by Arfanis, to expose the following agenda items for a public comment period ending June 30. The motion passed unanimously.

a. Agenda Item 2023-12

Bruggeman directed the Working Group to agenda item 2023-12: Residuals in SSAP No. 48 Investments. Gann stated that this agenda item proposes revisions to clarify the scope and reporting for investments that represent residual interests that are not captured in the scope of SSAP No. 43R—*Loan-Backed and Structured Securities*. She stated that at the Spring National Meeting, there was a lot of discussion on how residual interests can exist in other investment structures and that previously adopted guidance only captured those that were in the scope of SSAP No. 43R, which requires those to be reported on Schedule BA – Other Long-Term Invested Assets on a dedicated reporting line for year-end 2022. She stated that the Working Group received a referral from the Valuation of Securities (E) Task Force. She stated that this agenda item is in response to that referral, as well as other discussions on this topic at the Spring National Meeting. She stated that the current population of residuals on the dedicated reporting line on Schedule BA may not reflect the entire population of residuals that are captured in other investment structures. She stated that this agenda item proposes to capture guidance in SSAP No. 48—*Joint Ventures, Partnerships and Limited Liability Companies*, so those investment structures would be separately reported on the residual line. The agenda item also has conforming edits to SSAP No. 43R and the *Annual Statement Instructions*. She stated that for those items that are not reported as residuals now because they are in the scope of SSAP No. 48, it is strictly a Schedule BA reporting line change because those items would currently

be under the joint venture, limited liability, or partnership line. Therefore, those investments that represent residuals will move to the Schedule BA residual line.

b. Agenda Item 2023-13

Bruggeman directed the Working Group to agenda item 2023-13: PIK Interest Disclosure Clarification. Gann stated that this agenda item was 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-end 2023 that identifies the amount of PIK interest as a cumulative balance on an aggregate basis. She stated that since adoption, NAIC staff have received questions on how that should be calculated, whether it be on a first in, first out (FIFO) basis or a weighted average basis. She stated that this agenda item proposes clarifying revisions to ensure consistency in identifying the amount of PIK interest included in the cumulative principal par balance. She stated that it does not change accounting or any ultimate amounts reported as assets on the balance sheet or income statement. She stated that this identifies the amount of PIK interest that is still being reported as an asset. She stated that the recommendation is to identify that any paydowns that occur would first be applied to reported PIK interest. She stated that there is also a practical expedient that says one can identify the PIK interest from the original par through to the current par, not to go less than zero. She stated that this is to provide clarification to the investment software vendors who are asking if they had to do a retroactive analysis to identify all the PIK interest received and the paydowns. She responded that the answer is no, and the resulting calculation should be the same. She stated that NAIC staff proposed revisions in a footnote to *SSAP No. 34*; however, most of the edits are proposed for inclusion in the *Annual Statement Instructions*, are editorial only, and can be provided by the Working Group in a memorandum to the Blanks (E) Working Group if they are adopted after the deadline to include them in the *Annual Statement Instructions* for year-end 2023.

c. Agenda Item 2022-14

Bruggeman directed the Statutory Accounting Principles (E) Working Group to agenda item 2022-14: New Market Tax Credit Projects. Wil Oden (NAIC) stated that this agenda item was drafted in response to the federal Inflation Reduction Act and the subsequent issuance of *Accounting Standards Update (ASU) 2023-02—Investments—Equity Method and Joint Ventures (Topic 323): Accounting for Investments in Tax Credit Structures Using the Proportional Amortization Method (A Consensus of the Emerging Issues Task Force)*, which amends U.S. generally accepted accounting principles (GAAP) guidance on the application of the proportional amortization method (PAM) for income tax equity investments. He stated that based on direction from the Working Group and feedback received from interested parties, this agenda item now includes *SSAP No. 94R—Transferable and Non-Transferable State Tax Credits*, and it has expanded the scope of *SSAP No. 93—Low-Income Housing Tax Credit Property Investments*.

Oden stated that *SSAP No. 93* is proposed to include all qualifying tax credit investments, irrespective of the structure or tax credit program. He stated that this represents a departure from U.S. GAAP, as *ASU 2023-02* only applies to income tax equity investments that elect to use PAM. He stated that as part of the proposed revisions, both *SSAPs* are intended to work together. *SSAP No. 93* provides guidance on the tax investment itself, whereas *SSAP No. 94R* provides guidance on tax credits allocated from the investments and purchase tax credits.

Oden stated that the proposed scope of *SSAP No. 94R* has been expanded to include all state and federal tax credits, whether allocated or purchased. Additionally, the revised version proposes to amend the requirement to report tax credits at cost, which effectively results in an off-balance sheet asset for tax credits purchased at a discount. Oden stated that tax credits would now be recorded at face value upon receipt; acquisitions at a premium would immediately realize the loss; and acquisitions at a discount would defer the gain as an Other liability until the reporting entity has utilized tax credits in excess of those acquisition costs. He stated that NAIC

staff recommend that the Working Group expose the draft revisions to SSAP No. 93 and SSAP No. 94R as new SSAP concepts with a public comment period ending June 30.

3. Discussed Other Matters

a. Valuation of Securities (E) Task Force Referral Response

Gann stated that the Working Group reviewed the Valuation of Securities (E) Task Force referral on the acquisition of commercially available data and deemed that a response was not necessary.

b. Update on the Referral to the Life Actuarial (A) Task Force on Negative IMR

Hemphill stated that there are a few action items that the Life Actuarial (A) Task Force would take in response to this referral.

First, the Task Force is working on a template that will have additional disclosures on the reflection of interest maintenance reserve (IMR) in principle-based reserving (PBR) and asset adequacy testing (AAT). Those disclosures would support the verification of the requirements that the Working Group is considering for admittance of negative IMR, including: 1) the admitted IMR is appropriately allocated for PBR and AAT; 2) negative IMR is reflected in starting assets and would not generate subsequent income; and 3) that would increase reserves in PBR or decrease reserve sufficiency for AAT. Hemphill noted that the template would include verifications for the company that any admitted negative IMR not reflecting bonds sold due to historical or anticipated future excess withdrawals and bonds generating admitted negative IMR would only be those sold and replaced with similar bonds. She stated that the Task Force was outlining a potential template that is consistent with the current Working Group exposure. She stated that if there were changes by the Working Group, the template would be modified accordingly. She stated that due to the *Valuation Manual* timing constraints, this template would be optional but could be recommended starting with year-end 2023 reporting. The earliest it could be required would be 2025; although, individual state insurance regulators could request or require the information earlier. She stated that the Task Force was working on a draft and had requested input from the American Academy of Actuaries (Academy) and the American Council of Life Insurers (ACLI) on the template.

Second, Hemphill stated that the Task Force was drafting guidance for companies for year-end 2023 and 2024, consistent with what was put out for 2022, to address the potential double-counting issue. She stated that the Task Force was continuing to affirm that a principle-based, reasonable, and appropriate allocation of IMR for PBR and AAT would be consistent with the handling of the IMR asset for statutory reporting. She stated that the Task Force does not believe any double counting is required because the language currently in the *Valuation Manual* endorses a principle-based, appropriate allocation and so would not imply a double hit. This guidance would be for 2023 and 2024, as any change in the *Valuation Manual* at this time would be applicable for 2025. Hemphill stated that the Task Force would work on an amendment proposal form to make clarifying changes directly to the *Valuation Manual* so the Task Force does not have to keep producing guidance each year-end, noting that a principle-based, appropriate allocation does not require such double counting.

Finally, Hemphill stated that the Task Force recommends to the Working Group that any decision to admit or not admit aggregate negative IMR would not rely on AAT as a guardrail at this time. The Task Force wants to clarify that national AAT is not formulaic and is heavily judgment-based, without prescriptive guardrails on that judgment, such as with the reinvestment guardrail or other guardrails that apply in PBR. She stated that in response to the specific concerns around the lack of consistency in AAT asset assumptions, *Actuarial Guideline LIII—Application of the Valuation Manual for Testing the Adequacy of Life Insurer Reserves* (AG 53) was developed. She stated that AG 53 has additional disclosures but no prescriptive guardrails. She stated that the actuaries and

others are now working on reviewing initial AG 53 disclosures, but that it is not the only area where concerns could arise regarding the reliability of specific AAT assumptions or results. She stated that, in summary, the Task Force does not believe it would be appropriate to admit negative IMR if doing so depends on AAT as the sole or primary safeguard for any related solvency concerns. She stated that the Task Force has a few workstreams to work on over the upcoming months and would update the Working Group as it has additional work products.

Having no further business, the Statutory Accounting Principles (E) Working Group adjourned.

[https://naiconline.sharepoint.com/teams/frsstatutoryaccounting/national meetings/a. national meeting materials/2023/8-13-23 summer national meeting/hearing/04 - may 16, 2023, minutes.docx](https://naiconline.sharepoint.com/teams/frsstatutoryaccounting/national%20meetings/a.%20national%20meeting%20materials/2023/8-13-23%20summer%20national%20meeting/hearing/04%20-%20may%2016,%202023,%20minutes.docx)

Draft: 7/26/23

Statutory Accounting Principles (E) Working Group
Virtual Meeting
June 28, 2023

The Statutory Accounting Principles (E) Working Group of the Accounting Practices and Procedures (E) Task Force met June 28, 2023. The following Working Group members participated: Dale Bruggeman, Chair (OH); Kevin Clark, Vice Chair (IA); Sheila Travis (AL); Kim Hudson (CA); William Arfanis (CT); Rylynn Brown and Tom Hudson (DE); Cindy Andersen (IL); Stewart Guerin (LA); Judy Weaver (MI); Doug Bartlett and Pat Gosselin (NH); Bob Kasinow and Bill Carmello (NY); Diana Sherman (PA); Amy Garcia (TX); Doug Stolte and David Smith (VA); and Amy Malm (WI). Also participating was: David Wolf (NJ).

1. Reviewed Comments on Exposed Items

a. INT 23-01T

Bruggeman directed the Working Group to *Interpretation (INT) 23-01T: Net Negative (Disallowed) IMR (Attachment One)* and the corresponding agenda item 2022-19: Negative IMR (*Attachment Two*). He directed Julie Gann (NAIC) to summarize the Life Actuarial (A) Task Force response letter dated June 15 (*Attachment Three*). Gann stated that the Task Force is moving forward with the development of an interest maintenance reserve (IMR) template, drafting guidance for 2023 and 2024 for the Working Group's potential admittance of some portion of aggregate negative IMR, and a recommendation to the Working Group to not rely on asset adequacy testing (AAT) as the sole or primary guardrail for aggregate negative IMR. Bruggeman noted that the key part of the recommendation was using AAT as the "sole or primary" guardrail, and the Working Group has been discussing the usage of AAT as the first-level safeguard and how it should be used in combination with other safeguards. IMR is included as a long-term agenda item for the Task Force as one of its primary concerns, which means it should be captured in the valuation documentation for the years ending 2022 and 2023.

Gann stated that in April, the Working Group exposed the limited-time optional INT to allow the admittance of net negative disallowed IMR in the general account up to 5% of adjusted capital and surplus. That 5% limit was directed by the Working Group at the Spring National Meeting. The exposed INT proposed restrictions as to what is permitted to be captured specifically for derivatives that have been reported at fair value and then for only general account IMR, with an exclusion for separate accounts. Detailed comments were received from the American Council of Life Insurers (ACLI), and NAIC staff request that the Working Group hear, discuss, and provide direction on the requested revisions to the INT. If the INT is revised, NAIC staff anticipate exposing a revised INT with a shortened comment period to allow for potential adoption consideration at the Summer National Meeting. Gann recommended that the Working Group defer the adoption of the INT until the Summer National Meeting, as there are a significant number of comments to consider. She then noted that the ACLI comment letter broke out eight key topics, and the first two topics—Surplus Considerations and Exclusion of Fair Value Derivatives from Determining Admitted Net Negative IMR—appeared to be the most significant. She also requested that the Working Group provide direction on the effective duration of the INT and whether there should be a sunset time frame. Bruggeman requested that the ACLI provide its overall comments to the Working Group prior to going through each of the eight topics individually.

Mike Reis (Northwestern Mutual), representing the ACLI, stated that he would like to begin by reading from the Financial Condition (E) Committee's *Asset Valuation Reserves and Interest Maintenance Reserves Blue Book (Attachment Four)* report from December 2002, as it includes some foundational concepts. He stated that the main driver of the development of IMR and asset valuation reserve (AVR) is that without these mechanisms, many

circumstances gave rise to inappropriate results from the statutory formula valuation methods. For example, changes in value 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 activities. The development of AVR and IMR also recognized that trading gains and losses were transitory with reinvestment, where they are offset with new lower-yielding and higher-yielding assets, respectively; IMR should, theoretically, apply symmetrically. So, all points in the ACLI letter and items discussed today emanate from these concepts; consequently, with the non-admittance of negative IMR, the financial statements are not fairly represented. Reis continued by stating that to avoid incentivizing companies to manage the financial reporting outcomes rather than affect appropriate risk management practices, the ACLI believes an interim solution should have a surplus cap of at least 10% or greater, along with no adjustments to surplus or exclusions. The rationale for this is that IMR is different from other intangibles, and it is more akin to unrealized losses on bonds with no change in immediate claims-paying ability after trading.

Reis stated that for the interim solution, non-hedge accounting derivatives, which are still economically effective hedges and appropriate for the duration and risk management, should not be changed from current industry practice. The industry has been deferring effective hedge gains to IMR for decades. For the interim solution, book value separate accounts, both insulated and non-insulated, have the same products and risk management issues as the general account and should not be excluded. Also, any proof of reinvestment should be on a macro basis looking at the totality of the NAIC framework and recognizing the fungibility of cash. Reis suggested that a new technical working group with members of the Working Group, the Life Actuarial (A) Task Force, the American Academy of Actuaries (Academy), and industry members may be needed to help develop a long-term solution to these issues. Beyond this, the ACLI does not believe it is in the collective best interest to make interim changes to current IMR deferral practices, as this would drastically change longstanding and important risk management practices.

Bruggeman stated that the Working Group will begin its discussion of the second topic—Exclusion of Fair Value Derivatives from Determining Admitted Net Negative IMR—and he noted that non-accounting-effective hedges are recorded at fair value, and the unrealized gain/loss would already be in surplus. Disposal of a fair value hedge would result in an immediate adjustment to surplus via the IMR irrespective of the IMR's positive/negative position. This issue is one of the discussion points that the Working Group wants to understand better, as there is a difference between accounting-effective hedges and economic-effective hedges, and if it is not one of those two, then it would likely be a speculative hedge.

Mike Huff (Teachers Insurance and Annuity Association of America—TIAA), representing the ACLI, stated that Bruggeman made a good distinction between hedges that are accounting-effective versus economic-effective. He also noted that he would not even consider speculative hedges to be a hedge derivative position, as speculative hedges are not allowed under insurance law or company derivative use plans. The industry's interpretation is that accounting-effective and economic-effective hedges are both considered equally economically effective, but accounting-effective just happens to be specifically defined within the accounting guidance. All interest rate derivatives, both hedge accounting and fair-valued interest rate derivatives, are instruments that industry uses interchangeably with fixed-rate bonds as asset and liability management tools. As these instruments are used interchangeably, consistent treatment is considered important and within the spirit of the development of IMR. Historical industry practice has been to defer gains from fair value derivatives when the gain is related to a change in interest rates, and that has previously resulted in a significant deferral of gains into IMR and not into surplus. Huff noted that industry's position is that this is the appropriate accounting treatment, as it does not artificially inflate surplus, given the fact that there is then reinvestment into lower-rate assets. He stated that the ACLI wants to avoid the potentially adverse outcome of disincentivizing the prudent use of derivatives in asset-liability management (ALM) and risk management to ensure that financial statements reflect the fairest representation

of financial condition for companies, particularly in surplus. He then discussed the examples included in the ACLI's comment letter.

Bruggeman noted that the example scenarios place an emphasis on the income statement impact, whereas the Working Group has noted that the hedge is at fair value, which means that surplus has already been affected irrespective of whether the derivative has been disposed of. He then inquired as to whether disposals occur when derivatives are still economically effective or if that occurs after effectiveness has lapsed. Additionally, he requested clarification on what industry considers a derivative that is not economically effective. Huff stated that a hedge will occasionally become economically ineffective, but for the most part, this does not happen. Hedges that industry feels have become speculative are immediately taken off the books; likewise, industry would never put a derivative on the books that was not an economically effective hedge.

Bruggeman asked if, in the second scenario described in the ACLI comment letter, the hedge was to become economically ineffective, whether industry would dispose of the hedge before or after it became ineffective, and whether the gain/loss would be recorded through IMR. Huff responded that in all three scenarios, the hedge would be considered effective, as it has locked in the rate at 5%. Bruggeman clarified that he is trying to assess industry's practice for recording through IMR in the event that the hedge did become ineffective. Huff responded that he believes that while the hedge is effective, any realized gain/loss would go to IMR, and after it becomes ineffective, it would not. Bruggeman stated that there is a distinction that needs to be made between when there is an ineffective hedge that has been disposed of/terminated based on when it became ineffective. If the derivative is not interest-rate sensitive, it would not meet the blanks instructions on interest-rate sensitivity. The issue is gaining a proper understanding of what happens when a derivative becomes ineffective and how state insurance regulators would get assurance that when a derivative was disposed of it would roll through IMR only if it was still effective. He stated that he believes there is a breakpoint where, once it is ineffective, it is no longer an interest-rate-sensitive type of disposal that qualifies for IMR. Bruggeman stated that there is a need for these detailed discussions as part of a long-term IMR assessment, but he does not want to put reporting entities in a whipsaw position where they have been deferring all derivative gains to IMR over the years; now the derivative losses are not permitted through IMR.

Gann noted that due to the complexity of this discussion, she would like to make some clarifying comments. In the scenarios presented by the ACLI, she clarified that these are not actual hedges of specific assets. Rather, these are derivative hedges for the portfolio, which is why they do not qualify as accounting-effective hedges under statutory accounting. Industry considers these to be economic-effective hedges because they are in line with a company's derivative use plan; however, there is no metric or assessment that could occur to prove that the derivative is effective as required for accounting-effective hedges. So, if the hedge is in accordance with a company's derivative use plan, then industry considers them to be effective, and there would be very limited situations, if any, where a derivative would move from being considered an effective hedge. Gann noted that what industry is identifying as an effective hedge is not an accounting-effective hedge. As such, industry's interpretation would encompass many more derivatives than are considered effective hedges for accounting purposes under *Statement of Statutory Accounting Principles (SSAP) No. 86—Derivatives*. Gann stated that she just wants to make sure that that was clear because the example appears to reflect a hedge of a single asset, but hedges of single assets could be designed to qualify as accounting-effective. Reis noted that hedges from the example scenarios could be assigned to assets that are subsequently purchased, and if that is to occur, the derivative arrangement could qualify as accounting-effective. The company would have to end up buying those assets for them to be assigned to the hedge, so the hedge is not assigned to a specific asset when it is initiated, but if assets are purchased, the hedge could be assigned. If the assets were purchased with a maturity duration of two years instead of a planned 10-year time frame, this could be a situation in which the hedge becomes ineffective.

Tom Karafin (Prudential) noted that hedges generate a gain or loss while they are effective, and the moment a derivative is to become ineffective, they take them off. However, the gain or loss was in existence during the hedge's effective life, and the current model says that gain/loss has become permanent and should follow the hedged item. As such, the gain/loss would continue to be reported through IMR.

Smith asked how certain the industry representatives are that during the periods in which interest rates were decreasing, everyone in industry was consistently applying this approach to defer gains in IMR over the life of the hedge versus recognizing all gains in surplus at the time of disposal. Reis responded that while no one would suggest that this is an absolute statement, all attendees to the ACLI working group meeting (approximately 30–40 representatives) responded that they were deferring hedge gains through IMR. Smith reiterated his concern that some of the more aggressive companies were not involved in the industry's discussion. For companies that have been deferring the gains, it would be punitive to not defer the losses, but there is a concern that some companies historically recognized the gains and now want to defer the losses. Bruggeman noted that they are looking to avoid an imbalance in which gains are recognized immediately in surplus, but the realized losses are deferred through IMR. He proposed a solution to have companies that have been following the approach in which derivative gains were historically taken to IMR continue doing so with derivative losses, but companies that have not previously recognized derivative gains through IMR would not be permitted to begin that practice under the INT with derivative losses. He stated that while it is a bit inconsistent, it would avoid the imbalance issue of reporting gains and losses differently.

Huff stated that he believes he can safely state that all the major players have been deferring derivative gains through IMR, and the big four accounting firms agreed with that treatment. Bruggeman noted that the Working Group wants to provide some kind of direction for NAIC staff, and in the long-term, they will need to work with the Life Actuarial (A) Task Force for a solution; however, for the short-term, there needs to be some kind of assurance that hedges were disposed of while they were still economically effective in order for gains or losses to go through IMR. This would provide state insurance regulators with some amount of comfort that ineffective hedges are not being run through IMR, especially if resulting in a loss. That said, economically effective hedges do not have any kind of metric for determining if the hedge is still economically effective, so state insurance regulators need more assurance that something was not deferred through IMR that should not have been. Huff stated that the vast majority of the time when hedges are unwound, as illustrated in the example scenarios, they are done so on a schedule, and the company will know the approximate time at which the hedge would be disposed of. While it is possible that a hedge may be unexpectedly unwound, it would be quite unusual for a company to have a hedge become ineffective prior to disposal because of this.

Clark stated that it does not make any sense to have different accounting treatment between unrealized and realized changes. The concept of IMR exists to create consistency for bonds for unrealized and realized losses. The same should hold for derivatives. It does not make sense to mark derivatives to market (fair value) when it is open (unrealized) only to reverse that treatment at termination (realized). This disconnect is one of the two things, at least in the long-term, that need to change to get accounting consistency. The second thing is the lack of measurement parameters around the effectiveness of a hedge. There is a reason U.S. generally accepted accounting principles (U.S. GAAP) and statutory accounting have a concept of effective hedge accounting, but with industry's interpretation, there is essentially a way around effective hedge accounting without any kind of overarching parameters, and that is a concern. Given the historical practice, the least disruptive thing to do would be to allow companies to continue with the practices they have already been doing. Clark stated that as for Smith's point, a company should not change its practice because of this interpretation, and in the interim, it would be appropriate for companies to continue with the practices they have already been doing.

Wolf stated that he supports that approach, and the guidance must specify that the company needs to continue following its past practices. If a company has been amortizing gains in IMR for similar derivative positions in the

past based on documented internal accounting policies, then it can continue to do so with like derivative positions that are now resulting in losses, but allowing new practices permitting derivative losses in IMR to go forward at this point should be avoided.

Bruggeman then directed the Working Group to discuss book value guaranteed separate accounts. He stated that he believes it makes sense to permit admitted IMR in a separate account. Although there is a distinction between insulated and non-insulated, he would like to avoid that discussion for this interpretation. Separate accounts for certain products are still general accounts affected, but that is not relevant for IMR purposes. Bruggeman then recapped the annual statement blanks instructions of how IMR from separate and general accounts are presented. He then inquired about the operational mechanics, such as if there was a cap based on surplus, whether it was 5% or 10%, and how that would affect the instructions for reporting negative IMR within general and separate accounts. Specifically, he inquired about whether the cap should first apply to the general account, with the separate account only admitting if the admittance in the IMR does not exceed the percentage permitted. He stated that he believes there is support for book value guaranteed separate accounts recognizing negative IMR, but it is an order of operations question between the general and separate accounts.

Brad Caprari (Prudential), representing the ACLI, stated that there has been a bit of back and forth on what the order of operations should be. The initial discussion was for negative IMR to be applied to the general account first and then to the extent that there remains availability within that 10% surplus limit, which would then apply to the separate account. This is also to say that the ACLI supports a 10% surplus limit. That said, the ACLI believes there should be proportionate admittance between insulated and non-insulated separate accounts. Caprari noted that he does not see any distinction between insulated versus non-insulated as it relates to the discussion of IMR, and there should be proportionate admittance there to the extent that someone has negative IMR that can be captured within the available cap of 10%.

Carmello asked for clarification on whether it is an insulated account with the negative IMR asset and whether the IMR would be held in that insulated account. Caprari replied that any admitted negative IMR asset or contra-liability would be held in the insulated account. Carmello noted that this does not really help the customers that have the insulated accounts, as they can only acquire real assets in the event of an insolvency, and he is concerned that this may be somehow benefiting the insulated customers, but that does not appear to be the case. Caprari said he agrees, and he noted that it is only tangible if taken into consideration with the reinvestment of funds, which will make up for the initial loss over time. Carmello then asked for clarification on how the order of operations would proceed if the general account is negative but the separate account is positive in excess of the general account. Caprari responded that it would be the cumulative total of the two accounts to determine the net negative position. If there is a cumulative net negative position, then it depends on whether one or both accounts are negative to determine how the cap is applied. If both accounts are negative, then the general account would apply first, and the separate account would be eligible for any amount of the cap left over.

Gann noted that the concept of admitted and non-admitted assets does not exist in the separate accounts, and the current process in the separate accounts is to take negative IMR as a direct charge to surplus. So, if the direction of the Working Group is to include separate accounts in the interpretation, NAIC staff will include this order of operation that was discussed. NAIC staff will also detail how to reflect this asset in the separate accounts, which would likely be a reversal of the prior hit to surplus, with a recognition of a miscellaneous aggregate write-in asset to reflect what is going to be permitted as admitted. NAIC staff do not recommend reporting it as a contra-liability, as it could be commingled with the non-disallowed negative IMR. Gann stated that it can be identified in the financial statements when reported separately as miscellaneous aggregate assets. When there are changes on what is permitted to be admitted in the separate account, the entry would be to remove the asset with a charge in surplus. As such, companies may be reversing and re-entering entries as the balance in IMR changes based on what is permitted to be admitted from percentage limitations. Gann stated that if separate accounts are

captured, the interpretation will include the recognition process to ensure consistency across industry. Bruggeman stated that there should be a proportional allowance in the insulated and non-insulated separate accounts if IMR is permitted without exceeding the percentage cap. He noted that there are separate account surpluses, and he asked if that counts when adding up all the surpluses.

Caprari stated that if you look at the general account blank, the reported surplus is the surplus the ACLI believes should be used for the cap, and it is inclusive of a separate account surplus. As such, there would not need to be any aggregation, and the ACLI prefers to use it as the cap instead of trying to aggregate out a separate account cap versus a general account cap. Gann stated that NAIC staff should have what they need to move forward with updating the interpretation, and she noted that the agenda does identify other things that may need to be considered in the future, perhaps as a long-term project for separate accounts with regard to the products that are used for book value. She also noted that on a broad scale, variations from what is permitted for book value under *SSAP No. 56—Separate Accounts* are not detailed, identifying that only three permitted practice disclosures were reported for items that were held at book value beyond what was permitted in SSAP No. 56. She also noted the need to assess overall accounting, reporting, and risk-based capital (RBC), if the separate account blanks are being used as an extension of the general account or a segregated general account, as the accounting and reporting in the separate account is not designed with that original intent. Bruggeman noted that this might represent an add-on to the current project, but IMR interpretation will proceed with IMR to be recognized from book value guaranteed separate accounts, whether insulated or non-insulated; and, as proposed by Caprari, if there is net negative IMR, then the amount admitted by the surplus cap goes to the general account first, and then whatever is left will be allocated to the insulated and non-insulated separate accounts proportionally.

Linus Waelti (New York Life Insurance Company), representing the ACLI, noted that state insurance regulators understand the importance of being able to distinguish between what they refer to as the good scenario, where the sale proceeds from the asset sale are going into a reinvestment, versus what they call the bad scenario, where that is happening inadequately and the proceeds from asset sales go to pay major cash outflows, whether they are expenses, claims, or withdrawals. To do a granular asset-to-asset mapping of proof of reinvestment is not going to be practical and will be highly challenging. So, the question comes down to what the package of safeguards should be that would give state insurance regulators comfort that the reinvestments are occurring adequately and appropriately. The ACLI recommended that state insurance regulators use existing safeguards, like AAT, to provide comfort in the activity. While AAT would not be considered the sole or primary safeguard, it certainly should play a role in combination with other safeguards, at least in the context of proof of reinvestment, to ensure that assets and reinvested assets are generating returns adequate to cover claim liabilities. The ACLI's position is that if claims payments become compromised by inadequate reinvestment or inappropriate reinvestment, the AAT analysis would identify that shortfall. The AAT shortfall would cause reserve strengthening, which would result in a direct impact on surplus, much like what would be seen if negative IMR was written off.

Waelti noted that in terms of other recommendations, the ACLI proposes the inclusion of a macro demonstration of reinvestment. This could involve the use of the cash flow statement to provide an aggregate view of cash activity, with a comparison of investment proceeds to the cost of investments acquired. This also helps navigate some of the problems with the fungibility of cash that would plague other demonstrations of proof of reinvestment. There are some imperfections with using a macro demonstration, as proceeds reported in the cash flow include maturities, and the amount reported as reinvestments includes cash in-flows from other sources, but at least at a high level, this would provide state insurance regulators with a view of the reinvestment occurring and whether it is at a healthy level. Another proposal from the ACLI is a company attestation that confirms that investment activities are in line with documented investment strategies and policies of the company. This company attestation could also be expanded to provide additional comfort to state insurance regulators as needed. Additionally, the ACLI suggests that a company will attest that asset sales are not being compelled by liquidity pressures, whether they are coming from collateral calls or from excess withdrawal activity.

Carmello asked if companies could potentially capture the information needed to perform granular asset-to-asset mapping as proof of reinvestment as a goal of the long-term project. Waelti responded that while some of this information is available on Schedule D, it would still be very difficult to perform asset-to-asset mapping due to the complexity and volume of activity. Carmello noted that in his mind, he is envisioning a short report that maps together and provides comfort to state insurance regulators that there is not a situation where asset sale proceeds are being used to cover claims instead of being reinvested. He stated that it seems Waelti is proposing that state insurance regulators would be able to get this type of report prepared by the companies if requested. Waelti responded that this would likely include some information from Schedule D, and they would need to work with state insurance regulators to determine what other information and commentary state insurance regulators are looking for. Bruggeman noted that this conforms with what is in the instructions; if there are excess withdrawal situations, those asset sale gains/losses do not go through IMR. The bigger question of the fungibility of cash is when a company sells a newly purchased asset, but they are not buying a fixed-income instrument with the proceeds. This may be something better addressed in the long term, but for the short term, what Carmello is requesting is a more distinct disclosure of the transactions or how they are done.

Carmello said he agrees, and he noted that on the long-term project, they should consider looking at the 150% factor to determine if it is still appropriate since it was a factor developed around 30 years ago when IMR was established. Bruggeman then asked Gann if state insurance regulators could ask for additional disclosure within AAT or if it would require a referral to the Life Actuarial (A) Task Force. Gann stated that this would likely require a referral to the Task Force. She also noted that the exposed interpretation was drafted with reference to an “immediate” investment of sale proceeds in another fixed-income instrument. While this language has been identified as potentially problematic, she noted that it was not intended to imply instantaneous action, but the company is investing directly in fixed-income instruments, not holding onto the cash, and investing six months down the road or in equities. Gann stated that the industry-proposed attestation can be included as an additional disclosure. Bruggeman clarified that he is not sure where this attestation disclosure would actually be reported. Gann noted that this could be done as a narrative disclosure for year-end 2023, but it is too late in the year for a data-captured disclosure. If the INT were to go on for a period of time, the disclosure could be included in the financial statements as a general interrogatory or as a new data-captured disclosure. Bruggeman noted that he would like to see some kind of distinct matching as part of the long-term solution and an assessment of whether the 150% factor for excess withdrawals still makes sense.

Bruggeman noted that there was not any disagreement on the topic of special surplus accounts, and the only comment he has is that the wording should be specific to ensure that everyone is using the same terminology so information entered can be easily aggregated. He noted that as soon as a “write-in” line is provided, state insurance regulators tend to lose all ability to aggregate data by line and column number. Specific wording should also be developed to make it easier to consistently identify and aggregate year-end data.

Bruggeman directed the Working Group to the topic of existing safeguards. Reis noted that industry is not opposed to additional safeguards, but he wants to make sure the rationale for each safeguard is clearly understood. Gann stated that the Life Actuarial (A) Task Force has communicated that AAT should not be relied on as the sole safeguard for the admittance of negative IMR. There is the ability for permitted practices, but there is the desire for a uniform standard, and there were only two permitted practices for year-end 2022. For derivatives, there is the reliance on a company’s filed derivative use plan, but NAIC staff do not receive these plans and cannot comment on what is included or how much is included regarding interest rate derivatives or what is going through IMR. For the long-term project, the Working Group could potentially expand Schedule DB to get more information, but that is not something that could be done for this year-end. NAIC staff are requesting comments on the ACLI proposed safeguards and direction on whether there are other safeguards that should be incorporated. Bruggeman noted that the Working Group’s direction is that what is included in the exposure is sufficient for consideration; although, it should be noted that AAT should not be the primary safeguard, and individual

circumstances that vary from what is permitted in the ultimate interpretation can still go through the permitted practice process. States should also be aware that derivative use plans are key components for the potential admittance of net negative IMR, as they review and assess those submissions. Wolf asked whether there would still be a safeguard around minimum RBC. Bruggeman confirmed that the 300% threshold for potential action would still be in place. Wolf stated that negative IMR should not be permitted for admittance when a reporting entity hits the 300% threshold. Wolf also noted support for calculating the 300% threshold with the removal of admitted negative IMR, goodwill, operating system software and electronic data processing equipment, and deferred tax assets similar to the calculation of adjusted capital and surplus.

Bruggeman noted that to have a line on RBC sensitivity would require a structure change to RBC, which cannot be completed for year-end 2023, as it would have needed to be exposed by at least the end of January. He noted that RBC sensitivity would be appropriate, especially if it resulted in an email sent to the domestic regulators, noting that the company's RBC, with or without this IMR, is well above 300%. Hudson noted that his understanding of Wolf's request was regarding whether the Working Group wants to include language that companies could not admit negative IMR if RBC was below 300%. Bruggeman responded that this should be included. Gann responded that this is included in the INT, but the comment was to calculate 300% after adjustments. Wolf agreed that this was his comment, as he wants to make sure that the 300% RBC is determined after adjustments to remove admitted negative IMR, goodwill, operating system software and electronic data processing equipment, and deferred tax assets. Reis noted that the industry is not opposed to providing disclosures, but he wants to make sure that the disclosures are discussed in the context of the cap.

Bruggeman asked the Working Group whether there should be a termination date for the INT, and he proposed a termination date three years after adoption. Hudson agreed with Bruggeman on including an end date on the INT, as it will provide pressure to resolve the issue. Bruggeman suggested an end date of Jan. 1, 2026. Reis stated that the industry is also supportive of an end date, and while the ACLI has not discussed a three-year end date, his opinion is that this time frame sounds reasonable for developing a long-term solution. Bruggeman said that three years is the best option, as it allows for that extra year that is often needed to develop and put the structure in place.

Bruggeman then directed the Working Group to discuss the proposed 5% cap on adjusted capital and surplus, and he asked if this cap should be adjusted surplus or straight surplus without any adjustments. He noted that the Working Group had previously discussed and settled on 5%, but he believes 10% makes more sense, as it would line up with the goodwill admittance limitation. Hudson asked whether the prior concern about the 300% company action level RBC was that the soft assets, including negative IMR, could not be used by the company after reaching the action level, which Wolf confirmed. Reis stated that negative IMR is akin to unrealized losses, and it is deferred because they are transitory due to the company reinvesting the proceeds in a higher or lower-yielding asset, and it does not change the claims accountability. It can be distinguished from other soft assets, and it is more akin to the soft asset of unrealized gains/losses that are on the balance sheet. Reis expressed that it is cleaner and more theoretically appropriate not to lump IMR in with other soft assets, as to do so would miss the point of why IMR was developed. Clark agreed and noted that the interim proposal to cap IMR based on capital and surplus is more related to the fact that the Working Group is not comfortable enough with all the existing safeguards to allow unlimited admittance of negative IMR. He noted that he would be ok with the 10% cap and no adjustments, as this is a different type of intangible compared to other soft assets.

Weaver stated concern that these intangibles are starting to add up, and if a company were in trouble, it would not be able to pay claims right away with some of these intangible assets. Reis responded that in the ACLI's comment letter, it details its position that the bonds are on the books at amortized cost, which is not the sales price at which bonds could be sold to pay claims, and IMR is no different. Clark stated that the 300% RBC threshold is intended to address this, as once the company reaches the solvency concern, it no longer gets to report IMR as

a soft asset, and the accounting becomes closer to a liquidation basis of accounting. Hudson stated that a reasonable compromise would be to go up to 10% but to use adjusted surplus and capital, noting that he would be uncomfortable going up to 10% using unadjusted surplus and capital. Bruggeman noted that the reason the ACLI is trying to make the distinction of using the RBC below 300% and then using adjusted surplus is if a company did get to 300% without all those soft assets and without negative IMR, then the company has to eliminate IMR as an admitted asset earlier as opposed to using the 10% of surplus as a cap.

Bruggeman then requested further comments and questions from the Working Group, noting that NAIC staff need to be provided with direction for drafting an updated INT for exposure, specifically requesting responses from members on the 10% cap and unadjusted versus adjusted surplus. Bartlett, Brown, Andersen, and Arfanis stated support for a 10% cap with adjusted surplus and capital. Smith stated that he prefers 5% with adjusted surplus and capital but could live with 10% adjusted surplus and capital, and Sherman agreed. Kasinow requested clarification on the calculation of adjusted surplus and capital. Gann clarified which items are excluded, and she noted that the calculation is further detailed in the meeting materials, found in paragraph 9a of the exposed INT. Kasinow stated support for 10% with adjusted surplus and capital. Reis asked the Working Group members voting for the use of adjusted surplus and capital what their theoretical basis for this was and if a higher cap could be considered since adjusted surplus and capital would further reduce the admitted amounts of IMR. He stated that the ACLI agreed that the 10% cap is reasonable, but he does not understand the foundation for using adjusted surplus and capital outside of a desire to be conservative. Malm stated support for 10% with unadjusted surplus and capital. Bruggeman noted that at this point, the vote is approximately eight for 10% adjusted versus two for 10% unadjusted out of 15 members.

Bruggeman noted that this majority vote would indicate that the Working Group is directing NAIC staff to draft the exposure with a 10% limitation using adjusted surplus and capital. Clark asked if Working Group members could change their minds when the vote for the adoption of the INT comes up. Bruggeman stated that members could, as this was originally exposed with a 5% limitation of adjusted capital and surplus, and now the Working Group is directing NAIC staff to draft an exposure with 10% using adjusted capital and surplus. Bruggeman noted that the Working Group will perform an e-vote exposure vote on the updated draft exposure.

2. Discussed Other Matters

Bruggeman requested any additional comments or discussion on other matters. Gann noted that the other items on the agenda are just notices. First, NAIC staff received an extension for comments from the June 1 referral from the Valuation of Securities (E) Task Force (**Attachment Five**) until July 7. The second thing is letting everyone know that the Insurance Core Principals (ICPs) 14 and 17 have been released for comments, both of which are available for review and comment on the International Association of Insurance Supervisors (IAIS) website.

Having no further business, the Statutory Accounting Principles (E) Working Group adjourned.

[https://naiconline.sharepoint.com/teams/frsstatutoryaccounting/national meetings/a. national meeting materials/2023/6-28-23 - negative imr/minutes/sapwg minutes 06.28.23tpr.docx](https://naiconline.sharepoint.com/teams/frsstatutoryaccounting/national%20meetings/a.%20national%20meeting%20materials/2023/6-28-23%20-%20negative%20imr/minutes/sapwg%20minutes%2006.28.23tpr.docx)

Draft: 7/11/23

Statutory Accounting Principles (E) Working Group
E-Vote
July 5, 2023

The Statutory Accounting Principles (E) Working Group of the Accounting Practices and Procedures (E) Task Force conducted an e-vote that concluded April 10, 2023. The following Working Group members participated: Dale Bruggeman, Chair (OH); Kevin Clark, Vice Chair (IA); Kim Hudson (CA); Bill Arfanis (CT); Rylynn Brown (DE); Judy Weaver (MI); Doug Bartlett (NH); Bob Kasinow (NY); Jamie Walker (TX); David Smith (VA); and Amy Malm (WI).

1. Exposed INT 23-01

The Working Group considered an e-vote exposure of a revised *Interpretation (INT) 23-01: Net Negative (Disallowed) Interest Maintenance Reserve*. This tentative INT proposes a limited-time, optional exception to statutory accounting to admit net negative (disallowed) interest maintenance reserve (IMR) up to 10% of adjusted capital and surplus. Revisions from the prior exposure as directed by the Working Group on June 28, include:

- 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.

Clark made a motion, seconded by Hudson, to expose the revised INT 23-01T for a public comment period ending July 21. The motion passed with 11 Working Group members responding with affirmative votes, meeting the NAIC Policy Statement on Statutory Accounting Principles Maintenance Agenda Process requirement for a 2/3 vote of the membership for INTs that conflict with existing statutory accounting.

Having no further business, the Statutory Accounting Principles (E) Working Group adjourned.

<https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/NationalMeetings/A.NationalMeetingMaterials/2023/8-13-23SummerNationalMeeting/Hearing/06-July5,2023,E-Vote.docx>

**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.

<https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/NationalMeetings/A.NationalMeetingMaterials/2023/8-13-23SummerNationalMeeting/Hearing/07-23-02-43R-CLOFM.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.

<https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/NationalMeetings/A.NationalMeetingMaterials/2023/8-13-23SummerNationalMeeting/Hearing/08-23-05a-ASU2022-06-LIBOR.docx>

Interpretation of the Statutory Accounting Principles (E) Working Group

INT 20-01: *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

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 (TBD), 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.

ASU 2020-04 - Reference Rate Reform

- 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/Hearing/09-23-05b-INT20-01-ReferenceRateReform.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~~ as 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:

- c. The share option or similar award is granted at the money.
- d. 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.
- e. The grantee can only exercise the award. The grantee cannot sell or hedge the award.
- f. 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.

<https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/NationalMeetings/A.NationalMeetingMaterials/2023/8-13-23SummerNationalMeeting/Hearing/10-23-07-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.

<https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/NationalMeetings/A.NationalMeetingMaterials/2023/8-13-23SummerNationalMeeting/Hearing/11-23-08-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.

<https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/NationalMeetings/A.NationalMeetingMaterials/2023/8-13-23SummerNationalMeeting/Hearing/12-23-09-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><i>ASU 2018-12, Financial Services—Insurance (Topic 944): Targeted Improvements to the Accounting for Long-Duration Contracts</i></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.

<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 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 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.)

- 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.

• **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:

- 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.

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.

<https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/NationalMeetings/A.NationalMeetingMaterials/2023/8-13-23SummerNationalMeeting/Hearing/14-23-13-PIKInterest.docx>

Exposed Revisions to SSAP No. 26R – 2023 Spring National Meeting

Summary of Revisions:

1. All changes exposed in November 2022 have been accepted with new edits shown as tracked. (This has been done for readability and to highlight changes from the prior exposure.)
2. Paragraph 4d: New scope exclusion paragraph to exclude 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. This edit was driven from industry comments as it was recognized that guidance for first loss positions was still in SSAP No. 26R. Edits have been proposed to be explicit with the accounting guidance (see paragraph 10b) as well as incorporate guidance into SSAP No. 21R.
3. Paragraph 4e: New scope exclusion to clarify that replication (synthetic asset) transactions are addressed in SSAP No. 86 and are not impacted by the principles-based bond definition. This edit was also driven from industry comments but is reflected within the scope language rather than with the structured note language in paragraph 6d.i.
4. Paragraph 6d: Revisions revise the reference to “credit rating related” to “credit-quality related.” This change was recommended by industry to encompass the broader range of adjustments that align interests of debtholders and issuing entities (e.g., debt to EBITDA ratio, interest coverage ratio, debt service coverage ratio, etc.) Industry noted that these bonds are very prevalent.
5. Paragraph 6d: Revisions include an exception for nominal interest rate adjustments. A new footnote defines the exception as adjustments that are too small to be taken into consideration when assessing an investment’s substance as a bond. The footnote includes an example application, and clarifies that any adjustments that cause an investment to meet the definition of a structured note would not be considered nominal.
6. Paragraph 10b: Incorporate accounting and reporting guidance for first loss positions as recommended by industry. The guidance also retains the pointer to SSAP No. 21R. Industry noted that the guidance was not included in SSAP No. 21R so to provide direction for Schedule BA in SSAP No. 26R. Although the guidance will be captured in SSAP No. 21R, NAIC staff supports the explicit guidance in SSAP No. 26R for ease of reference.
7. Paragraph 44: Revisions to clarify that investment assessments are required as of origination and to permit current or acquisition information in determining whether investments qualify at the time of transition. This edit is also in line with industry comments.
8. Paragraph 47: Included guidance to clarify that 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. This edit is also in line with industry comments.
9. Example 2 (Page 23-24): Revisions to incorporate the industry’s editorial suggestions and to clarify in the example that the reporting entity determined that the debtholder was in a fundamentally different position than if the real estate was owned directly.

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

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.

Bonds

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 10**.
 - 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

Principal-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.

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

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.

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 6a-6d 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

Bonds

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 ~~rating~~-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*.

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

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.

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.

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.

8. An asset⁶ backed security 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,

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.

Bonds

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.

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 ~~should be reported as a non-bond security pursuant to 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 interests 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.

Bonds

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.

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 issue 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

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.

¹⁰ For perpetual bonds with an effective call option, any applicable premium shall be amortized utilizing the yield-to-worst method.

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.

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*

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 D 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.

Bonds

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.

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 fees to be reported as investment income or loss shall be calculated as follows:

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.

- 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 explicit prepayment penalty or acceleration fees, 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 fees, the reporting entity shall calculate the resulting realized gain as the difference between 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.

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.

Bonds

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, 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 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.

¹⁶ With the inclusion of these SVO-identified investments as bonds, specific guidelines are detailed in the annual statement instructions for reporting purposes.

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*.

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 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.

¹⁹ This guidance requires investments purchased in lots to follow the measurement method established at the time the investment was first acquired.

²⁰ Exhibit B details the established systematic value approach.

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 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-

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.

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](#), 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 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.

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.

Bonds

- 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.
- 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 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 ~~acquisition~~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.

Bonds

- 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 45b.i and 45b.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 46a 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 of SSAP No. 26R:

47.48. 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.
- 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.

Bonds

- 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 included 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.
- b. 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.
 - c. Revisions to clarify existing guidance that all prepayment penalty 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 anyall 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 are 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.

Bonds

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 <u>ETF provider website</u> .	
NAV:	\$115.07 (Official end-of-day NAV found on <u>ETF provider website</u>)
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)

All formulas on the left are at a per share level (excepting “Par Value” which represents the number of shares purchased for this lot).

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.

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.

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).

Bonds

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.

	12/15/2010	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	104	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).

Bonds

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
12/31/2016	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 explicit prepayment penalty or acceleration fees.

**Entity 2 has in place a process to identify explicit prepayment penalty or acceleration fees.

<https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/NationalMeetings/A.NationalMeetingMaterials/2023/8-13-23SummerNationalMeeting/Hearing/15-19-21a-SSAP26R-2-14-23.docx>

Exposed Revisions to SSAP No. 43R– 2023 Spring National Meeting

Summary of Revisions:

1. All changes exposed in November 2022 have been accepted with new edits shown as tracked. (This has been done for readability and to highlight changes from the prior exposure.)
2. Paragraph 4c: Revisions to exclude residual tranches, interests and first loss positions from the scope of SSAP No. 43R and to identify that they are captured in SSAP No. 21R. (The guidance for these to be on Schedule BA is still included in paragraph 11c, but this revision is intended to be clear that these items do not qualify for reporting as bonds.)
3. Paragraph 11c (and footnote 4): Revisions to remove reference to residual tranches and interests being captured in scope of SSAP No. 43R and to point to the accounting and admittance requirements of SSAP No. 21R.
4. Paragraph 48: Revisions to clarify that investment assessments are required as of origination and to permit current or acquisition information in determining whether investments qualify at the time of transition. This edit is also in line with industry comments.
5. Paragraph 51: Included guidance to clarify that 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. This edit is also in line with industry comments.

Statement of Statutory Accounting Principles No. 43 - Revised

Asset-Backed Securities

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. (P5)
- 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 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*.

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.

- 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-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*.

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.

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. (P8)

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.
- 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. (P44)

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. (P43)

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. (P45)
- 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. (P46)

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: (P26)

- 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.
- 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 ~~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*. 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,

³ Paragraphs 39-40 provide guidance on the NAIC financial modeling approach applicable to certain securities in determining NAIC designations.

⁴ 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.

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. (P10)

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. (P12)

15. The amount of prepayment penalty and/or acceleration fees to be reported as investment income shall be calculated as follows: (P13)

- 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.

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. (P14)

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. (P15)

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

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.

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 qualify, the reporting entity may continue to apply the retrospective method unless the security is other-than-temporarily impaired. (P16)

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. (P17)

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 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. (P18)

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. (P20 – In Part) (FASB Glossary / ASC 325-40-35-1 & 3) *(Note – Modified to be applicable to all ABS and not just those with known credit deterioration.)*

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

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.

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). (ASC 325-40-35-4, 4A and 4B)

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 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. (ASC 325-40-35-5 & 6.)

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. (P31 & 30)

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. (P32)

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. (P33)

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 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. (P34)

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.) (P35)

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. (P41, ASC 325-40-35-10A)

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,

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).

⁸ See Footnote 1.

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 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. (P42)

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.) (P36)

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.) (P37)

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 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 (P38):

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.

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.

- 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.
- 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. (P39)

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. (P40)

Designation Guidance

39. 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 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 39.a. or 39.b., are required to follow the analytical procedures for non-financially modeled securities (paragraph 39.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 39.b. 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. (P47)

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. (P48)

43. Transaction fees charged by the issuing agencies shall be capitalized and amortized over the life of the repooled security. (P49)

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.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 accretable 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.

Note – With adoption, U.S. GAAP standards previously adopted in SSAP No. 43R will be identified as rejected for statutory accounting. With the issuance of this standard, all relevant literature guidance will be removed. This information can be detailed in the issue paper for historical tracking purposes.

Effective Date and Transition

47. This statement 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 acquisition/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 49b.i and 49b.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 50a 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.

~~51,52.~~ 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 34, 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 on 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/NationalMeetings/A.NationalMeetingMaterials/2023/8-13-23SummerNationalMeeting/Hearing/16-19-21b-43R-2-14-23.docx>

Bond Definition - Proposed Revisions to other SSAPs

SSAP Reference Revisions

Spring 2023 Exposure – Only Changes to SSAP No. 86 (shaded)

SSAP No. 21R Moved to Separate Document

1. ***SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments***

SSAP No. 26R: Update 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: Update 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: Update disclosure reference that link to SSAP No. 26R, paragraph 51m

7. ***SSAP No. 86—Derivatives***

SSAP No. 26R and SSAP No. 43R: Updated the guidance for structured notes in paragraph 5.g.

Note: This footnote updated per February 10, 2023, industry comments. See shading within.

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: Update 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: Remove quoted guidance.

SSAP No. 43R: Updated reference in list of applicable SSAPs and remove 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.f30.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 are 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 ~~20H~~.
- 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.~~ 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.

Proposed Revisions to SSAP No. 21R – 2023 Summer National Meeting

Summary of Revisions:

1. All changes exposed in Spring 2023 have been accepted with new edits shown as tracked. (This has been done for readability and to highlight changes from the prior exposure.)
2. Paragraph 22: Revisions reflect interested parties' comments. The revised guidance requires debt securities that do not qualify as bonds, for which the primary source of repayment is derived through rights to underlying collateral, to be reported as admitted assets if the underlying collateral primarily qualifies as admitted invested assets. Further, any residual tranches or first loss positions held from the same securitization would also only qualify for admittance based on whether the underlying collateral qualifies as admitted invested assets. (This guidance intends to clarify that a residual is not reported as an admitted asset when the debt security does not qualify as an admitted asset.) The guidance requiring an assessment of the underlying collateral fair value was deleted.
3. Paragraph 25: Revisions do not reflect interested parties' comments. After considering the comments, it is identified that the provisions of SSAP No. 43R for the continuous assessment of cash flows in determining amortized cost, bifurcation of IMR/AVR and the recognition of OTTI are more appropriate for the less-traditional investments that would be captured as debt securities that do not qualify as bonds. With this assessment, the original guidance was retained, which provides direction to SSAP No. 43R for these aspects for debt securities that do not qualify as bonds. This specific direction also eliminates potential inconsistencies in application based on differing company assessments on whether an investment that did not qualify as a bond was more akin to an issuer credit obligation or asset-backed security.
4. Paragraph 28: Revisions eliminate the aspect describing a residual. Reference to the location of the adopted residual definition will be included. (Residual definition is being discussed in a separate agenda item.)
5. Paragraph 29: Revisions reflect interested parties' comments with additional clarifications. These revisions correspond with the edits made to paragraph 22, clarifying that residuals shall be nonadmitted if the debt tranche from a securitization did not qualify for admittance.
6. Paragraphs 30-32: These revisions do not reflect interested parties' comments. After reviewing the reported book adjusted carrying value (BACV), as well as amounts for unrealized valuation changes and amortization for residuals as of Dec. 2022, it has been identified that there are inconsistencies across industry on measurement method, and how changes are reflected. Industry provided comments in response to the Spring 2023 exposure noting that it has been a general industry practice to follow the SSAP No. 43R effective yield method guidance for beneficial interests, and for estimates of cash flows to be calculated quarterly with prospective yield adjustments for changes in expected cashflows. As such, if a company has an expectation of 20% yield over the life of the residual, they would accrue interest (accretion) to the BACV at a rate of 20% unless and until that expectation changes, at which point it would revise the yield further upward (for a favorable change in expectation) or impair the asset (if unfavorable). Due to the inherent uncertainty in both the timing and amount of cash flows for residual tranches, using expected cash flows to accrete residual tranches may not be conducive to the conservatism principle under statutory accounting. At origination of a residual tranche, the best estimate expectation is generally that it will generate very favorable returns. The balancing tradeoff of this is that this best estimate expectation is highly uncertain, given the first loss nature of its position in the capital stack of the structure, and provisions that divert cash flows to other tranches upon the occurrence of

certain triggers. As a result, one would expect significant changes in best estimate cash flows under different economic conditions. Using the prior example, this could result in rapidly accreting the BACV at 20% in early periods, only to take significant impairments in stressed economic conditions, which may then recover and return to rapid accretion. While a company may well recover its entire initial investment with a positive return over the life of the investment, the pattern of recognition may be marked with varying periods of rapid accretion and rapid impairment. Due to the nature of residual tranches described above, using the effective yield method is likely not an appropriate fit for statutory accounting purposes. Instead NAIC staff has proposed guidance for exposure and feedback that requires a lower of 'adjusted cost' or fair value measurement method with no amortization or accretion and no changes based on changes in cash flow expectations other than OTTI. Rather, all cash flows received would be treated as a return of principal / investment until the residual BACV was zero. At that point, all cash flows would be treated as interest income. This proposed guidance intends to best suit how residuals work conceptually as previously described. Feedback is requested on the fit of this methodology for residual tranches in general, but also for individual types of residuals where the concepts described above may not be representative.

SSAP No. 21R—Other Admitted Assets*Debt Securities That Do Not Qualify as Bonds*

20. The guidance within paragraphs 20-28 of this statement shall apply for any security, as defined in SSAP No. 26R—*Bonds*, whereby there is a fixed schedule for one or more future payments (referred to herein as debt securities), but for which the security does not qualify for bond reporting under SSAP No. 26R as an issuer credit obligation or an asset backed security. Investments in scope of this guidance are limited to:

- a. Debt securities for which the investment does not reflect a creditor relationship in substance.
- b. Debt securities that do not qualify for bond reporting due to a lack of substantive credit enhancement.
- c. Debt securities that do not qualify for bond reporting due solely to a lack of meaningful cash flows.

21. Debt securities as described in this statement meet the definition of assets as defined in SSAP 4, and are admitted assets to the extent they conform to the requirements of this statement. The guidance in these paragraphs shall not be inferred to other securities or investment structures that are not otherwise addressed in statutory accounting, nor shall it be applied to any investments that are captured within other statutory accounting guidance.

22. Debt securities in scope of this standard that do not qualify as bonds under SSAP No. 26R and for which the primary source of repayment is derived through rights to underlying collateral, qualify as admitted assets if the underlying collateral primarily qualify as only to the extent they are secured by admitted invested assets. As detailed in paragraph 29, in the section pertaining to residual tranches, any residual tranches or first loss positions held from the same securitization that did not qualify as a bond under SSAP No. 26R also only qualify to the extent the underlying collateral primarily qualifies as admitted invested assets. Any amounts in excess of the fair value of the underlying admitted invested assets shall be nonadmitted.

23. Debt securities in scope of this statement shall be initially reported at acquisition at cost, including brokerage and other related fees on *Schedule BA: Other Long-Term Invested Assets*.

24. Debt securities captured in scope shall be reported at the lower of amortized cost or fair value. Changes in measurement to reflect a lower value or to reflect changes in fair value shall be recorded as unrealized gains or losses.

25. Debt securities that do not qualify as bonds ~~captured in the~~ scope of this statement shall follow the guidance in SSAP No. 43R—*Asset-Backed Securities*—for calculating amortized cost, for determining and recognizing other-than-temporary impairments and for allocating unrealized and realized gains and losses between the asset valuation reserve (AVR) and interest maintenance reserve (IMR).

26. Investment income shall be recorded, with assessments for collectability and nonadmittance completed and recognized, pursuant to SSAP No. 34—*Investment Income Due and Accrued*.

27. Securities captured within this section shall be included in all invested asset disclosures, along with the following disclosures:

- a. Fair values in accordance with *SSAP No. 100R—Fair Value*.
- a. Concentrations of credit risk in accordance with *SSAP No. 27*;
- b. Basis at which the securities are stated;
- c. The adjustment methodology used for each type of security (prospective or retrospective);
- d. Descriptions of sources used to determine prepayment assumptions.
- e. 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.
- f. 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.
- g. 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):
 - v. The aggregate amount of unrealized losses (that is, the amount by which cost or amortized cost exceeds fair value) and
 - vi. The aggregate related fair value of securities with unrealized losses.
- h. 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*.
- i. 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.
- j. 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.

- k. 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.

Residual Tranches or Interests / Loss Positions

28. Residual tranches or interests from securitization tranches, beneficial interests and loss positions ~~that lack contractual payments along with substantive credit enhancements~~ as defined in ~~SSAP No. 26R—Bonds and SSAP No. 43R—Asset-Backed Securities and SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies~~ (which are collectively referred to as residuals), do not qualify for bond reporting and are required to be reported on Schedule BA: Other Long-Term Invested Assets.

29. ~~As stated in paragraph 22, R~~residuals are permitted to be admitted assets if debt securities from the same securitization qualify (or would qualify) as admitted assets ~~or would qualify, as admitted assets. For example, if a debt security from a securitization does not qualify as a bond, and the source of repayment is derived through rights to the underlying collateral, the debt security is only permitted to be admitted if the underlying assets qualify as admitted assets.~~ If the debt security from a securitization is (or would be) nonadmitted due to the requirements under paragraph 22, then any residual interests or first loss positions held from the same securitization also do not qualify as admitted assets and shall~~would~~ be reported as nonadmitted assets.

30. Residuals shall be initially reported at cost, or allocated cost (using proportional fair values) if acquired along with debt tranches from the securitization). Subsequent to initial acquisition, residuals shall be reported at the lower of “adjusted amortized cost” as defined in paragraph 31 or fair value, with reductions ~~changes~~ in fair value below (or from adjusted amortized cost to fair value) reported as an other-than-temporary impairment, as detailed in paragraph 32 ~~unrealized gains or losses.~~

31. ~~The adjusted cost of residuals shall be calculated such that all cash flows received attributed to the residual tranche shall be treated as a return of principal and a reduction to the adjusted cost. In other words, cash flows received as a holder of the residual tranche shall not be recognized as interest or investment income until the residual tranche has a book adjusted carrying value (BACV) (adjusted cost basis) of zero. Once the residual has a zero BACV, cash flows received shall be recognized as interest income. The residual shall continue to be reported on Schedule BA, with the zero BACV, with reporting of the received cash flows as interest income, until the structure matures/terminates, is unwound or no longer meets the definition of a residual tranche.~~

- a. ~~The BACV (adjusted cost basis) shall not be increased prospectively or retrospectively based on a reporting entity’s estimates of future cash flows, and there shall be no amortization / accretion.~~
- b. ~~At such point that the residual ceases to meet the definition of a residual tranche (i.e., when all senior debt has been repaid), and the investment structure is expected to continue for more than a year (12 months), the investment shall be reclassified and accounted for prospectively in the scope of whichever SSAP applies.~~
 - i. ~~Although it will be determined based on the structure of the resulting investments, presumably, at the time a structure ceases to reflect a residual tranche, it will likely be considered a debt security that does not qualify as a bond or an equity investment in scope of SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies.~~
 - ii. ~~Reporting entities are not required to reclassify an investment if the resulting structure is unwound within 12 months of the senior debt being repaid.~~

32. Residuals shall be assessed for other-than-temporary impairment (OTTI) on an ongoing basis. An OTTI shall be considered to have occurred if the fair value is below adjusted cost.~~if it is probable that the reporting entity will not receive cash flows distributed to the residual tranche to cover the reported amortized cost basis.~~ Upon identification of an ~~probable~~ OTTI, the reporting entity shall recognize a realized loss equal to the difference between adjusted cost and fair value. Recognition of cash flows will continue to be recorded in accordance with paragraph 31, with cash flows reducing the updated adjusted cost basis. ~~remaining amortized cost basis.~~ ~~Subsequent to the recognition of an OTTI, the residual shall be reported with a zero book adjusted carrying value. Any subsequent cash flows received attributed to the residual tranche shall be reported as interest income.~~

Staff Note: As detailed in the summary, NAIC staff is soliciting feedback on the proposed measurement guidance for residuals in paragraphs 30-32. Comments are particularly welcome on the methodology for residual tranches in general, but also for different security structures that reflect residual interests. Feedback is also requested on transition guidance to move to a different measurement approach for residuals (whether this approach or a revised approach.)

Statutory Issue Paper No. 1XX

Principles-Based Bond Definition

STATUS

Exposure Draft – ~~December 12, 2022~~ 2023 Summer National Meeting

Original SSAP: SSAP No. 26 and SSAP No. 43

Current Authoritative Guidance: SSAP No. 26R and SSAP No. 43R

Type of Issue:

Common Area

SUMMARY OF ISSUE

1. The guidance within this issue paper introduces new statutory accounting concept revisions to *SSAP No. 26R—Bonds* (SSAP No. 26R) and *SSAP No. 43R—Loan-backed and Structured Securities* (SSAP No. 43R) pursuant to the Statutory Accounting Principles (E) Working Group’s (Working Group) Investment Classification Project as well as in response to expanding investment structures that have been reported on Schedule D-1: Long-Term Bonds. The Investment Classification Project reflects a comprehensive review to address a variety of issues pertaining to definitions, measurement and overall scope of the investment SSAPs. Although SSAP No. 26R was previously revised pursuant to the Investment Classification Project in 2017, it was identified that some entities were classifying securities issued from special purpose vehicles (SPVs) in scope of SSAP No. 26R instead of SSAP No. 43R. As the focus of this current project is on the substance of investments, regardless of whether they include an SPV for issuance, this project includes both SSAP No. 26R and SSAP No. 43R.

SUMMARY CONCLUSION

2. Investments eligible for reporting as bonds on Schedule D-1 shall comply with the principles-based definition of a bond or be specifically noted in scope of SSAP No. 26R or SSAP No. 43R. Revisions to reflect the principles-based bond definition will be incorporated to SSAP No. 26R, with SSAP No. 43R revised for accounting and reporting guidance investments that qualify as asset-backed securities under the bond definition. SSAP No. 21R—Other Admitted Assets has been revised to detail accounting and reporting guidance for debt securities that do not qualify as bonds under SSAP No. 26R. Lastly, various revisions to other SSAPs have been incorporated to update guidance and/or references to the bond guidance. and SSAP No. 43R. Tracked changes The final adopted SSAPs and other revisions to reflect this guidance are shown in the Exhibits to this Issue Paper. Exhibit A & B.

DISCUSSION

3. The discussion of this issue originally began in August 2019 with agenda item 2019-21: SSAP No. 43R – Equity Investments. This agenda item was drafted to consider clarification to SSAP No. 43R particularly with regards to collateralized fund obligations and similar structures that reflect underlying equity interests. In response to the discussion of comment letters in January 2020, this project was expanded to include a comprehensive review of SSAP No. 43R under the Working Group’s Investment Classification Project, with NAIC staff directed to prepare a discussion document for subsequent review.

4. A preliminary discussion document was exposed for comment on March 18, 2020. Although there were no proposed recommendations in that exposed document, it captured the following:

- a. History of the definition / scope development of SSAP No. 43R. (This history has been retained in Exhibit of this Issue Paper.)

- b. Definitions of asset backed securities (ABS) from the Code of Federal Regulations (CFR), the Securities Exchange Act of 1934 and NAIC Model 280, Investments of Insurers Model Act (Defined Limits Version).
 - c. Potential options for the accounting and reporting of ABS based on whether they were considered traditional securitizations in accordance with the Code of Federal Regulations (CFR) (17 CFR 229.1101(c)) definition of an ABS or non-traditional securitizations that did not comply with the CFR definition.
5. In response to this initial exposure, a detailed comment letter dated July 31, 2020, was received from interested parties. Although a variety of elements were noted, two key issues were the primary focus:
 - a. Separation between SSAP No. 26R and SSAP No. 43R: Pursuant to the comments received, it was identified that many insurers had different interpretations of the adopted 2010 revisions that separated investments between SSAP No. 26R and SSAP No. 43R due to the presence of a “trust” or an “SPV” structure. As such, investment designs that had been identified as concerning due to the underlying investments in the SPV (e.g., equity-driven investments) believed by some to be limited to SSAP No. 43R were, under some interpretations, eligible to be captured in scope of SSAP No. 26R.
 - b. Defining an asset backed security: The comments received focused heavily on whether the 17 CFR definition captured securities within the 1933 or 1934 Securities Act. The proposed use of the 17 CFR definition, which is the ABS definition used by the SEC as a nationally recognized statistical ratings organization (NRSRO) registered for asset-backed securities, was intended to allow consistency in ABS items permitted for NRSRO designations. Furthermore, it was only the first “broad brush” in determining whether an investment would be initially captured in scope of SSAP No. 43R. Regardless, based on the comments received, which noted variations between the 1933 and 1934 Securities Act, differences of assessments based on whether an entity is the issuer or acquirer, the legal scrutiny that may be required in determining whether an investment complies with the definition, as well as a recommendation for independent principles for determining an investment as an asset backed security, it was identified that further discussion should occur before utilizing the CFR definition of an asset-backed security.
6. After considering the interested parties’ July 31, 2020, comments, the Working Group directed that a small group of industry work with Iowa representatives and NAIC staff to first define what should be considered a bond for reporting on Schedule D-1. It was identified that some investment designs, which have been previously captured on Schedule D-1 or are proposed for inclusion on that schedule, may be well-performing assets, but are not bonds and should not be captured on Schedule D-1. It was also noted that regulators are not anticipating these sorts of investment structures when reviewing D-1 and assessing investment risk. These small group discussions began December 1, 2020 and continued until the bond proposal was exposed for public comment on May 20, 2021.
7. After considering the comment letters from the May 2021 exposure, on August 26, 2021, the Working Group affirmed the direction of the principle-based bond concepts and directed NAIC staff to utilize those concepts in proposing statutory accounting revisions. With this explicit direction, it was noted that all elements of the principles-based bond proposal, and the reflection of those concepts in statutory accounting guidance, is subject to continued discussion and deliberation. Revised guidance for Schedule D-1 investment classification will not be considered authoritative statutory guidance until the specific effective date detailed in the adopted authoritative SSAP. With the direction to proceed with the development of statutory guidance to reflect the principle-based concepts, the Working Group directed that NAIC staff continue to work with the small group of regulators and industry to discuss concepts, review proposed language and consider innovating investment designs. (During this meeting, the small group was repurposed and referred to as the “study” group with additional regulators participating.)

8. From September 2021 through January 2022, the study group of regulators and industry met to continue discussions on the bond proposal definition. Key elements discussed during this timeframe included 1) the requirement for a credit enhancement that puts the holder of an ABS in a different economic position from holding the underlying collateral directly, 2) the contractual stapling restriction, and 3) guidance for when a debt instrument is issued from an SPV that owns a portfolio of equity interests. Revisions from these discussions, as well as other aspects to clarify the definition and an initial issue paper were presented to the Statutory Accounting Principles (E) Working Group on March 2, 2022, with a request for exposure.

9. This issue paper intends to provide information on discussions that occurred when considering the principles-based bond definition and the needed statutory accounting revisions to specify the types of investments that shall be reported on Schedule D-1: Long-Term Bonds.

- a. This issue paper, along with the principles-based bond definition, was exposed March 2, 2022, with comments due May 6, 2022. The Working Group heard comments on July 18, 2022, and directed limited edits to be reflected as followed:
 - i. Revise the guidance related to U.S. Treasury Inflation Protected Securities (TIPs) and to clarify the guidance regarding variable contractual principal and interest payments. These revisions clarified that securities with plain-vanilla inflation adjustment mechanisms are not intended to be captured within the provisions that restrict bond classification due to varying principal or interest payments, as well as clarified that other variances in contractual amounts due to reference variables (and not just equity interests) are intended to be precluded from bond treatment.
 - ii. Revise guidance describing substantive credit enhancements, particularly to revise reference to the first loss “tranche” as the first loss “position” and clarify that securitization tranches that do not have contractual principal and interest payments along with substantive credit enhancement do not qualify as a Schedule D Bond and shall be reported on Schedule BA. (Tranches without contractual principal and interest payments are considered residual tranches shall be on Schedule BA.)
 - iii. Document the outcome of small group discussions around the application of the bond principles (particularly the equity-backed example in Appendix I) to feeder fund structures. Feeder fund structures shall not automatically be assumed to qualify for bond classification (even if the ultimate collateral is fixed income), nor be automatically precluded bond classification. The substance of the investment should be the determining factor in these and other similar situations. In particular, the assessment of feeder fund structures should evaluate whether the structure ensures the pass through of the underlying cash flows, or whether uncertainty as to the timing or amount of cash flows is introduced by the structure.
 - iv. Requested interested parties to work with NAIC staff in proposing revisions to capture examples currently in Appendix I of the bond definition into the main components of the bond definition.
- b. In addition to the revisions incorporated from the July 18, 2022, call, the Working Group also heard comments and elected not to incorporate revisions for the following items:
 - i. The Working Group identified that non-bond items that are specifically scoped in to SSAP No. 26R will not be identified in the bond definition. The Working Group was explicit that the inclusion of an investment in-scope of SSAP No. 26R did not make the investment a “bond” and such a distinction is necessary to prevent scope-

creep or inference of other investments into the bond definition. For example, although SVO-Identified Bond ETFs, SVO-Identified CTLs and certificates of deposit that exceed one year are explicit inclusions to SSAP No. 26R and reported on Schedule D-1, these investments are not bonds.

- ii. The Working Group did not incorporate industry proposed edits to limit guidance that requires the consideration of all returns to equity-backed ABS. Rather, the Working Group clarified that all investments that have contractual principal and interest that can fluctuate due to a referenced variable shall consider all returns in excess of principal repayment as interest when determining whether the investment qualifies for bond reporting under the principles-based definition.
 - iii. The Working Group did not agree with comments supporting ABS to be reported as cash equivalents or short-term investments if acquired within those timeframes. To ensure proper assessment under the bond definition, and reporting based on the underlying components of the investments, the Working Group retained the provisions that all ABS shall be captured within SSAP No. 43R and reported on Schedule D-1.
 - iv. The Working Group did not direct changes to the exposed bond definition or issue paper after considering the industry “Lease Backed Securities Working Group” May 5, 2022, comment letter. That letter, which is consistent with their prior comments, proposes to capture securities as issuer credit obligations if they pass-through cash flows unaltered (such as with certain lease-backed structures) and are supported primarily by a single rated credit payor, though principal repayment is not fully supported by the obligation of that payor. The discussion noted that these securities shall follow the guidance for asset backed securities if they are not fully supported by an underlying contractual obligation of a single operating entity, including the criteria for substantive credit enhancement and meaningful cash flows. The Working Group identified that these structures are not based on the credit worthiness of a single operating entity and rely on the underlying collateral for repayment, which is why they should be considered asset backed securities rather than issuer credit obligations. The comment letter also raised concerns around guidance included for evaluating project finance debt as it is perceived that inconsistent classification may occur for investments with similar characteristics. As a result of the discussion, there were no changes to the exposed bond definition. Working Group members and other interested parties noted during the discussion that the guidance pertaining to project finance is intended to provide guidance for evaluating issuers that share characteristics of both operating entities and ABS Issuers (i.e., the middle of the spectrum). Nevertheless, the guidance is clear that issuers of project finance debt must themselves have the characteristics of operating entities in order to qualify as issuer obligations. As such, project finance bonds issued by operating entities and other municipal revenue bonds will be retained as issuer credit obligations as the design of these structures are supported by the credit worthiness of a single operating entity and are therefore different than the investment structures presented by the industry Lease Backed Securities Working Group.
- c. This issue paper, along with the principles-based bond definition, and proposed revisions to *SSAP No. 26R—Bonds* and *SSAP No. 43R—Asset-Backed Securities* was exposed August 10, 2022, with comments due October 7, 2022. Comments were received from Fermat Capital, the industry Lease-Backed Securities Working Group and Interested Parties. After considering the comments, the following key revisions were incorporated:

- i. Revisions to incorporate the entire bond definition within SSAP No. 26R, with a deletion of guidance from SSAP No. 43R. Securities that qualify as ABS after application of the bond definition will follow the measurement and reporting guidance within SSAP No. 43R. This edit prevents unintended inconsistencies in the guidance that could occur if aspects of the bond definition are in both SSAPs.
- ii. Revisions to incorporate the guidance for determining a creditor relationship, which was in an exhibit, into the body of guidance within SSAP No. 26R.
- iii. Revisions to the examples for ABS analysis, which were moved to SSAP No. 26R, to reflect a scenario in which payments under the instrument are secured by a note, a legal assignment from the borrower of a lease for real property and the assignment of the lease payments from an operating entity tenant. This revision was in response to comments from the industry Lease-Backed Security Working Group and detail that the SPV does not need to have ownership interest in the underlying collateral for the security to qualify as an ABS.
- iv. Revisions to SSAP No. 26R to clarify that investments with specific guidance and reporting lines (such as surplus notes, working capital finance investments (WCFI) and structured settlements) shall follow the guidance in their specific SSAP and be reported on designated reporting lines. This edit was made in response to the comments from Fermat Capital, who identified that WCFI meet the definition of issuer credit obligations. These investments shall follow the guidance *in SSAP No. 105R—Working Capital Finance Investments* and be reported of their specific reporting lines on Schedule BA.
- v. Revisions to SSAP No. 26R, and the addition of a new footnote, to clarify that the general creditworthiness of an entity can be direct or indirect recourse and is the primary source of repayment for issuer credit obligations.
- vi. Revisions to SSAP No. 26R to clarify application when interest and principal vary based on the performance of an underlying value or variable. The revised guidance adds language to clarify that the exclusion is not intended to restrict variables that are commonly linked to debt instruments, such as plain-vanilla inflation or benchmark interest rates.
- vii. Revisions to SSAP No. 26R to delete the glossary, with the inclusion of the bank loan definition into a footnote. Other definitions were identified as not being necessary for retained inclusion in the statement.
- viii. Revisions to SSAP No. 43R to identify Freddie-Mac When Issued Trust Certificates, pursuant to INT 22-01, as an explicit scope inclusion.
- ix. Revisions to SSAP No. 43R to clarify the guidance for prospective adjustment method for high-credit quality investments, and on the assessment of cash flows. This guidance clarifies that if a security is in an unrealized loss position, and there is an adverse change in cash flow, the entity shall recognize an other-than-temporary impairment.
- x. Revisions to both SSAP No. 26R and SSAP No. 43R to provide specialized transition and disclosure guidance for the reclassification of securities previously reported that will no longer qualify for reporting as bonds.

- xi. Revision to the issue paper to clarify the application of the feeder fund guidance.
- d. After considering the comments and proposed revisions, on November 16, 2022, the Working Group exposed revisions to SSAP No. 26R and SSAP No. 43R for comment. The Working Group also exposed proposed revisions to other SSAPs that will be impacted with the revisions under the bond project. This includes revisions to detail the short-term and cash equivalent restriction for ABS in SSAP No. 2R as well as guidance for debt securities that do not qualify as bonds in SSAP No. 21R. This guidance was exposed until February 10, 2023. The Working Group considered comments during the 2023 Spring National Meeting and exposed updated guidance, with a comment period ending June 9, 2023, to reflect most of the interested party comments. Most of the edits were minor, but the following elements are specifically noted:
- i. Revisions to SSAP No. 26R incorporated an exception for nominal interest rate adjustments. The guidance defines the exception as being too small to be taken into consideration when assessing an investment's substance as a bond. This revision was added based on industry's comments on inadvertent impact to sustainability-linked bonds, but the exception guidance is not limited to those specific bonds.
 - ii. Revisions clarify that replication (synthetic asset) transactions are addressed in *SSAP No. 86—Derivatives* and are not impacted by the principles-based bond definition.
 - iii. Revisions to SSAP No. 26R to explicit identity residuals, including first loss positions that lack contractual payments or substantive credit enhancement, do not qualify as bonds and shall be captured in *SSAP No. 21R—Other Admitted Assets*.
 - iv. Revisions specific to transition that clarify that investment assessments are required as of origination and to permit current or acquisition information in determining whether investments qualify as bonds at the time of transition. Furthermore, the guidance was clarified that the transition guidance shall be applied prospectively beginning with the first year of adoption. For disclosures that provide comparable information, reporting entities shall not restate the prior year's information in the 2025 disclosure.
 - v. An updated SSAP No. 21R was also exposed to update guidance for the measurement of debt securities at the lower of amortized cost or fair value and to incorporate proposed accounting and reporting guidance for residuals.
- e. The Statutory Accounting Principles (E) Working Group received comments on June 9, 2023 from the 2023 Spring National Meeting exposure. No comments were received on SSAP No. 26R, SSAP No. 43R or the document that detailed revisions to other SSAPs. The Working Group adopted the SSAP revisions reflected in these documents on August 12, 2023, during the 2023 Summer National Meeting, effective January 1, 2025.
- f. During the 2023 Summer National Meeting, the Working Group considered comments received on SSAP No. 21R on the guidance for debt securities that do not qualify as bonds and for residual interests and exposed a revised SSAP No. 21R until [redacted]. The revisions for debt securities that do not qualify as bonds reflect a majority of interested parties' comments. For debt securities that do not qualify as bonds, the revisions clarify that if the primary source of repayment is derived through underlying collateral, the investment shall only be admitted if the underlying collateral qualifies as admitted invested assets. For residuals, the revisions clarify that if the reporting entity holds a debt tranche from the same

securitization, and the debt tranche does not qualify as a bond (either an issuer credit obligation or asset-backed security), and the debt security does not qualify as an admitted asset under SSAP No. 21R, then the residual does not qualify as an admitted asset. In addition, the revisions to SSAP No. 21R included a proposed new measurement method for residuals. This guidance is different from what was proposed by interested parties but intends to reflect the highly uncertain amount and timing of residual cashflows. This proposed guidance will require all cash flows received to be treated as a return of principal / investment until the residual book adjusted carrying value (BACV) is zero. At that point, all cashflows received would be treated as interest income. This proposed guidance intends to best suit how residuals work conceptually. The reporting BACV will reflect the potential risk of loss prior to recovering the initial investment, rather than requiring an assessment of potential loss over the entire life of the securitization. Comments on the proposed measurement method for residual tranches in general, and also for individual types of residuals, were specifically requested.

Discussion of Principles-Based Bond Concepts

10. Pursuant to the “small group” discussions comprised of industry, Iowa representatives and NAIC staff, the broad principle-based bond concepts discussed on August 26, 2021 reflected the following key concepts:

- a. Definition of a bond requires a security structure, representing a creditor relationship, that is considered an Issuer Credit Obligation or an Asset Backed Security (ABS).
- b. The assessment of whether a security represents a creditor relationship requires consideration of the substance, rather than the legal form of the document, as well as consideration of other investments owned in the investee and other contractual arrangements. A security that possesses equity-like characteristics or that represents an ownership interest in the issuer in substance does not represent a creditor relationship.
- c. An ABS is a bond issued by an entity created for the primary purpose of raising debt capital backed by financial assets or cash generating non-financial assets owned by the ABS Issuer, whereby repayment is primarily derived from the cash flows associated with the underlying defined collateral rather than the cash flows of an operating entity.
- d. There are two defining characteristics that must be present for a security to meet the definition of an asset backed security: 1) 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, and 2) When the assets owned by the ABS are non-financial assets, the assets are expected to generate a meaningful level of cash flows towards repayment of the bond other than through the sale or refinancing of the non-financial assets.

11. Various discussions and components were addressed in the establishment of these broad concepts. Specific elements and discussion points are detailed within.

Security Structure Representing a Creditor Relationship

12. Similar to long-standing guidance in defining a bond, the principles-based bond concepts only permit security structures to be considered eligible for Schedule D-1 reporting. Although the concepts continue reference to the adopted security definition from U.S. GAAP, the guidance is expanded to require that the evaluation of the structure under the security definition considers the substance of the instrument rather than solely its legal form.

13. The consideration of whether a structure reflects a “security” is a key factor in determining the appropriate SSAP for accounting and reporting. A structure with one or more future payments that qualifies as a security has historically been captured as a bond, with measurement and risk-based capital (RBC) charges based on the NAIC designation. Under the prior SSAP guidance, bond securities did not require additional provisions for admittance and would likely only be subject to nonadmittance based on state investment limits. This treatment is distinctly different than a “non-security” structure considered to be a loan under SSAP No. 20—*Nonadmitted Assets* or SSAP No. 21—*Other Admitted Assets*. For these structures, the ability to admit the loan under the SSAP provisions is contingent on the nature of the loan and qualifying collateral or related party assessments. (State investment limits may have additional loan to value requirements that impact admittance.) Loans (other than mortgage loans) are captured on Schedule BA: Other Long-Term Invested Assets and are likely limited by state investment limits along with other invested assets reported on Schedule BA. Although the RBC charge for admitted collateral loans is lower than other Schedule BA investments, the RBC charge is still higher than Schedule D-1 investments with most NAIC designations.

14. Over time, since the codification of statutory accounting principles, various industry comments have been received questioning the difference between loans and securities (e.g., bonds), particularly with the different reporting outcomes. This discussion was also revisited as part of the principles-based bond proposal, and it was concluded that structures must meet the security definition to be captured on Schedule D-1. Although industry requested “loans with recourse” to be added to the bond scope paragraph as well as an explicit reference to “loans” as a type of investment captured in the bond definition, these proposals were not supported for inclusion. This discussion highlighted that the security definition is not a high threshold to meet, and direct loans should not be reflected as bonds if they do not qualify as securities. With this discussion it was noted that an investment could meet the definition of a bond regardless of the legal form (paper) it was written on and/or how it was described (such as a bond, note, obligation, etc.) Although an instrument could be described as a “loan,” if it meets the security definition requirements and other principle concepts, it shall be captured as a bond. The same concept would be true for instruments named as a “bond” but that do not meet the security or other principle requirements, as they would not be permitted for Schedule D-1 reporting.

15. The statutory accounting guidance in SSAP No. 26R and SSAP No. 37—*Mortgage Loans* adopts the U.S. GAAP definition of a security as it is used in FASB Codification Topic 320 and 860:

- a. 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:
 - i. 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.
 - ii. 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.
 - iii. It either is one of a class or series or by its terms is divisible into a class or series of shares, participations, interests or obligations.

16. The “security/non-security” discussion highlighted that the naming convention of an investment (as a “note,” “bond,” “obligation,” “loan,” or other such term) does not determine the correct underlying SSAP or reporting location. Non-security structures (other than mortgage loans) shall be captured as collateral or non-collateral loans pursuant to SSAP No. 20—*Nonadmitted Assets* or SSAP No. 21—*Other Admitted Assets* as applicable. To prevent incorrect assumptions that all loans could be captured as issuer credit obligations, the group agreed not to include explicit reference to loan structures within the principles-based bond concepts and instead refer to the substance of the investment structure. Additionally, the

following existing guidance was noted as support for this conclusion and to further highlight that the naming convention does not override the structural design of an investment when it comes to reporting or the application of statutory accounting principles.

- a. Existing guidance in SSAP No. 21 states that if an instrument meets the definition of a bond, but has supporting collateral, then the investment is not classified as a collateral loan. This concept was affirmed as part of the principles-based bond discussion, noting that such arrangements that qualify for Schedule D-1 shall not be classified as collateral loans regardless of whether there is collateral backing the investment.
- b. Guidance in *SSAP No. 25—Affiliates and Other Related Parties* applies to all transactions, regardless of the SSAP that governs the underlying accounting and reporting. As such, the provisions in SSAP No. 25 that require assessment of “loans or advances (including debt, public or private)” is intended to apply to all forms of lending from a reporting entity to a related party. As such, this guidance applies regardless of the naming convention of the agreement (e.g., loan, bond, note, obligation, etc.). Structures reported on Schedule D-1 that reflect related party transactions shall only be admitted if the requirements in SSAP No. 25 are met. In addition to having a specific due date and written agreements, these requirements include specific assessments based on whether the arrangement is with a parent or principal owner or to other related parties.

17. After determining whether a structure represents a security, the next component for the principle-based bond definition is assessing whether the security represents a creditor relationship. Although the reference to a “creditor relationship” may seem very similar to prior guidance in SSAP No. 26R, that prior guidance did not explicitly detail the intended meaning of a “creditor relationship” but simply identified that such structures have a fixed schedule for one or more future payments. This prior guidance resulted with interpretations that structures qualified as “bonds” strictly on legal form. With the focus of the principles-based definition, it is explicit that the assessment of a whether a security represents a creditor relationship requires consideration of the substance, rather just the legal form, along with consideration of other investments owned in the investee and other contractual arrangements.

18. Original regulator concerns with the current guidance and reporting were in part due to the identification of investments with underlying equity interests that were structured to resemble bond instruments. This discussion identified that there is a significant incentive for insurers to characterize equity exposures, which would traditionally be captured on Schedule BA, as bonds due to the favorable capital treatment. Transferring or acquiring them as debt issued by an SPV (such as through a collateralized fund obligation (CFO) type structure) is a mechanism to reclassify these equity instruments and characterize them as bonds. The lack of current safeguards in existing SSAPs also provides significant opportunity for these reclassifications.

19. Equity investments differ from other types of financial assets in that they generally do not have contractual payments. Distributions are typically at the discretion of whichever decision maker has control of the entity. However, certain types of entities have greater likelihood and predictability of cash flows than others. For example, private equity and debt funds are often designed to have finite lives that begin with a capital raising and investment phase, and once the portfolio is built and seasoned, investments are monetized, returns realized, and distributed to investors. Therefore, while there can be variability in timing and amounts of cash flows, distributions can be expected with some level of predictability compared to other types of equity investments (e.g., publicly traded companies). Private debt funds are more predictable still given that the underlying investments of the fund have contractual cash flows. If a large, diversified pool of such types of seasoned funds are securitized, referred to as a CFO, there can be a level of predictable cash flows that is suited to support a bond, when coupled with the overcollateralization, liquidity facilities, and other protections that are built into the structure.

20. A regulator concern arises when features that facilitate the production of predictable cash flows are not present. In such a case, when there are not predictable cash flows equipped to service the debt, repayment may rely on sale or refinancing of the underlying equity investments at maturity in order to satisfy the debt. In that case, equity valuation risk may be the primary risk for the non-payment of the SPV-issued debt. If repayment predominantly relies on a point-in-time equity valuation (such as at maturity), then the substance of the risk is not consistent with what is expected of a bond on Schedule D-1.

21. Although the full disallowance of equity-backed debt would prevent these concerns, there is a position that there are CFO securitizations (or other investments) of well-diversified, seasoned funds for which there is compelling evidence that there will be sufficient cash distributions to amortize the debt and structure protections that minimize the residual equity exposure. The approach to allow such CFO securitizations/investments only works when there are appropriate safeguarding principles established, which require a relatively high standard of proof.

22. An investment for which the primary risk for non-payment is equity devaluation is not consistent with the substance-intent for what is expected to be on Schedule D-1 under the principles-based definition. Allowing these items to be reported on Schedule D-1 could result with the regulatory arbitrage that regulators are concerned about without any real mitigants. This could ultimately result in a situation where industry has taken on significantly more equity risk than they have historically, all while characterizing the investment as a bond exposure. As such, it was noted as critical that appropriate safeguards be incorporated to address this concern, which is why the small group supported a rebuttable presumption that equity-backed ABS do not qualify to be reported on Schedule D-1 unless a documented analysis supporting the predictability of cash flows is completed to overcome that presumption.

23. The principles-based definition is clear that a security that possesses equity-like characteristics or that represents an ownership interest in the issuer in substance does not represent a creditor relationship. Examples of equity investments, equity holdings and equity-like interests include any security ultimately reflecting an ownership or membership interest in an entity (such as common stock, preferred stock, private equity holdings, investments in joint ventures, partnerships, and LLCs) as well as any structure that reflects the performance of an entity (such as dividends or capital gains). Furthermore, examples of equity instruments also include any debt instrument where the risk/reward profile is substantially similar to an equity interest.

24. With the prohibition of equity-like structures or items that represent ownership interests, there is a rebuttable presumption that debt instruments collateralized by equity interests do not qualify as bonds because they do not reflect 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.

25. With the establishment of the principles-based bond definition, this rebuttable presumption was specifically discussed, and it was concluded that the determination of whether debt instruments collateralized by equity interests qualify as bonds inherently requires significant judgment and analysis. Unlike debt instruments collateralized with contractual cash flows, or debt instruments collateralized by cash-generating non-financial assets, debt instruments collateralized by equity interests may be dependent on cash flow distributions that are not contractually required to be made and/or may not be controlled by the issuer of the debt. In some instances, sale or refinancing of the underlying equity interests may be the only means of generating cash flows to service the debt instruments. If this is the situation, then it is expected that compensating factors from other characteristics will be present to qualify. For example, if the source of cash flows is driven from the sale or refinancing, then an appropriate, compensating level of overcollateralization would be required to overcome the presumption that the structure does not qualify as a bond.

26. For debt instruments that are collateralized by equity interests, various factors should be considered in determining whether debt collateralized by equity interests qualify as bonds. Additionally, to overcome the presumption that the structure does not qualify as a bond, it is presumed that reporting entities will have sufficient documentation supporting this conclusion. Factors to consider include, but are not limited to, the following:

- a. Number and diversification of the underlying equity interests
- b. Characteristics of the equity interests
- c. Liquidity facilities
- d. Overcollateralization
- e. Waiting period for the distributions / paydowns to begin
- f. Capitalization of interest
- g. Covenants (e.g., loan-to-value trigger provisions)
- h. Reliance on ongoing sponsor commitments
- i. Source(s) of expected cash flows to service the debt (i.e., dividend distributions from the underlying collateral vs. sale of the underlying collateral)

27. The assessment of equity backed securities should be looked at, not only in form, but in substance. For example, a common arrangement exists where debt is issued from a feeder fund, and the feeder fund has an equity interest in another fund which predominantly holds debt instruments. The fund passes those fixed income cash flows through the structure to the ultimate feeder fund debt holder(s), in a way that produces substantially the same risk profile to the debt holders as a collateralized loan obligation (CLO). Accordingly, such an arrangement may have its substance aligned with a debt investment rather than a single equity investment, despite the direct holding being a fund investment. This conclusion would be supported if the terms of the structure ensure that underlying fixed income cash flows are passed through. Factors that add additional uncertainty as to the timing and/or amount of the pass through of the cash flows from the underlying debt instruments may call into question a conclusion that a feeder fund structure is a debt-backed structure in substance. For example, discretion of an underlying fund manager to withhold distribution of the underlying cash flows passed through from underlying debt instruments may create uncertainties as to the timing and/or amount of cash flows in such a manner that is more characteristic of an equity investment. Likewise, a feeder fund structure that is not expected to provide for regular cash interest payments would also call into question the substance as a debt-backed investment. Note, features that are customary to CLOs and other asset backed securities would not ordinarily call the investment's substance into question on its own. For example, a waterfall structure dictating the pass-through and order of payments or retaining sufficient funds for covering contractual underlying fund level payments (e.g., investment management fees, legal costs, and other customary fund level expenses) are common to CLOs and other ABS, as are customary payment in kind (PIK) features designed to address temporary liquidity issues where the PIK then gets prioritized in the waterfall structure. These customary features do not constitute manager discretion that would call into question a conclusion that a feeder fund structure is a debt-backed structure in substance.

28. Conversely, if the feeder fund debt ultimately relies on equity interests for repayment (the final fund holds equity interests that generate the pass-through cash flows), the held debt instrument from the feeder fund would have to meet the requirements of [paragraph 26](#) while looking at the substance of equity interests supporting the debt. Regardless of the underlying collateral, feeder fund arrangements would have to meet the other relevant parts of the standard (e.g., have a substantive credit enhancement, etc.) to qualify for bond

reporting. Investments that resemble feeder fund structures will require entity review to determine the underlying source of cash flows and identify the uncertainties or vulnerabilities that could impact the cash flows that will be passed through to the reporting entity holder. Ultimately, the conclusion that a structure represents a feeder fund shall not automatically qualify the structure for bond classification but shall not automatically preclude bond classification. Substance over form should be the determining factor in these and similar situations.

Determination of Issuer Credit Obligation or Asset Backed Security (ABS)

29. Security structures that qualify as creditor relationship are divided between issuer credit obligations and ABS. The initial distinction between an issuer credit obligation and an ABS is a key factor with the principle-based bond concepts. Given their differing characteristics, investments that qualify as issuer credit obligations are not required to complete assessments for qualifying credit enhancements or meaningful cash flow generation. As such, it is critical to ensure that structures which should be considered ABS or that reflect non-qualifying Schedule D-1 structures, are not classified as issuer obligations to avoid those detailed assessments.

30. Determining whether an investment reflects an issuer credit obligation or an ABS focuses on the issuer and the primary source of repayment of the instrument. An issuer credit obligation represents a bond structure where the repayment is supported primarily¹ by the general creditworthiness of an operating entity or entities. The support for this structure consists of direct or indirect recourse to an operating entity or entities. An “operating entity” can be any sort of business entity, not-for-profit organization, or other provider of goods or services, but cannot be a natural person or an Asset Backed Security (ABS) issuer. An ABS is a bond issued by an entity (an ABS Issuer) created for the primary purpose of raising debt capital backed by financial assets or cash generating non-financial assets owed by the ABS Issuer, whereby repayment is primarily derived from the cash flows associated with the underlying defined collateral rather than the cash flows of an operating entity.

31. The prior assessments to divide structures between SSAP No. 26R and SSAP No. 43R seemed to focus primarily on legal form (issued by trust/SPV that held pledged assets) or on the basis of prepayment risk within the structure (meaning, that the expected timing of cash flows may vary, impacting the effective interest rate). Under the principle-based bond definition, neither of these components shall be used as a determinant in concluding whether a structure represents an issuer credit obligation or an ABS.

- a. The prior guidance which focused on the use of an SPV relied more on legal form than the substance of the transaction. Although it is common that many ABS Issuers are in the form of a trust or SPV, the presence or lack of a trust or SPV is not a definitive criterion in determining that a security meets the definition of a Schedule D-1 investment, or that it is limited to a classification as an ABS. A key component of the principles-based bond definition is that it will not be possible to recognize a non-qualifying investment as a bond simply by moving it to a debt-issuing SPV to resemble a creditor relationship with a future payment obligation. Furthermore, the guidance does not preclude the use of SPVs in issuer credit obligations. Such structures are commonly utilized in project finance arrangements to separate business operations that support specific debt instruments, or to facilitate

¹ To clarify the phrase “supported primarily by the general creditworthiness of an operating entity,” this means that the full repayment is expected to come from cash flows generated by the operating entity, not from collateral, although secondary recourse to collateral may be present. If it is expected that a majority of repayment will come from operating entity cash flows, but it is expected that some cash flows will come from collateral, this investment does not qualify as an issuer credit obligation and shall be assessed as an asset-backed security. The expectation must be that full repayment will be generated from operating entity cash flows. For asset-backed securities, the expectation is that the source of cash flows will come from collateral, even though there may be secondary recourse to an operating entity.

efficient marketing of an issuer credit obligation (e.g. funding agreement backed notes). Although packaging investments together in an SPV, with an SPV-issued note may currently result with better RBC charges, such structures that simply reflect a pass-through of cash flows or performance from the underlying collateral and provide no economic difference than if holding the underlying collateral items directly should not be characterized as bonds.

- b. With regards to the prior interpretation that SSAP classification was based on the presence of prepayment risk, which was not an interpretation based on any explicit guidance to that effect, the presence or absence of prepayment risk will continue to play no role in SSAP classification. Classification is based on whether the investment has the substance of an issuer obligation or asset backed security. This distinction aligns the accounting and measurement with the characteristics of the bond. As asset backed securities rely on the cash flows of underlying collateral, the measurement method described in SSAP No. 43R, which requires a quarterly review of underlying cash flow assumptions, is appropriate regardless of whether variations in timing of cash flows impact the effective yield. This methodology captures variations in **both** timing and **amount** of the underlying cash flows.
32. Whether an issuer of debt represents an operating entity or ABS Issuer is expected to be clear in most instances, but certain instances may be less clear. Ultimately, for an issuer credit obligation, it comes down to whether support for repayment consists of direct or indirect recourse to an operating entity or entities. In addition to “traditional bond” structures previously included in SSAP No. 26R, examples of issuer credit obligations include:
- a. Investments in the form of securities for which repayment is fully supported by an underlying contractual obligation of a single operating entity. (e.g., CTLs, ETCs, other lease backed securities, Funding Agreement Backed Notes (FABNs), etc.). For purposes of applying this principle 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.
- b. Bonds issued by real estate investment trusts (REITS) or similar property trusts.
- c. Bonds issued by business development corporations, closed-end funds or similar operating entities, in each case registered under the 1940 Act. With this inclusion, it is important to highlight that the intent is specific to bonds issued from SEC-registered entities. The reference to “similar entities” is not intended to capture items issued from collateralized fund obligations (CFOs) or other such structures. Although some may consider CFOs to be similar to closed-end funds, that assessment is not supported for classification as an issuer credit obligation. Instruments considered to reflect CFOs (and other like structures) are required to be assessed as asset-backed securities for inclusion on Schedule D-1.
- d. Project finance debt issued by operating entities. These investments reflect financing of a single asset or “operation” (such as a toll road or power generation facility) that collateralizes a debt issuance and the cash flows produced by the asset/operation service the debt, where the issuer may also represent an operating entity. These designs have characteristics of both issuer credit operations, as the operation constitutes a stand-alone business, as well as characteristics of ABS, 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 holistically, these issuing entities are typically used to facilitate the financing of an operating component of a project sponsor or municipality. Although the use of a bankruptcy-remote entity (e.g., SPV) facilitates the efficient raising of debt as a source of

financing, the primary purpose is to finance an operating project. Therefore, when 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, the issuing entity shall be considered an operating entity despite certain characteristics that resemble ABS issuances.

- i. It is important to highlight that the guidance for project finance is strictly for instruments issued by operating entities, similar to other instruments that qualify as issuer credit obligations under the principles-based bond definition. Consistent with other concepts, the naming convention (e.g., referring to an instrument as project finance) or the presence or absence of an SPV/trust structure are not definitive components in determining whether an investment qualifies for reporting on Schedule D-1, or is classified as an issuer credit obligation or ABS. Instruments (even if identified as “project finance”) that do not qualify as issuer credit obligations as they not issued by operating entities, shall be assessed for qualification for reporting on Schedule D-1 as ABS. If the instruments do not qualify for reporting as ABS, they shall not be reported on Schedule D-1.
- e. U.S. Treasury Inflation-Protected Securities (TIPs): The inclusion of U.S. TIPs specifically as an issuer credit obligation intends to highlight a specific exception to the determination as a creditor relationship as the variation is due to plain-vanilla inflation adjustment mechanisms. Although U.S. TIPs are specific as issuer credit obligations, Under the bond definition encompassing both issuer credit obligations and asset-backed securities, in order for a debt instrument to represent a creditor relationship, 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 (e.g., performance) of any underlying collateral value or other non-debt variable². 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 variables are precluded from bond treatment as they do not reflect creditor relationships. Although US TIPS are indexed to the consumer price index and grows with inflation, these securities shall be captured as issuer credit obligations on Schedule D-1.

33. This Schedule D-1 project is not expected to reconsider certain investments previously considered by the Working Group and explicitly permitted for Schedule D-1 reporting. As such, unless subsequently addressed within this project, the following investment types are expected to continue to qualify as Schedule D-1 investments and be classified as issuer credit obligations. (By including these investments as issuer credit obligations, these investments are not subject to the assessments of sufficiency or meaningful cash flow generation required for ABS securities.)

- 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.

² The principles-based bond definition requiring pre-determined principal and interest payments with contractual payments that do not vary based on the performance of an underlying collateral value or other non-debt variable does not intend to encompass nominal interest rate adjustments. 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.

Principles-Based Bond Definition

- b. Bank loans that are obligations of operating entities, issued directly by a reporting entity or acquired through a participation, syndication or assignment.
- c. Debt instruments in a certified capital company (CAPCO).
- d. SVO-Identified Bond ETFs.

34. The investment structures explicitly permitted for Schedule D-1 reporting no longer includes a generic reference to “hybrid securities”. Under prior guidance in SSAP No. 26R, hybrid securities, defined in the Annual Statement Instructions as securities with characteristics of both debt and equity securities, were included and captured on a specific Schedule D-1 reporting line. Examples in the Annual Statement Instructions included Trust Preferred Securities and Yankee Tier 1 bonds, however, both types of securities are no longer overly prevalent, although some insurers may continue to have them in their portfolios. Pursuant to the intent of the principle-based bond proposal, a broad exception for securities that have characteristics of both debt and equity is not viable. Rather, to ensure that securities are classified and reported based on the substance of the investments, securities with characteristics of both debt and equity shall be assessed for inclusion on Schedule D-1 in accordance with the principal-based bond definition. If the securities qualify as issuer credit obligations or ABS, then they can be reported on Schedule D-1.

- a. Trust Preferred Securities – With these securities, there is a trust funded by debt where shares of the trust are then sold to investors in the form of preferred stock. The shares held are referred to as “trust preferred” securities. These securities have characteristics of both stock and debt. While the trust is funded with debt, the shares are considered to be preferred stocks and pay dividends like preferred stock. However, since the trust holds the bank’s debt as the funding vehicle, the payments received by investors are considered interest payments. These securities are considered equities under U.S. GAAP, but are taxed as debt obligations by the IRS. With the Dodd-Frank reforms, the incentives for banks to issue trust-preferred securities decreased, resulting with a significant reduction in the issuance of these securities. If these securities continue to be held by insurers, they should be assessed for reporting on Schedule D-1 under the principal-based bond proposal. If these securities do not qualify for Schedule D-1, presumably, these securities would be reported as preferred stock on Schedule D-2-1.
- b. Yankee Bond – A Yankee bond is one issued by a foreign bank or company but that is traded in the U.S and priced in U.S. dollars. Yankee bonds are normally issued in tranches, with a large debt structure financing arrangement, with each tranche having different levels of risk, interest rates and maturities. The non-U.S. issuers have to register Yankee bonds with the SEC before offering the bond for sale. If these securities are held by insurers, they should be assessed for reporting on Schedule D-1 under the principal-based bond proposal.
- c. Other Hybrid Securities – From information received, it was noted that some reporting entities have previously reported securities on Schedule D-1 as hybrids due to a code in Bloomberg that identified the security as having characteristics of both debt and equity. Such securities shall be reviewed in accordance with the principles-based bond definition and reported on Schedule D-1 only if they qualify.

35. For securities that represent principal-protected securities and structured notes that have been previously captured within SSAP No. 26R or SSAP No. 43R, the principles-based bond definition will no longer permit these security structures to be reported on Schedule D-1. Fundamentally, these structures

have the potential for variable principal or interest / returns, or both, due to appreciation or depreciation (i.e., performance) of an underlying collateral value or other non-debt variable. This structural characteristic precludes these investments from being captured as issuer credit obligations or ABS as the investment does not represent a creditor relationship in substance. It should be clear that the principles-based bond definition is intended to require a structural assessment inclusive of all investment components, therefore it is not permissible to segregate components within a structure, such as bond collateral supporting principal and interest payments to determine Schedule D-1 reporting when the structure also includes other collateral with the potential to generate additional interest or returns. Such structures must be viewed holistically within the principles-based bond definition, with all potential returns considered in determining whether the structure qualifies as a creditor relationship.

- a. A principal-protected security is defined in *the Purposes and Procedures Manual of the NAIC Investment Analysis Office*, but generally includes a high-quality traditional bond (such as a U.S. Treasury) that is used to safeguard principal repayment at the structure's maturity, has along with performance components where payments originate from, or are determined by, non-fixed income securities. These returns, often based on underlying equity factors, prevents these structures from qualifying as a creditor relationship. In addition to the traditional design of principal-protected notes, other designs have been identified that may provide "interest" payments in the form of tax-credits based on underlying equity exposures. (So, a high-quality bond still safeguards principal returns, but the structure acquires equity elements that provide tax credits to the note holder as a form of interest.) Although the classification of a creditor-relationship may not be as clear in this example, such designs would further be disqualified from Schedule D-1 reporting as they would not qualify as issuer credit obligations due to the different forms of collateral within the structure (considering both the bond and equity items) and such structures would not qualify as ABS as there is generally no credit enhancement. These investments shall follow the guidance for non-bond securities in *SSAP No. 21—Other Admitted Assets*.
- b. A structured note is a security that otherwise meets 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 failure of the borrower to pay the principal amount due. These instruments, 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. 43R*. Foreign-denominated bonds subject to variation as a result of foreign current fluctuations are not structured notes.

36. The guidance in the principles-based bond proposal requires "assessment at origination" in determining whether a security complies for Schedule D-1 reporting. This provision intends to reflect the reporting entity's understanding of the intent and ultimate structure of the security at origination, not simply what a structure holds on the day of origination. It is not permissible to conclude that a principal-protected security is an issuer credit obligation at origination (when the structure includes only a US Treasury and cash) and disregard the intended use of the cash in the structure to subsequently acquire other investments to generate additional returns. The determination of whether an investment qualifies as a creditor-relationship, and then as an issuer creditor obligation or ABS (as applicable) requires an assessment of the full structure as it is ultimately intended by the reporting entity at the time of acquisition.

37. Consistent with prior guidance in SSAP No. 26R, mortgage loans and other real estate lending activities, which are not securities, made in the ordinary course of business are excluded from Schedule D-1. Those investments shall follow the application statutory accounting guidance in *SSAP No. 37—Mortgage Loans* and *SSAP No. 39—Reverse Mortgages*.

Asset Backed Securities and Required Components

38. An Asset Backed Security (ABS) is a bond issued by an entity (an ABS Issuer) created for the primary purpose of raising debt capital backed by financial assets or cash generating non-financial assets owed by the ABS issuer, whereby repayment is primarily derived from the cash flows associated with the underlying defined collateral rather than the cash flows of an operating entity. 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. As previously noted, ABS Issuers are often in the form of a trust or special purpose vehicle, though the presence or lack of a trust or special purpose vehicle is not a definitive criterion for determining that a security meets the definition of an asset backed security.

39. To qualify on Schedule D-1 as an ABS, there are two defining characteristics that must be present. If the structure is a not an issuer credit obligation or identified for specific inclusion on Schedule D-1, and does not meet these ABS requirements, the instrument is not permitted to be reported as a bond. Assessment on these aspects is investment specific, with determination at origination by the reporting entity based on the overall intent and ultimate expected holdings of the structure:

- a. **Substantive Credit Enhancement:** The holder of the debt obligation issued by the ABS Issuer is in a different economic position than if the holder owned the ABS Issuer's assets directly.
- b. **Collateral Assets:** The assets owed 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 source of cash flows for repayment of the bond through use, licensing leasing, servicing or management fees, or other similar cash flow generation. other than through the sale or refinancing of the assets.

40. **Substantive Credit Enhancement:** The component for substantive credit enhancement is required for all ABS structures. There are no practical expedients or thresholds that can be applied in determining whether a structure reflects substantive credit enhancement. Although certain structures may only require a limited analysis (such as agency-backed MBS), and insurers may benefit from prior analysis when acquiring similar subsequent structures, an automatic assessment is not permitted for this requirement.

41. To qualify as an ABS, the holder of the debt obligation is required to be in a different economic position than if the holder owned the ABS issuer's assets directly. For purposes of this assessment, the holder of the instrument is considered to be in a different economic position if the instrument benefits from substantive credit enhancement through guarantees (or other similar forms of recourse), subordination and/or overcollateralization. This element is required for all ABS designs, regardless of the collateral that is backing the ABS.

42. The requirement for substantive credit enhancement is intended to address investment designs crafted to appear as a debt / bond structure for reporting and RBC purposes, but for which the holder does not have a "more than nominal" change to the risk or reward profile than if they held the underlying investment directly. This guidance prevents using a specifically designed legal form (such as transferring assets to an SPV and acquiring an SPV-issued note), but which lacks any economic substance, to obtain

favorable measurement and RBC impact or to avoid nonadmittance that would occur if the assets were directly held by the reporting entity.

43. The intent of the “substantive” threshold 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 a bond 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 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 investment 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.

44. The original exposure (May 2021) detailed this ABS requirement as a “sufficient” credit enhancement and detailed the provision as the level of credit enhancement a market participant (i.e., reasonable investor) would conclude is expected to absorb losses (or decreases in cash flows) to the same degree as other debt instruments of similar quality, under a range of stress scenarios (i.e., scenarios are similar to stress scenarios performed for other debt instruments of the same quality). This original proposal noted that losses are those a market participant would estimate with consideration of historical losses (including loss recoveries) on similar collateral, current market conditions, reasonable and supportable forecasts, and prepayment assumptions associated with the collateral. Excluded from the estimate of expected losses are historical gains on similar collateral and expected market appreciation on the collateral. After further discussion of this concept, it was identified that the term sufficient and its proposed definition implies a quantitative assessment of credit quality is required. As a result, the proposed concept could be interpreted to mean that a reperformance of the credit underwriting process would be needed to support accounting classification, which is not the intent and could be seen to violate the policy that credit ratings not determine accounting classification, as well as introduce an administrative reporting burden that is both duplicative and lacking any added value. Further, a misinterpretation could occur that would permit satisfaction of this component if a credit rating or NAIC designation was obtained. The intent of the concept is not to address credit quality. Rather, the intent is to require that there must be economic substance to support the transformation of the underlying collateral risk, to bond risk. As a result of these discussions, revisions were incorporated to revise the terminology and related definition to reflect a “substantive credit enhancement.” In addition to eliminating a perception that reporting entities could use credit ratings to support this distinction, this guidance incorporates principle concepts to ensure that the provision cannot be satisfied with structural elements that are merely nominal or lack economic substance.

45. Substantive credit enhancement can come in various forms, including but not limited to, subordination/overcollateralization, guarantees, or other forms of recourse. In whatever form the credit enhancement comes in, it must be of a level of significance that the holder of the debt instrument is in a substantively different position than owning the underlying collateral directly. Evaluation of whether a credit enhancement has substance may involve an evaluation of the level of overcollateralization (LTV) or the capacity of whatever form of subordination, guarantee or recourse to absorb collateral losses. As noted, the guidance intends to be specific that an NAIC designation, obtained from either the NAIC Securities Valuation Office (SVO) or from a Credit Rating Provider (CRP) does not provide standalone evidence to support a conclusion that the structure includes a substantive credit enhancement. Although the presence of independent market validation may provide evidence supporting the substance of a credit enhancement, that provision shall not be interpreted to indicate that the presence of an NRSRO rating is automatic validation that the substantive threshold has been met.

46. The following elements were specifically discussed with regards to the requirement for a substantive credit enhancement:

Principles-Based Bond Definition

- a. Agency-Backed Pass-Through Structures (e.g., RMBS/CMBS): These structures, when they have an agency guarantee, are expected to meet the substantive credit enhancement requirement with little analysis. 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 mortgages directly because the credit risk has been redistributed and assumed by the agencies.
- b. Non-Agency Backed Pass-Through Structures: Unlike the above agency-backed example, a pass-through MBS without a credit enhancement, if one were to exist, would not put the holder in a different economic position as owning the mortgage loans directly as they would participate proportionally in the first dollar of losses on the underlying loans. Pursuant to the intent of the overall Schedule D-1 project and required substantive credit enhancement, the guidance does not permit use of an SPV to recharacterize an asset to qualify for Schedule D-1 reporting if the holder is in the same economic position as holding the underlying investments directly. This would apply to any type of underlying asset. In contrast, if the holder of the debt instrument held a senior interest in the pool of loans, through existence of a subordinated tranche for example, the holder may conclude that it is in a different economic position, provided the subordination is determined to be substantive.
- c. Loan-To-Value (LTV) Assessments: An assessment of LTV at origination may provide evidence of substantive credit enhancement through overcollateralization. The review should be a holistic assessment, evaluating the expected LTV over the life of the transaction, in conjunction with the liquidity and market value volatility of the underlying collateral, particularly in points in time when the underlying equipment is expected to be off-lease or at the time of maturity if refinancing or sale is required. It is appropriate to consider any expected economic depreciation, but it is not appropriate to factor in any expected economic appreciation. Although an expected decline in the LTV ratio may support the presence of a credit enhancement, a declining LTV is not required, and an increasing LTV is not prohibited, as long as the structure continues to provide a substantive credit enhancement. An expected high LTV at maturity, relative to the market value volatility of the underlying collateral, is considered to lack substantive overcollateralization and would require other forms of credit enhancement in order to meet the substantive credit enhancement criteria.
- d. The first loss position may be issued as part of the securitization in the form of debt or equity interest, or it may be retained by the sponsor and not be issued as part of the securitization. The holder of the loss position, or whether it is issued as a tranche or retained by the issuer, does not impact the determination of whether the loss position provides substantive credit enhancement. Rather, the assessment focuses on whether the holder of the debt instrument is in a substantively different position than owning the underlying collateral directly. This assessment include consideration on the first loss position (or more senior positions, if the first loss position is not sufficient) regardless of the holder of the loss positions. 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 ~~should be reported as a non-bond security pursuant to~~ SSAP No. 21R—Other Admitted Assets.)

47. Meaningful Level of Cash Flows to Service Debt: The element for meaningful cash flow generation is only a requirement for ABS that are backed by non-financial assets. ABS designs backed by financial assets, when there is no future performance obligation outside of default risk that could impact the ability to generate cash flows to service the debt, are not required to be assessed under the meaningful cash flow requirement.

48. To qualify as an ABS, there must be a meaningful level of cash flows generated from non-financial assets backing an ABS to service the debt, other than through the sale or refinancing of the assets. The evaluation is specific to each transaction and should consider the market volatility and remarketing potential of the underlying collateral, the variability of the cash flows produced, as well as the diversification of the source of cash flows within the structure. The main intent of this guidance is to ensure that non-financial assets supporting structures reported as bonds on Schedule D-1 encompass a level of “cash generation” that is conducive to servicing traditional bond-like cash flows.

49. Consistent with the substance theme of the principles-based bond proposal, this guidance intends to prohibit situations in which the legal form of an investment is utilized to receive favorable accounting and reporting treatment, while the primary non-payment risk is the point-in-time valuation of an underlying asset. The prior guidance in SSAP No. 43R that focused on placing collateral assets in trust, with the SPV issuing a debt instrument, enabled situations in which non-cash generating structures could be reported as bonds on Schedule D-1. As a simple example, this guidance prevents artwork from being captured as the collateral backing a debt instrument issued by an SPV, with the reporting entity then reporting the SPV-issued note as a bond investment that reflects the expected future value that will be received upon the ultimate sale of the artwork.

50. The guidance requires meaningful cash generation to satisfy the debt instrument throughout the duration of the debt term. The timing of the cash generation, at points prior to maturity of the investment, is a key element as it intends to specifically exclude transactions in which the underlying assets must be sold or refinanced at maturity to produce cash to meet the meaningful requirement. However, this restriction is not intended to automatically exclude all structures that may incorporate collateral asset sales or refinancing throughout the debt duration as part of the expected cash generation. An example could be the securitization of short-term rental car receivables. Such a design could encompass both the rental car lease payments as well as periodic sales of the rental cars as the means to generate meaningful cash flows to service the debt. This design, with planned periodic sales of the non-financial collateral assets over the debt term, is distinctly different than a structure in which cash flows are not meaningfully generated over the course of the debt term and would rely predominantly on the sale or refinancing of the underlying collateral at maturity to satisfy the debt obligation. This restriction also does not exclude all structures that have any amount of sales or refinancing at the end of the debt term. Such investments can qualify for Schedule D-1 reporting if they meet the meaningful cash generation criteria throughout the term of the instrument other than through the sale/refinancing at maturity.

51. The assessment of meaningful cash flows may require detailed evaluations as it is not permissible to conclude that the presence of any cash flows generated within the structure will result with the investment reaching the “meaningful” threshold. It is also not expected to commonly see asset-backed securities that include both financial and non-financial collateral. Such designs shall be reviewed to determine that the structure is in line with the principle intent of the bond definition and has not been developed to circumvent separate assessment or reporting of non-financial asset components. As a simplistic example, including mortgage-backed securities and artwork in a single structure, and identifying that the cash flows of the MBS satisfies the meaningful threshold, with the artwork representing a minimal residual element, so that the full structure qualifies for Schedule D-1 reporting is not reflective of the intent of the principles-based standard. If there are instances in which financial asset and non-financial asset collateral are combined in a single asset-backed structure, consideration should occur on the intent of commingling these collateral elements pursuant to the intent of the principles-based bond definition and in assessing the meaningful cash flow requirements. Structures identified that have been developed to circumvent the provisions of the

principle-based bond definition are not permitted to be reported on Schedule D-1 and shall be reported on Schedule BA at the lower of amortized cost or fair value.

52. The assessment of meaningful cash flows is specific to each transaction, determined at origination, and should consider various factors collectively in determining if the meaningful threshold is met. For this assessment, it is noted that an increase in price volatility or variability of cash flows requires a greater percentage of cash flows generated to service the debt from sources other than the sale or refinancing of the underlying collateral. On the flip side, 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 is permitted to decrease. The following factors should be considered with the assessment of meaningful cash flows:

- a. Price volatility in the principal market in the underlying collateral.
- b. Liquidity in the principal market for the underlying collateral.
- c. Diversification characteristics of the underlying collateral (i.e., types of collateral, geographic locations, sources of cash flows within the structure, etc.,)
- d. Overcollateralization of the underlying collateral relative to the debt obligation.
- e. Variability of cash flows, from sources other than sale or refinancing, expected to be generated from the underlying collateral.

53. The assessment of meaningful cash flows does permit a practical expedient under the principles-based bond definition. 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 asset may be considered. This practical expedient should not be construed to mean that assets cannot meet the meaningful criteria if they rely on the 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 do not qualify under the practical expedient and would require a complete analysis of the noted factors.

Additional Elements for Asset Backed Securities

54. When establishing the ABS definition and required components, various aspects were discussed to improve clarity on the application of the guidance.

55. Determination of “Assets” Backing Securities: Although the definition of an asset detailed in SSAP No. 4 is applied throughout the statutory accounting principles, the question was raised as to where the asset definition would be applied in determining a qualifying ABS. For example, an entity that expects to have subsequent receivables from future operations does not have recognized “assets” from those expectations as the requirements of the asset definition have not been met. However, if that entity were to sell the rights to future cash flows from expected operations, the selling entity would receive cash (a qualifying asset), and the acquiring entity would also have a recognized asset from the acquired right to future cash flows.

56. For purposes of qualifying as an “asset” permitted in an ABS structure, the definition of an asset must be met by the ABS issuer. In some situations, particularly when the asset represents a right to future cash flows, the asset may not be in a form that could be liquidated to provide payment towards the debt obligations. (For example, if the asset represents acquired rights to future royalties, those royalty rights would have to materialize to have liquid assets available toward the debt obligations.) The ability to liquidate the backing collateral asset at a single point in time does not impact the structural determination of whether the issued security meets the definition of an ABS provided that the assets are expected to produce meaningful cash flows to service the debt terms. Additionally, the inability to liquidate the assets

backing the instrument may impact the assessment of what constitutes substantive credit enhancement. Failure of cash flows to materialize may impact recoverability and require impairment of an ABS.

57. There is no requirement for a collateral asset backing an ABS structure to qualify as an admitted asset under statutory accounting. Assessing whether the underlying asset qualifies for admittance is not necessary as non-financial assets backing ABS must meet the meaningful cash-generating criteria. If the structure fails to meet the meaningful cash-generating requirement, the instrument does not qualify for reporting on Schedule D-1. Note that statutory accounting has not historically restricted bonds backed by inadmissible assets from being admissible either, nor has it included any kind of evaluation of the cash flow producing ability of underlying assets. The proposed bond definition adds a requirement to evaluate the cash flow producing ability of the underlying collateral, but continues to recognize that assets that may not be admissible if held individually on an insurer's balance sheet, may be well suited to support bond-like cash flows when securitized in large numbers with appropriate structuring (e.g. prioritization of cash flows).

58. Determining Whether the Structure Reflects "Financial" or "Non-Financial" Assets: – The definition of a "financial asset" has previously been adopted from U.S. GAAP and is reflected in *SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* as cash, evidence of an ownership interest in an entity, or a contract that conveys to one entity a right 1) to receive cash or another financial instrument from a second entity or 2) to exchange other financial instruments on potentially favorable terms with the second entity.

59. For purposes of excluding financial assets from the ABS meaningful cash generation criteria, the financial asset definition was clarified, for the avoidance of doubt, to not include assets for which the realization of benefits conveyed by the rights to receive or exchange financial assets depends on the completion of a performance obligation such as with a lease, mortgage servicing right, royalty rights, etc. For purposes of applying the ABS guidance, when there is a performance obligation required before the cash flows are generated, the assets represent non-financial assets, or a means through which non-financial assets produce cash flows, until the performance obligation has been satisfied. As another way to assess this clarification, if the assets backing the ABS are only subject to default risk (meaning the risk of nonpayment is solely based on failure of the underlying payer to satisfy its unconditional promise to pay), then the asset is a financial asset. If the asset is subject to any other risk in addition to default risk, then the assets represent non-financial assets. As simple illustrative examples:

- a. A mortgage-backed security (MBS), where the underlying mortgages have been securitized into a structure, the mortgage receivables represent unconditional promises to pay, with no further performance obligation of the lender or any other party. This structure is considered to be backed by financial assets. Although this structure is excluded from the meaningful cash flow assessment, it must still comply with the substantive credit enhancement requirement
- b. A structure that represents the securitization of rental car leases is contingent on the lessor performing its side of the transaction (providing the car for use) before the lessee is obligated to pay. Therefore, a lease is a non-financial asset due to the performance obligation that must be satisfied in order for payment to become unconditional. Additionally, as is the case with short-term car rentals, the lease (rental agreement) may not themselves be in place and the structure may represent a securitization of the rights to future rental payments, which adds an additional performance condition. This structure combines performance risk with default risk, resulting with the structure not qualifying for classification as being backed by financial assets. For this structure, the reporting entity would have to complete assessments that 1) the structure results with substantive credit enhancement and 2) the structure produces meaningful cash flows over the term of the instrument to satisfy the debt obligation other than through the sale or refinancing at maturity. If at origination, the cash flows from the underlying collateral (rental cars) are

expected to generate at least 50% of the original principal, then the meaningful criteria would be met through the practical expedient.

60. Whole-Business Securitizations: In most ABS structures, the assets backing the cash flows are specified and limited to a distinct collateral pool. For example, dedicated cash flows from specific lease arrangements, or specific receivables from credit cards or mortgages. However, ABS structures can exist that represent an entire range of operating revenues or cash flows generated by the business. These structures are often referred to as “whole business” or “operating asset” securitizations.” These structures (which could only include cash flows from certain operating segments, and not necessarily the entire business of a company’s operations) transfer the cash flows from the dedicated operations first to the investment holders, with the operating entity receiving their “operation proceeds” after the investment holders have been paid. This is different from a traditional bond structure where the operating entity first receives the proceeds from their operations, and has discretion for how it uses those proceeds to continue operations and pay expenses and then ultimately pay the bond holders according to the debt terms. Further, debt holders in a whole-business securitization generally only have recourse to the cash flow streams pledged to support the debt, unlike a general credit obligation of the operating entity.

61. For the principles-based bond definition, structures that refer to whole-business securitizations, or that refer to operation proceeds as the collateral for the source of debt repayment still meet the definition as an ABS and do not reflect issuer credit obligations. For these structures, the dedicated operational cash flows represent the defined collateral pool and should not be classified as issuer credit obligations based on an interpretation that the proceeds represent the cash flows of an operating entity as they are not supported by the general creditworthiness of an operating entity, but rather only on referenced cash flow streams from operations.

62. Residual Tranches / “Equity” Components of Schedule D-1 Qualifying Structures: The assessment of qualifying Schedule D-1 investments has to consider the overall investment structure but focuses primarily on the specific instrument held by the reporting entity. Structures, particularly ABS, may include residual tranches that do not have contractual principal or interest payments, but rather provide payment after contractual principal and interest payments have been made to other tranches or interests based on remaining available funds. Although payments to residual note holders could 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. In all instances, despite whether other tranches of the investment structure qualify for Schedule D-1 reporting, residual tranches do not qualify for reporting on Schedule D-1.

63. Under prior guidance in SSAP No. 43R, there was no exclusion that restricted residual tranches of qualifying securitizations from being captured in scope and being reported as bonds. From the outreach performed in developing the principles-based bond definition, it was identified that several insurers have previously reported these residual tranches on Schedule BA: Other Long-Term Invested Assets. However, it was noted that some reporting entities have reported these tranches on Schedule D-1 as a component of the securitization or as a beneficial interest in scope of SSAP No. 43R. Although residual tranches (first loss tranches) are not rated, when reported on Schedule D-1, an NAIC designation would be required. From information obtained, entities reporting residual tranches on Schedule D-1 have either been reporting as self-assigned 6* or applied the NAIC 5GI concept to self-designate these securities. Under the 5GI concept, the P&P Manual permits self-designation as an NAIC 5 if the documentation necessary for a full SVO credit analysis does not exist, the issuer is current on all principal and interest payments, and the reporting entity has an expectation that they will receive all contracted interest and principal. The use of the NAIC 5GI concept to self-designate residual tranches on Schedule D-1 is a misapplication of this guidance. It is faulty to conclude that an investment is current and will provide all contractual interest and principal payments when the investment has no contractual interest or principal payments. Furthermore, the 5GI provision was intended to prevent an NAIC 6 designation simply because the documentation for a full credit analysis could not be provided or reviewed, such as situations involving foreign securities when the

supporting documents may be in a foreign language. The NAIC 5GI provision was not intended to permit self-assignment of an NAIC 5 designation to securities that would not qualify as a fixed-income instrument eligible for an NAIC designation under the P&P Manual.

64. With the identification that residual tranches are inconsistently reported, with some entities reporting on D-1 and others reporting on Schedule BA, the Working Group drafted and exposed agenda item 2021-15: SSAP No. 43R – Residual Tranches in September 2021 as an interim action prior to the conclusion of the bond proposal project. The guidance within this agenda item clarifies that residual tranches shall be reported on Schedule BA at lower of amortized cost or fair value. The guidance also clarifies that the reference to residual tranches intends to capture securitization tranches and beneficial interests, as well as other structures captured in scope of SSAP No. 43R that reflect loss layers without contractual interest or principal payments. Payments to holders of these items occur after contractual interest and principal payments have been made to holders of other tranches or interests and are based on the remaining available funds. Although payments can occur throughout an investment's duration, such instances still reflect the residual amount permitted to be distributed after other holders have received contracted interest and principal payments.

65. On November 10, 2021, the Statutory Accounting Principles (E) Working Group adopted the agenda item, clarifying that residual tranches are required to be reporting on Schedule BA: Other Long-Term Assets beginning December 31, 2022, with early adoption permitted. The effective date of this action allows time for reporting entities to implement this change and corresponds with a Blanks (E) Working Group proposal to incorporate separate reporting lines for residuals, based on underlying characteristics, on Schedule BA. With the adoption of this guidance, the Working Group noted that reporting entities may elect to reclassify residual tranches or interests to Schedule BA in advance of the effective date. As of the effective date, residual tranches or interests previously reported on Schedule BA shall be reclassified to the appropriate residual tranche Schedule BA reporting line based on the underlying characteristics of the investment structure.

66. Along with the action to specify the Schedule BA reporting for residuals, the Working Group and the Valuation of Securities (E) Task Force provided a joint memorandum to the Blanks (E) Working Group to specifically identify that application of the NAIC 5GI process is an inaccurate application. Residual tranches or interests reported on Schedule D-1 for year-end 2021 shall be reported with an NAIC 6. The Working Group also provided the Task Force a referral requesting clarification of the NAIC 5GI process so future misapplications could be mitigated. The Task Force considered specific changes to address residuals and adopted those revisions during the 2021 Fall National Meeting.

67. With the specific removal of residuals from being classified as a bond, guidance has been incorporated to SSAP No. 21R to specific and accounting and reporting guidance for residuals. This guidance has the following key aspects:

- a. Residuals are permitted to be admitted assets if debt securities from the same securitization qualify (or would qualify) as bonds under SSAP No. 26R as an issuer credit obligation or asset-backed security. If a debt security held from the same securitization is (or would be) nonadmitted, then any residual interests or first loss positions held do not qualify as admitted assets.
- b. Residuals shall be initially reported at cost, or allocated cost (using proportional fair values) if acquired along with debt tranches from the securitization. Subsequent to initial acquisition, residuals shall be reported at the lower of adjusted cost (as defined in paragraph 67c) or fair value, with changes in fair value (or from adjusted cost to fair value) reported as other-than-temporary impairments.
- c. The adjusted cost basis shall be calculated such that all cash flows received attributed to the residual tranche shall be treated as a return of principal and a reduction to the adjusted

cost. In other words, cash flows received as a holder of the residual tranche shall not be recognized as interest or investment income until the residual tranche has a BACV (adjusted cost basis) of zero. Once the residual has a zero BACV, cash flows received shall be recognized as interest income. The residual shall continue to be reporting on Schedule BA, with the zero BACV, with reporting of the received cash as interest income until the structure matures/terminates, is unwound or no longer meets the definition of a residual tranche. With this guidance, the BACV (adjusted cost basis) shall not be increased prospectively or retrospectively based on a reporting entity's estimates of future cash flows, and there shall be no amortization or accretion. Furthermore, adverse changes in estimated cash flows, resulting in an expectation that cash flows will not be received to cover the adjusted cost basis shall be recognized as an other-than-temporary impairment.

- a.d. At the point the residual ceases to meet the definition of a residual tranche (i.e., when all senior debt has been repaid), and the investment structure is expected to continue for more than a year, the investment shall be reclassified and accounting for prospectively in the scope of whichever SSAP applies. Although dependent on the resulting structure, presumably structures that cease to reflect a residual will likely be considered a debt security that does not qualify as a bod or an equity tranche in scope of SSAP No. 48. Reporting entities are not required to reclassify an investment if the resulting structure is unwound within 12 months of the senior debt being repaid.

66-68. Stapling of investments: The original exposure of the principles-based bond definition (May 2021) included an initial example (originally referred to as Appendix I – Example I) detailing a situation where “equity interests” from a tranche (such as residuals) were required to be held by a reporting entity when holding debt tranches. (That language identified situations where the reporting entity would be restricted from selling, assigning, or transferring the unsecured debt investment without also selling, assigning or transferring the equity interest to the same party. This restriction is often referred to as the “stapling” of investments.) Pursuant to the guidance in the original example, although the debt instrument would separately qualify as a creditor relationship for bond reporting, when considering the entirety of the holdings (both the equity interests and debt tranches combined), the investment would be considered an equity instrument in substance. Although the debt instrument would appear to have a higher priority of payment, that priority would be supported by the equity interest the reporting entity has to hold. (Ultimately, the reporting entity would be subordinate to themselves as they would recognize a loss on the equity tranche to safeguard payment under the debt tranche.) Under that initial proposed guidance, all holdings under such situations, including the debt tranches, would not qualify as creditor relationships and would not qualify for bond reporting.

67-69. After considering comments from the first exposure period, as well as discussing within the small group of industry and regulators, this example was eliminated from the principles-based bond definition. These discussions ultimately concluded that tranches that separately qualify as bonds should be reported as bonds even if other tranches from a structure that do not qualify as bonds are also held by the reporting entity. Elements noted as part of the decision to remove the stapling restriction include:

- a. A key element in the initial proposal to require the entire holdings as equity was to ensure that the risk of the holdings was properly captured. It was noted that recent developments to tranche investments that were previously reported as investments in LLCs or joint ventures could result in RBC arbitrage. This is because the risk of the investment would be concentrated in a specific tranche intended to absorb losses, and only that limited tranche would be reported on BA with higher RBC charges. This would allow the debt tranches (as they are subordinated by the equity tranche) to likely qualify as bonds with Schedule D-1 reporting and lower RBC charges. However, because risk has been concentrated into the smaller equity tranche as a result of leverage, and because Schedule BA RBC charges are fixed and insensitive to leverage, there is a lowering of risk-based capital in total despite

- no change in risk. The subsequent discussions highlighted that this is an RBC issue for the equity tranche and is not an accounting classification issue. As consideration on appropriate risk charges for residual tranches has been requested to the Financial Condition (E) Committee and is a discussion item for the RBC Investment Risk and Evaluation (E) Working Group, this issue is not within the focus of the Statutory Accounting Principles (E) Working Group. It was also noted that consideration of statutory accounting provisions (such as nonadmittance) to achieve a desired risk assessment would be an inappropriate use of the accounting guidance. It was also noted that the investments within scope of these discussions are likely permitted for admittance under state law, and differing SAP guidance would only result with identification of prescribed practices as domiciliary state laws and statutes are the ultimate authority for the application of SAP.
- b. It was also identified that the initial exposed example was specific to investments that were “stapled” under contractual terms. This guidance would have only been applicable to dynamics in which there was an explicit restriction in the sale, assignment, or transfer of the equity tranche separately from a debt tranche. It was identified that without an active market for equity tranches (which is common) the explicit restrictions would not be necessary to achieve a similar result. Structures would only need to be designed to require initial acquisition of equity tranches when acquiring debt tranches (with removal of the explicit disposal restrictions) to avoid the proposed stapling guidance. Since the proposed guidance could be easily avoided, the guidance would not address the underlying concern.
- c. This discussion noted that it is quite common for acquisitions to require purchases of a vertical slice of a structure and for investments to be stapled for a short duration of time. These provisions are generally done for easier marketing and for easier compliance with conflict-of interest provisions. The short-term aspect of some stapled investments raised concerns as to how bond-qualifying debt tranches would be reported if stapling provisions to an equity tranche were subsequently eliminated. This was identified as likely requiring a schedule move (from BA to D-1) with potential other accounting and reporting impacts (such as with NAIC designations and measurement method). This discussion noted that an issuer’s stapling of investments may reflect a legitimate business purpose, and not intend for RBC arbitrage, and the elimination of such components after the stated timeframe could cause confusion or unnecessary noise in the financial statements from the reclassification of investments. This discussion further supported that the acquisition of different tranches, even if explicitly stapled, should not prevent separate debt (bond) and equity recognition based on the characteristics of the specific tranche.

68-70. ABS as Short-Term or Cash Equivalents: With the required focus and requirements to be met for asset-backed securities, as well as dedicated reporting based on the underlying collateral assets, ABS will no longer be permitted to be reported as short-term or cash equivalents. All qualifying ABS will be required to be reported on Schedule D-1, even if acquired within one year or less from the maturity date, to allow for full assessment of the extent of ABS by the regulators. Investments captured in scope of *SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments* 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.

Key Discussions / Aspects in Developing the Definition:

69-71. Refinancing Risk / Residual Risk Exposure: Discussion of refinancing risk (where there is outstanding debt owed at maturity that will need to be refinanced for the remaining principal to be received by the note holder) was a key element discussed in accordance with the meaningful cash flows requirement

for non-financial asset backed securities. This discussion highlighted that traditional refinancing risk is accepted in the context of corporate debt but is viewed differently when assessing the cash flows of non-financial assets in an ABS structure. This differentiation was confirmed, with identification that there are concerns unique to non-financial asset-backed securities.

70-72. The requirement for a non-financial asset backed security to produce meaningful cash flows to service the debt other than through the sale or refinancing of the collateral assets ensures that structures captured on Schedule D-1 actually reflect bond-like cash flows. Structures that rely on the sale or refinancing at maturity to generate cash flows to repay debt obligations ultimately reflect a point-in-time reliance on the underlying collateral asset values that does not reflect the intent of Schedule D-1 reporting of bond-like cash flows. These structures are more reflective of the underlying collateral risk, ultimately contingent on the market at a future point in time and whether the underlying assets can be sold or refinanced in accordance with original expectations at the time of the structure origination.

71-73. A key comment raised by industry with regards to the meaningful cash flow requirement, and the restriction against relying on the sale/refinancing at maturity to produce meaningful cash flows, is that consideration should be given to the level of overcollateralization that exists in a structure if the meaningful requirement will not be met without sale or refinancing. These industry comments take the position that as the level of overcollateralization to the debt obligation increases, then there is a greater likelihood that the debt issuer will be successful in refinancing or selling the assets and generate the means to repay the debt obligation. Although overcollateralization is a factor in securities for bond classification, allowing overcollateralization to override the requirement for meaningful cash flows other than the refinancing / sale at maturity is not permitted for the following reasons:

- a. The intent of the principles-based bond proposal is to clarify what shall be reported as long-term bonds on Schedule D-1. Non-financial asset backed securities that do not generate meaningful cash flows and rely on the refinancing or sale of the underlying assets do not reflect bond-like cash flows and are not characteristic of bond investments. These structures ultimately reflect equity (point-in-time) valuation risks of the assets held as collateral.
- b. The industry position that overcollateralization safeguards the asset performance is an argument that supports the quality of the structure, but not the substance of the investment design. The principles-based bond proposal does not factor in investment or credit quality within the determination of whether a structure qualifies for reporting on Schedule D-1. Permitting an assessment based on overcollateralization would introduce a concept that credit quality determines Schedule D-1 reporting, and that is not an accurate conclusion in line with the principle concepts of bond classification.

72-74. Consistent with prior conclusions, reporting on Schedule D-1 is not indicative of the quality of the investment, but rather reflects securities expected to generate bond-like cash flows. Securities reporting on Schedule D-1 may be of high-quality or low-quality, but the reporting is based on the substance of the structure, which ultimately requires bond-like cash flows for all investments. This includes a requirement that non-financial asset backed securities must produce meaningful cash flows through the use of the underlying collateral assets other than through the sale or refinancing of the assets.

73-75. Additionally, through the small group discussions around the refinancing restriction noted above, it was noted that even if a debt instrument meets all of the criteria to be reported as a bond on Schedule D-1, there will still be a potential for unintentional RBC arbitrage related to securitizations, because the residual tranches absorb all of the redistributed risk of the underlying collateral, but receives a fixed RBC charge that is not in any way risk-rated. While this could be the case in any type of securitization, it is particularly pronounced if the underlying collateral is equity investments. Equity investments generally receive a 30% RBC charge for life companies. If equity investments are securitized, the bond tranches will

get low bond charges (<2%), while the residual tranche will continue to receive a flat 30% charge. This will have the effect of bringing the overall weighted-average capital charge on the underlying investments from 30% to approximately 10-15%, as an example. This will occur even if the bond tranches have all of the substance associated with a bond. Following these discussions, it was identified that this regulatory concern may not be able or appropriate to address through the accounting standards but may warrant discussion for the Capital Adequacy (E) Task Force. Subsequent discussions from the Financial Condition (E) Committee directed the new RBC working group (the RBC Investment Risk and Evaluation (E) Working Group) to evaluate this and any other investment-related RBC items.

74-76. Use of NAIC Designation / SVO Review in Determining Schedule D-1 Reporting: The accuracy of the financial statements, and compliance with statutory accounting provisions, is the responsibility of the reporting entity. Assessment and compliance with key concepts, such as the “meaningful” and “substantive credit enhancement” concepts for ABS are also the responsibility of the reporting entity, along with appropriate documentation of these assessments for regulator review when requested. As such, consistent with the existing *NAIC Policy Statement on Coordination of the Accounting Practices and Procedures Manual and the Purposes and Procedures Manual of the NAIC Investment Analysis Office*, a reporting entity cannot obtain an NAIC designation to conclude on the substance of an investment or the resulting reporting schedule. Pursuant to the policy statement, obtaining an NAIC designation does not change an investment’s applicable SSAP, annual or quarterly statement reporting schedule, or override other SSAP guidance required for an investment to be an admitted asset.

75-77. Questions have been received whether an NAIC designation in the AVS+ product or an assessment of an investment from an RTAS submission can be utilized as support that an investment qualifies for Schedule D-1 reporting. These are inaccurate interpretations on the use of NAIC designations within those products. The assignment of an NAIC designation (either from the SVO or CRP) reflects the credit quality of an investment. An assessment of credit quality does not provide assurances that the investment qualifies for reporting on Schedule D-1 as an issuer credit obligation or an ABS. As part of this project, consideration is planned to expand the ability to report and use NAIC designations on Schedule BA (or other schedules) so that investments that do not qualify as bonds can have appropriate risk assessments that factor in the credit quality of the investment. This capability would ultimately depend on action by the Capital Adequacy (E) Task Force.

76-78. Although the NAIC designation and RTAS processes cannot be used in determining Schedule D-1 compliance, it is envisioned that a small group of regulators and NAIC staff could be formed to review specific investment structures under the principle-based concepts to assist in assessments of complex new investment designs. It is anticipated that NAIC staff on the statutory accounting side and within the SVO would assist this small group.

77-79. Interest Only / Principal Only Strips: Discussion occurred on whether specific guidance should direct the reporting of interest only (IO) and principal only (PO) strips. The resulting conclusion from this discussion was that the principle concepts from the bond definition should continue to be applied for these investments. If the strips qualify within the definition as issuer credit obligations, they would be captured in scope of that guidance. If the strips qualified as asset-backed securities, they would be captured in scope of that guidance. It was noted that interest only strips shall also be assessed in accordance with the residual guidance. If the interest only strip reflects excess interest (e.g., remaining differential spread from interest collected from interest paid), these investments would be akin to a residual investment without contractual interest or principal payments and shall be captured in scope of that guidance. (Residuals are required to be reported on Schedule BA and not permitted to be reported on Schedule D-1.)

78-80. The discussion of IO/PO strips with industry representatives identified that they are not overly prevalent investments with insurance reporting entities. It was also noted that IO/PO based on RMBS are relatively rare due to the prepayment risk, however those based on CMBS generally have contractual provisions that prohibit prepayments, thus ensuring that they act more akin to typical bonds. This discussion further highlighted that changes to the principal-based bond definition are not justified for IO/PO

investments, and insurers should document their accounting policies for these investments to demonstrate compliance with the bond definition.

79-81. The discussion of IO/PO strips focused on U.S. Treasury strips and mortgage-backed securities as likely investments, but it was noted that the application of the overall bond definition concepts should be applied to any future design of these investments. Specific elements noted for the two general designs:

- a. U.S. Treasury Strips: Treasury Strips are created when a bond's coupons are separated from the bond. The coupons separated from the bond are also sold individually (IO), becoming separate securities from the principal payments due at maturity (PO). U.S. Treasury Strips are backed by the U.S. government. U.S. Treasury strips (IO/PO) were noted to be considered U.S. government issues and would be captured with other securities backed by the U.S. government as issuer obligations. Specific identification of U.S. Treasury strips as specific elements as issuer credit obligations, captured within the U.S. government category, was noted to be repetitive and not necessary.
- b. Mortgage-Backed Securities and Other Non-Treasury Strips: Other IO and PO strips are required to be assessed in accordance with the principle concepts of the bond definition. It is anticipated that non-U.S. strips (including mortgage-backed security strips) would not qualify as issuer credit obligations and shall be reviewed in accordance with the asset-backed security concepts to determine whether the strip qualifies for reporting on Schedule D-1. The separation of the principal and interest components into separate securities does not change the application of the principle concepts for determining whether a security qualifies as a bond. It was noted that IO strips could be high in the capital structure (supported by subordination) or could represent residual interests (reflecting the spread between proceeds collected and contractual interest). The specific details of the individual IO/PO security shall determine the appropriate accounting and reporting.

80-82. The discussion of IO/PO strips identified that there is likely no current need to have separate reporting lines to identify these items within the investment schedules. However, it was identified that the ability to identify these investments with a code (or other feature) would allow for future aggregation and assessment. This was requested to be considered as part of the reporting revisions.

81-83. Embedded Derivatives / Underlying Variables: Discussion occurred on the language that precludes bond reporting based on the appreciation or depreciation of an underlying collateral value or other variable. Although industry comments noted that the intent of the language was understood, it was identified that the language could be interpreted to mean that amounts in both the magnitude and timing of principal and interest payments must be known in advance, and it could also be interpreted to mean the amounts need to be contractual in nature but can still vary as long as the variability is not dependent on the appreciation or depreciation of an asset or variable. It was also noted that the reference to "other variable" could be interpreted to mean interest is not allowed to vary based on any variable or just the appreciation or depreciation of the variable. After discussing these comments, revisions were drafted to clarify that the exclusion is not intended to restrict variables that are commonly related to debt instruments such as but not limited to plain vanilla inflation or benchmark interest rate adjustments (such as with U.S. TIPs or SOFR-Linked coupons), scheduled interest rate step-ups, or credit-ratingquality-related interest rate adjustments. (As detailed in footnote 2, this exclusion is not intended to encompass nominal interest rate adjustments.) This guidance has also been incorporated within the provisions for determining whether a debt instrument represents a creditor relationship and is applicable for debt instruments structured as issuer credit obligations and asset-backed securities.

Accounting for Debt Securities That Do Not Qualify as Bonds:

~~82.84.~~ Securities that have a fixed schedule for one or more future payments, but for which the security does not qualify for bond reporting as an issuer credit obligation or an asset backed security shall follow specific guidance captured in SSAP No. 21R and be reported on Schedule BA. Investments in scope of this guidance are limited to:

- a. Debt securities for which the investment does not reflect a creditor relationship in substance.
- b. Debt securities that do not qualify for bond reporting due to a lack of substantive credit enhancement.
- c. Debt securities that do not qualify for bond reporting due solely to a lack of meaningful cash flows.

~~85.~~ The debt securities captured in the guidance within SSAP No. 21R meet the definition of assets as defined in SSAP 4 and are admitted assets to the extent they conform to the requirements within ~~the SSAP No. 21R statement. The provisions include specific guidance that debt securities for which the source of repayment is derived through rights to underlying collateral, qualify as admitted assets only to the extent they are secured by admitted invested assets.~~

~~83.86.~~ Debt securities in scope of this standard that do not qualify as bonds under SSAP No. 26R and for which the primary source of repayment is derived through rights to underlying collateral, qualify as admitted assets if the underlying collateral primarily qualify as admitted invested assets. As detailed in the section pertaining to residual tranches, any residual tranches or first loss positions held from the same securitization that did not qualify as a bond under SSAP No. 26R also only qualify to the extent the underlying collateral primarily qualifies as admitted invested assets.

~~84.~~ Debt securities that do not qualify for bond reporting due solely to a lack of meaningful cash flows shall be reported on Schedule BA: Other Long Term Invested Assets using the same accounting and measurement basis described in ~~SSAP 43R Asset Backed Securities~~, including using a carrying value method determined by NAIC designation. Reporting entities that are reporting an amortized cost measurement shall obtain an NAIC designation in accordance with the parameters of the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* and report the designation on Schedule BA.

~~85.87.~~ All other ~~d~~Debt securities in scope of the SSAP No. 21R guidance shall be reported at acquisition at cost, including brokerage and other related fees on Schedule BA: Other Long-Term Invested Assets. ~~These securities are permitted as admitted assets, with s~~Subsequent measurement shall reflect at the lower of amortized cost or fair value. Changes in measurement to reflect the lower value or to reflect changes in fair value shall be recorded as unrealized gains or losses.

~~86.~~ Debt securities that do not qualify as bonds shall follow the guidance in ~~SSAP No. 43R Asset Backed Securities~~ for calculating amortized cost, for determining and recognizing other than temporary impairments and for allocating unrealized and realized gains and losses between the asset valuation reserve (AVR) and interest maintenance reserve (IMR). Investment income shall be recorded, with assessments for collectability and nonadmittance completed and recognized, pursuant to ~~SSAP No. 34 Investment Income Due and Accrued~~. Disclosures are also included consistent with other invested assets.

Transition Guidance:

~~87.88.~~ 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~~acquisition, 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.

~~88:89.~~ 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 the transition guidance 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.

89-90. 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:

- c. Aggregate book adjusted carrying value for all securities reclassified off Schedule D-1.
- d. 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 the aggregate BACV reclassified off Schedule D-1 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.)
- e. 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.

91. 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 above, 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. Immediate 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.

90-92. 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.

Investment Examples – Securities That Do Not Represent Creditor Relationship Despite Legal Form

91-93. As detailed in the principles-based bond definition, an initial determinant in the principles-based bond definition is whether the investment is a security that represents a creditor relationship in substance. Examples included intend to identify scenarios that do not reflect an in-substance creditor relationship.

92-94. Example 1: Debt Instrument from SPV with Large Number of Diversified Equity Interests: A reporting entity invests in a debt instrument issued by a SPV that holds a large number of diversified equity interests with characteristics that support the production of predictable cash flows. The structure contains sufficient overcollateralization and liquidity provisions to ensure the production of adequate cash flows to service both principal and interest payments without significant reliance on refinancing or sale of the underlying equity investments. The debt instrument’s periodic principal or interest payments, or both, contractually vary based on the appreciation or depreciation of the equity interests held in the SPV.

93-95. Example 1 Rationale: Because the instrument's principal or interest payments, or both, contractually vary with the appreciation or depreciation of the underlying equity interests, it contains an equity-like characteristic that is not representative of a creditor relationship. It would be inappropriate to conclude that a security with any variation in principal or interest payments, or both, due to underlying equity appreciation or depreciation, or an equity-based derivative, is a bond under this standard as such security would contain equity-like characteristics.

94-96. Example 2: Debt Instrument from SPV with Few Equity Interests, Not an Issuer Credit Obligation: A reporting entity invests in a debt instrument issued from a SPV that owns a portfolio of equity interests, and the debt instrument does not meet the definition of an issuer credit obligation.

95-97. Example 2 Rationale: Determining whether debt instruments collateralized by equity interests qualify as bonds under this statement inherently requires significant judgment and analysis. Unlike debt instruments collateralized by assets with contractual cash flows, or debt instruments collateralized by cash-generating non-financial assets, debt instruments collateralized by equity interests may be dependent on cash flow distributions that are not contractually required to be made and/or may not be controlled by the issuer of the debt. In some instances, sale or refinancing of the underlying equity interests may be the only means of generating cash flows to service the debt instruments. As a result, there is a rebuttable presumption that a debt instrument collateralized by equity interests does not qualify as a bond. Notwithstanding this rebuttable presumption, it is possible for such debt instruments to qualify as bonds, 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:

- a. Number and diversification of the underlying equity interests
- b. Characteristics of the underlying equity interests (vintage, asset-types, etc.)
- c. Liquidity facilities
- d. Overcollateralization
- e. Waiting period for distributions/paydowns to begin
- f. Capitalization of interest
- g. Covenants (e.g., loan-to-value trigger provisions)
- h. Reliance on ongoing sponsor commitments
- i. Source(s) of expected cash flows to service the debt (i.e., dividend distributions from the underlying collateral vs. sale or refinancing of the underlying collateral)

96-98. 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.

97-99. Furthermore, this analysis should 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 large and 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.

Investment Examples – Analysis of ABS Under the Meaningful and Credit-Enhancement Concepts

98-100. All asset-backed security structures are required to provide substantive credit enhancement to qualify for Schedule D-1 reporting. Furthermore, asset-backed security structures that are backed by non-financial assets must generate meaningful cash flows to service the debt without reliance on the sale or refinancing at the maturity of the investment. Examples 4-7 provide examples of analysis under these criteria:

99-101. **Example 4 – Agency Mortgage-Backed Securities:** 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.

100-102. **Example 4 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., 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. 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 of the principles-based bond definition to determine if the holder is in a substantively different economic position than if the holder held the ABS Issuer’s assets directly.

101-103. **Example 5 – Debt Instrument Issued by an SPV:** 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 payment, 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 any defaulted lease payments. The loan-to-value (as a percentage of property value) at origination is 100%.

~~102.104.~~ 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.

~~103.105.~~ Example 5 Rationale: The reporting entity determined that a 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.

~~104.106.~~ 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 of the principles-based bond definition. 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., a knowledgeable investor transacting at arm's length) would consider this level of overcollateralization to put the investor in a substantially different economic position than owning the underlying property directly.

~~105.107.~~ 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.

~~106.108.~~ Example 6 – Debt Instrument Issued by an SPV With Lease Term Less than Debt Instrument: A reporting entity invested in a debt instrument with the same characteristics as described in Example 5, 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.

107.109. Example 6 – Rationale: All details of this example, including the expected collateral cash flows, are consistent with those in Example 5, except that the cash flows in Example 5 are contractually fixed for the duration of the debt while the cash flows in this example 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.

108.110. 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.

109.111. Example 7 – Lease in SPV with 80% Balloon Payment: 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%.

110.112. 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.

111.113. Example 7 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

112.114. The reporting entity also determined that the structure lacks a substantive credit enhancement to conclude that investors are in a different economic position than holding the equipment directly, in accordance with the requirements of the principles-based bond definition. 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.

~~113.115.~~ 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.

Reflecting the Principles-Based Bond Proposal in SSAP

~~114.116.~~ This issue paper proposes that statutory accounting principles reflect the principles-based bond concepts and the specific accounting guidance for bonds, including both ~~(issuer obligations)~~ and asset backed securities and debt securities that do not qualify as bond be captured as substantive revisions to ~~two~~ existing SSAPs:

- a. ~~SSAP No. 26R—~~Bonds
- b. ~~SSAP No. 43R—~~Asset-Backed Securities (renamed from Loan-Backed and Structured Securities)
- ~~b.c.~~ SSAP No. 21R—Other Admitted Assets

~~115.117.~~ For SSAP No. 26R, the revisions capture the full bond definition, determining whether a security qualifies as either an issuer credit obligation or an asset backed security. The accounting guidance for issuer credit obligations is retained within SSAP No. 26R and is not changed with the inclusion of the bond definition. Other revisions include transition guidance, to reclassify debt securities that do not qualify as bonds from Schedule D-1 to the subsequent schedule and to delete the glossary as no longer necessary.

~~118.~~ For SSAP No. 43R, revisions ~~have been proposed to~~ reorder and streamline the existing guidance. Although the broad measurement concepts and requirements to assess cash flows have not changed, the guidance specific to whether collection of cash flows is probable, not probable, or pertains to a beneficial interest has been eliminated. Instead, the guidance has been rewritten to provide consistent guidance for the assessment of cash flows and considering the impact of prepayments. These revisions are not expected to result in significant deviations from past practice, as the resulting guidance is believed to be reflective of prominent past industry interpretations. Clarifications have been included to ensure recognition of an other-than-temporary impairment whenever a security is in an impaired state (fair value is less than amortized cost, regardless if an unrealized loss has been recognized) and there is an adverse change in cash flows expected to be collected. Other revisions include transition guidance to reclassify debt securities that do not qualify as bonds from Schedule D-1 to the subsequent schedule as well as to incorporate guidance that prohibits reporting ABS as cash equivalents / short-term investments and transition to reclassify any securities reported as such as of the effective date.

~~116.119.~~ For SSAP No. 21R, revisions incorporate new guidance for the accounting and reporting for debt securities that do not qualify as bonds as well as residual interests. These investments are reported on Schedule BA in designated reporting lines.

~~117.120.~~ In addition to SSAP No. 26R and SSAP No. 43R, ~~Exhibit [redacted]~~, details “revisions to other SSAPs.” This section identifies all SSAPs that have modified guidance, including revisions to *SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments* to restrict ABS from being in scope ~~and SSAP No. 21R—Other Admitted Assets, which details the guidance for debt securities that do not qualify as bonds.~~

History of Definition / Scope Development of SSAP No. 43R – Before the Principles-Based Definition

The following section details the historical development of SSAP No. 43R along with the prior benefits for reporting investments in scope of SSAP No. 43R and key issues from the prior guidance. Due to various revisions that have been reflected since its original adoption, this information is retained for historical reference on the SSAP No. 43R guidance prior to the reflection of the principles-based bond proposal.

~~118.121.~~ *SSAP No. 43—Loan-backed and Structured Securities* was originally effective with the SAP codification and resulted with separate guidance for “bonds” (in SSAP No. 26) and “loan-backed and structured securities” (in SSAP No. 43). (The initial guidance indicated that investments in scope of SSAP No. 43 met the definition of a bond in *SSAP No. 26—Bonds, excluding Loan-backed and Structured Securities*.) Although most of the guidance between the original SSAP No. 26 and SSAP No. 43 was the same, the guidance in SSAP No. 43 recognized the need to review (at least quarterly) the assumptions and resulting cash flows of the underlying loans, as changes in assumptions could necessitate a recalculation of the effective yield or other-than-temporary impairment.

~~119.122.~~ The original issue paper to SSAP No. 43 (Issue Paper No. 43) cited guidance originally contained in Chapter 1, *Bonds and Loan Backed and Structured Securities*, from the *Accounting Practices and Procedures Manual of the Life and Accident and Health Insurance Companies*. The issue paper identified that the *Accounting Practices and Procedures Manual for Property and Casualty Insurance Companies* contained similar guidance. In this Issue Paper No. 43, and the original SSAP No. 43, loan-backed securities were defined as “pass-through certificates, collateralized mortgage obligations (CMOs) and other securitized loans...” The reference to “securitized loans” was a key aspect of this original definition.

~~120.123.~~ Original definition / scope guidance for SSAP No. 43:

2. Loan-backed securities are defined as pass-through certificates, collateralized mortgage obligations (CMOs), and other securitized loans not included in structured securities, as defined below, for which the payment of interest and/or principal is directly proportional to the interest and/or principal received by the issuer from the mortgage pool or other underlying securities.
3. Structured securities are defined as loan-backed securities which have been divided into two or more classes for which the payment of interest and/or principal of any class of securities has been allocated in a manner which is not proportional to interest and/or principal received by the issuer from the mortgage pool or other underlying securities.
4. Loan-backed securities are issued by special-purpose trusts (issuer) established by a sponsoring parent organization. Mortgage loans or other securities securing the loan-backed obligation are acquired by the issuer and pledged to an independent trustee under the issuer’s obligation has been fully satisfied. The investor can only look to the issuer’s assets (primarily the trustee assets or third parties such as insurers or guarantors) for repayment of the obligation. As a result, the sponsor and its other affiliates may have no financial obligation under the instrument, although one of those entities may retain the responsibility for servicing the underlying mortgage loans. Some sponsors do guarantee the performance of the underlying loans.
5. Loan-backed securities meet the definition of assets as defined in *SSAP No. 4—Assets and Nonadmitted Assets* and are admitted asset to the extent they conform to the requirements of this statement.

~~121.124.~~ In agenda item 2007-26, *FAS 156: Accounting for Servicing of Financial Assets an amendment of FASB Statement No. 140*, the Working Group adopted with modification FAS 156 in *SSAP No. 91R—Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, revising the terminology for “retained interests” to “interests that continue to be held by the transferor.” This action also clarified that beneficial interests from the sale of loan-backed and structured securities shall be accounted for in accordance with SSAP No. 43. This initial adoption identified that the holder of a beneficial interest in securitized financial assets should recognize the excess of all cash flows attributed to the beneficial interest estimated at the acquisition date over the initial investment as interest income over the life of the beneficial interest using the effective yield method.

~~122.125.~~ In 2009, the Working Group adopted a substantively-revised SSAP No. 43R (effective September 30, 2009). The focus of the substantive revisions was to revise the valuation and impairment requirements based on the cash flows expected to be collected for the securities, rather than fair value. Although the focus of the revisions was inclusion of impairment guidance based on whether an entity has an intent to sell, whether an entity does not have the intent and ability to hold a security, and when there is a non-interest related decline if there is no intent to sell and the entity has the intent and ability to hold, the revisions resulted in a significant rewrite of the guidance in SSAP No. 43R, including the guidance for beneficial interests. This guidance expanded the prior scope inclusion from “beneficial interests from the sale of LBSS,” to include “purchased beneficial interests in securitized financial assets.”

~~123.126.~~ In agenda item 2010-12, *Clarify Definitions of Loan-Backed and Structured Securities*, the Working Group received a regulator-sponsored, nonsubstantive Form A with a proposal to revise the definitions of a loan-backed and structured security (LBSS). As a result of this proposal, the definition was revised to eliminate the reference to “securitized loans” and instead refer to “securitized assets.” These revisions were adopted with an effective date of January 1, 2011.

- a. Although the agenda item simply identifies that this item was exposed in August 2010, and then adopted after a single exposure in October 2010, with an effective date of January 1, 2011, there were significant comments received during the exposure period. In short summary, these comments highlighted that the scope of the changes were intended to move fixed-income assets that had been accounted for as bonds under SSAP No. 26 to SSAP No. 43R as LBSS. Particularly, the comments noted concerns with the movement of equipment trust certificates and credit tenant loans from the accounting provisions of SSAP No. 26 to the accounting rules of SSAP No. 43R. These comments stated that “instruments with radically different sources of cash flows and risk characteristics utilize trust structures, and not all should be classified as loan-backed.” There were no changes incorporated to the proposed guidance as a result of these comments, and the revisions were adopted as exposed.

~~124.127.~~ In 2019, revisions to the definition and scope section were also adopted to clarify the identification of affiliate/related party transactions (agenda Item 2019-03) as well as to explicitly capture mortgage-referenced securities issued from a government sponsored enterprise in scope of SSAP No. 43R (Agenda Item 2018-17). The inclusion of mortgage-referenced securities was a distinct departure from the “trust” structure required in determining inclusion within scope of SSAP No. 43R, but was incorporated as the securities (with the referenced pool of assets), functions similarly to the securities held in trust and the referenced pool of assets can be assessed for the underlying credit risk

~~125.128.~~ Between the adoption of agenda item 2010-12 and the items adopted in 2019, there were several revisions to SSAP No. 43R, but those revisions did not impact the definition / scope of the statement. Those revisions included changes to incorporate price-point NAIC designations, guidance for interim financials for RMBC/CMBS, clarification of disclosures, updating Q/A guidance, and guidance for prepayment fees.

~~126.129.~~ Definition of loan-backed and structured securities in the “As of March 2020” AP&P Manual:

2. Loan-backed securities are defined as securitized assets not included in structured securities, as defined below, for which the payment of interest and/or principal is directly proportional to the payments received by the issuer from the underlying assets, including but not limited to pass-through securities, lease-backed securities, and equipment trust certificates.
3. Structured securities are defined as loan-backed securities which have been divided into two or more classes for which the payment of interest and/or principal of any class of securities has been allocated in a manner which is not proportional to payments received by the issuer from the underlying assets.
4. Loan-backed securities are issued by special-purpose corporations or trusts (issuer) established by a sponsoring organization. The assets securing the loan-backed obligation are acquired by the issuer and pledged to an independent trustee until the issuer’s obligation has been fully satisfied. The investor only has direct recourse to the issuer’s assets, but may have secondary recourse to third parties through insurance or guarantee for repayment of the obligation. As a result, the sponsor and its other affiliates may have no financial obligation under the instrument, although one of those entities may retain the responsibility for servicing the underlying assets. Some sponsors do guarantee the performance of the underlying assets.
 - a. In determining whether a loan-backed structure is a related party investment, consideration shall be given to the substance of the transaction, and the parties whose action or performance materially impacts the insurance reporting entity holding the security. For example, although a loan-backed security may be acquired from a non-related issuer, if the assets held in trust predominantly³ 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, and the transaction shall also subject to the accounting and reporting provisions in *SSAP No. 25—Affiliates and Other Related Parties*.
5. Mortgage-referenced securities do not meet the definition of a loan-backed or structured security but are explicitly captured in scope of this statement. In order to qualify as a mortgage-referenced security, the security must be issued by a government sponsored enterprise⁴ in the form of a “credit risk transfer” in which the issued security is tied to a referenced pool of mortgages. These securities do not qualify as “loan-backed securities” as the pool of mortgages are not held in trust and the amounts due under the investment are not backed or secured by the mortgage loans. Rather, these items reflect instruments in which 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

³ 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.

⁴ Currently, only Fannie Mae and Freddie Mac are the government sponsored entities that issue qualifying mortgage-referenced securities. However, this guidance would apply to mortgage-referenced securities issued by any other government sponsored entity that subsequently engages in the transfer of residential mortgage credit risk.

borrowers in the referenced pool of mortgages. Unless specifically noted, the provisions for loan-backed securities within this standard apply to mortgage-referenced securities.

6. Investments within the scope of this statement are also subject to the provisions and disclosure requirements of SSAP No. 25 if the SSAP No. 43R transaction is a related party arrangement⁵. Loan-backed and structured 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.

7. The scope of this statement encompasses all types of loan-backed and structured securities, including, but not limited to, the following:

- a. Loan-backed and structured securities acquired at origination,
- b. Loan-backed and structured securities acquired subsequent to origination for which it is probable, at acquisition, that the reporting entity will be able to collect all contractually required payments receivable, and are accounted for at acquisition under SSAP No. 103R,
- c. Loan-backed and structured securities for which it is probable, either known at acquisition or identified during the holding period⁶, that the reporting entity will be unable to collect all contractually required payments receivable, and
- d. Transferor's beneficial interests in securitization transactions that are accounted for as sales under SSAP No. 103R and purchased beneficial interests in securitized financial assets⁷.

Benefits of Reporting in Scope of SSAP No. 43R – Before the Principles-Based Definition

~~127.130.~~ There are a variety of benefits for reporting investments as bonds on Schedule D-1. Also, with regards to bifurcated impairment, capturing an investment in scope of SSAP No. 43R may be more advantageous than capturing in scope of *SSAP No. 26R—Bonds*. These benefits include:

- a. Capturing an investment in scope of SSAP No. 26R or SSAP No. 43R results with reporting the investment on Schedule D-1, Long-Term Bonds. By reporting on this bond schedule, the investment is generally not subject to investment limitations, the asset is admitted and the investment has the benefit of lower risk-based capital (RBC) charges based on NAIC designation. (Moving held equity instruments from Schedule BA into a SSAP No. 43R trust has been particularly noted as providing “regulatory capital relief.”)
- b. Capturing an investment in scope of SSAP No. 26R or SSAP No. 43R may result in amortized cost reporting and a delay in recognizing decreases in value or other-than-temporary impairments than if the assets held in trust were reported separately on the statutory financial statements.
 - i. Under the SSAP No. 43R bifurcated impairment model, an entity is not required to recognize an OTTI or deviate from an amortized cost measurement as long as

⁵ As discussed in paragraph 4.a. of this statement, a SSAP No. 43R security may still be considered a related party transaction even if the asset trustee or security issuer is a non-related party.

⁶ Securities classified within the type of paragraph 7.a. or 7.b. may be required to change classification to type 6.c. when it becomes probable that the reporting entity will be unable to collect all contractually required payments receivable.

⁷ The accounting requirements related to these types of securities included in paragraphs 22-25 shall be determined at acquisition or initial transfer.

the entity can assert that they have the intent and ability to hold the 43R security to recover the amortized cost basis and there is no non-interest related decline. (This has been a key factor in the PPN design, as a high-quality bond is placed in trust (along with other assets), and the bond – over several years – will single-handedly satisfy the contractual requirements of the 43R issued security, preventing any recognition of OTTI or a reduction of NAIC designation even when the other securities held in trust could completely default to zero.)

- ii. The SSAP No. 43R bifurcated impairment can be considered an advantage over SSAP No. 26R as under SSAP No. 43R, if there is an intent and ability to hold the asset, a reporting entity only has to recognize an OTTI for the portion of the non-interest related loss. Under SSAP No. 26R, if there is any assessed OTTI (despite if interest or credit related), a reporting entity must recognize an OTTI down to the then-current fair value for the security.
- iii. Prior to the principles-based bond project, guidance in SSAP No. 43R did not differentiate between different types of tranches or payment streams for the issued securities. This is easiest to illustrate through the “equity” tranche of a SSAP No. 43R investment but could be a factor if payments are provided sequentially. (Sequential payments are used to pay the senior notes first, until paid in full, before payments are allocated to junior notes.) For the “equity” tranche, which is a term that refers to the junior-most layer of issued SSAP No. 43R securities, this tranche is the first-loss position and only receives payment after all other layers have been satisfied. Without prior guidance in SSAP No. 43R for this layer, entities were able to classify these residual tranches as “bonds” on Schedule D-1, which did not properly reflect the nature of those investments.
- c. SSAP No. 43R permits admittance of the security without any verification to the assets held in trust. As such, if a reporting entity was to derecognize a joint venture or LLC from Schedule BA, and reacquire through the ownership of a SSAP No. 43R security, the reporting entity would be permitted to admit the security without any verification of the joint venture or LLC held in trust. Under *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*, assets must have audited support (audited U.S. GAAP financials, audited reconciliation to U.S. GAAP, audited IFRS financials or audited U.S. tax basis equity) in order to be admitted in the statutory financial statements.

Key Issues with Scope / Definition Application of SSAP No. 43R – Before the Principles-Based Definition

~~128-131.~~ 131. With the existing guidance in SSAP No. 43R, there are no restrictions to the assets that can be placed in trust and used to support securities issued from the trust structure. Although these structural designs are referred to as “securitizations” and reported as debt instruments, these investment structures may not reflect actual securitizations in which cash flows from multiple contractual debt obligations held in trust are used to pay principal and interest payments on the trust-issued security. The assets being securitized may include assets that are not cash flow producing, creating reliance on an underlying collateral valuation risk. Or, there may be no economic substance to the use of the securitization structure, such that the insurer is in the same economic position as owning the underlying assets directly. As a result, there is a regulatory concern that assets being represented as bonds may contain unidentifiable risks that regulators would not traditionally associate with bond risk.

~~129-132.~~ 132. As an additional issue of the existing guidance, questions have been raised on whether securities captured in scope of SSAP No. 43R would be “asset-backed securities” as defined by the Code of Federal Regulations (17 CFR 229.1101(c)). These questions have arisen as an SEC identified nationally recognized statistical rating organization (NRSRO) must be specifically approved to provide ratings of

“asset-backed securities.” Since the CFR definition is different than what is permitted in scope of SSAP No. 43R, a rating from an NRSRO approved as a credit rating provider (CRP) that may not be approved by the SEC for “asset-backed securities” could provide a valid rating for a SSAP No. 43R instrument permitted as “filing exempt” if that asset was not an “asset-backed security.” This has caused questions as regulators have identified designations given by CRPs not SEC approved to provide “ABS” designations and have questioned the use of these CRP ratings in determining the NAIC designation.

<https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/NationalMeetings/A.NationalMeetingMaterials/2022/Fall-December/Exposures/19-21a-BondIP-11-14-22.docx>

**Bond Definition
Proposed Reporting Lines – Schedule BA
2023 Spring NM Exposure**

This document proposes annual statement reporting line and descriptions for suggested reporting lines for investments reported as other invested assets on Schedule BA. The main focus is to categorize debt securities that do not qualify as bonds under SSAP No. 26—Bonds or SSAP No. 43R—Asset-Backed Securities and are captured in scope of SSAP No. 21—Other Invested Assets. As detailed within, other revisions have also been proposed to update the schedule.

Comments are requested on all aspects of this document – including whether reporting lines should be added or deleted as well as the suggested instructions to clarify what should be captured in each location.

SCHEDULE BA – PARTS 1, 2 AND 3

OTHER LONG-TERM INVESTED ASSETS – GENERAL INSTRUCTIONS

Include only those classes of invested assets not clearly or normally includable in any other invested asset schedule, or that have been specifically identified for reporting on Schedule BA: Other Invested Assets. ~~Such assets should include any assets previously written off for book purposes, but which still have a market or investment value. Give a detailed description of each investment and the underlying security. If an asset is to be recorded in Schedule BA that is normally reported in one of the other invested asset schedules, make full disclosure in the Name or Description column of the reason for recording such an asset in Schedule BA.~~

For accounting guidance related to foreign currency transactions and translations, refer to SSAP No. 23—Foreign Currency Transactions and Translations.

If a reporting entity has any detail lines reported for any of the following required groups, categories, or subcategories, it shall report the subtotal amount of the corresponding group, category, or subcategory, with the specified subtotal line number appearing in the same manner and location as the pre-printed total or grand total line and number:

<u>Group or Category</u>	<u>Line Number</u>
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Debt Securities That Do Not Qualify as Bonds

Debt Securities That Do Not Reflect a Creditor Relationship in Substance

NAIC Designation Assigned by the Securities Valuation Office (SVO)

Unaffiliated

Affiliated.....

NAIC Designation Not Assigned by the Securities Valuation Office (SVO)

Unaffiliated

Affiliated.....

Debt Securities That Lack Substantive Credit Enhancement

NAIC Designation Assigned by the Securities Valuation Office (SVO)

Unaffiliated

Affiliated.....

NAIC Designation Not Assigned by the Securities Valuation Office (SVO)

Unaffiliated

Affiliated.....

Debt Securities That Do Not Qualify as Bonds Solely to a Lack Of Meaningful Cash Flows

NAIC Designation Assigned by the Securities Valuation Office (SVO)

Unaffiliated

Affiliated.....

NAIC Designation Not Assigned by the Securities Valuation Office (SVO)

Unaffiliated	
Affiliated.....	

Non-Registered Private Funds with Underlying Assets Having Characteristics of:BondsNAIC Designation Assigned by the Securities Valuation Office (SVO)

Unaffiliated	0799999
Affiliated.....	0899999

NAIC Designation Not Assigned by the Securities Valuation Office (SVO)

Unaffiliated	0999999
Affiliated.....	1099999

Mortgage Loans

Unaffiliated	1199999
Affiliated.....	1299999

Other Fixed Income Instruments

Unaffiliated	1399999
Affiliated.....	1499999

Joint Venture (Including Non-Registered Private Funds), Partnership or Limited Liability Company Interests with Underlying Assets Having the Characteristics of:Fixed Income InstrumentsNAIC Designation Assigned by the Securities Valuation Office (SVO)

Unaffiliated	1599999
Affiliated.....	1699999

NAIC Designation Not Assigned by the Securities Valuation Office (SVO)

Unaffiliated	1799999
Affiliated.....	1899999

Common Stocks

Unaffiliated	1999999
Affiliated.....	2099999

Real Estate

Unaffiliated	2199999
Affiliated.....	2299999

Mortgage Loans

Unaffiliated	2399999
Affiliated.....	2499999

Other

Unaffiliated	2599999
Affiliated.....	2699999

Surplus Debentures, etc.

Unaffiliated.....	2799999
Affiliated	2899999

Collateral Loans

Unaffiliated.....	2999999
Affiliated	3099999

Non-collateral Loans

Unaffiliated.....	3199999
Affiliated	3299999

Capital Notes

Unaffiliated.....	3399999
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Affiliated	3499999
Guaranteed Federal Low Income Housing Tax Credit	
Unaffiliated.....	3599999
Affiliated	3699999
Non-Guaranteed Federal Low Income Housing Tax Credit	
Unaffiliated.....	3799999
Affiliated	3899999
Guaranteed State Low Income Housing Tax Credit	
Unaffiliated.....	3999999
Affiliated	4099999
Non-Guaranteed State Low Income Housing Tax Credit	
Unaffiliated.....	4199999
Affiliated	4299999
All Other Low Income Housing Tax Credit	
Unaffiliated.....	4399999
Affiliated	4499999
<i><u>NAIC Staff Note: The reporting lines for Low Income Housing Tax Credits are anticipated to be updated as part of the current tax credit investment statutory accounting review.</u></i>	
Working Capital Finance Investment	
Unaffiliated.....	4599999
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
Any Other Class of Assets	
Unaffiliated.....	5899999
Affiliated	5999999
Subtotals	
Unaffiliated.....	6099999
Affiliated	6199999
TOTALS.....	6299999

The following listing is intended to give examples of investments to be included in each category; however, the list should not be considered all-inclusive, and it should not be implied that any invested asset currently being reported in Schedules A, B or D is to be reclassified to Schedule BA:

Oil and Gas Production

Include: ~~Offshore oil and gas leases.~~

Transportation Equipment

Include: ~~Aircraft owned under leveraged lease agreements.
Motor Vehicle Trust Certificates.~~

Mineral Rights

Include: ~~Investments in extractive materials.

Timber Deeds.~~

Debt Securities That Do Not Qualify as Bonds

Include: ~~Debt securities captured in SSAP No. 21—Other Admitted Assets. This is specific to securities, as that term is defined in SSAP No. 26—Bonds, whereby there is a fixed schedule for one or more future payments (referred to as debt securities), but for which the security does not qualify for bond reporting under SSAP No. 26 as an issuer credit obligation or an asset-backed security.~~

~~Investments that have been assigned an NAIC designation by the Securities Valuation Office (SVO) pursuant to the policies in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* shall be reported on Lines 0799999 and 0899999.~~

~~Investments that have not been assigned an NAIC designation by the Securities Valuation Office (SVO) pursuant to the policies in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* for this category. Designations received from an SEC NRSRO are permitted to be reported but are not required. Report these investments on Lines 0999999, 1099999, 1199999, 1299999, 1399999 and 1499999.~~

Exclude: ~~Any investment that does not qualify as a security. This term is defined in SSAP No. 26R.~~

~~Any investment that is not captured as a debt security that does not qualify as a bond pursuant to SSAP No. 21R—Other Admitted Assets.~~

~~Non-Registered Private Funds with Underlying Assets Having Characteristics of a Bond, Mortgage Loan or Other Fixed Income Instrument~~

Include: ~~Fixed income instruments that are not corporate or governmental unit obligations (Schedule D) or secured by real property (Schedule B).~~

~~Any investments deemed by the reporting entity to possess the underlying characteristics of a bond or other fixed income instrument that has been assigned an NAIC designation by the Securities Valuation Office (SVO) pursuant to the policies in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* for this category. Report these investments on Lines 0799999 and 0899999.~~

~~Any investments deemed by the reporting entity to possess the underlying characteristics of a bond or other fixed income investment that has not been assigned an NAIC designation by the Securities Valuation Office (SVO) pursuant to the policies in the *Purposes and Procedures Manual of the NAIC*~~

~~Investment Analysis Office for this category. Report these investments on Lines 0999999, 1099999, 1199999, 1299999, 1399999 and 1499999.~~

Joint Ventures (Including Non-Registered Private Funds), Partnership or Limited Liability Company Interests with Underlying Assets Having the Characteristics:

Fixed Income Instruments

Include: Joint venture (including non-registered private funds), partnership or limited liability company investments that are engaged in bond or preferred stock fixed income strategies. Leveraged Buy-out Fund.

A fund investing in the “Z” strip of Collateralized Mortgage Obligations.

~~Investments on the NAIC List of Schedule BA Non-Registered Private Funds with Underlying Assets Having Characteristics of Bonds or Preferred Stock Any investments deemed by the reporting entity to possess the underlying characteristics of fixed income instruments~~ that has been assigned an NAIC designation by the Securities Valuation Office (SVO) pursuant to the policies in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* ~~for this category~~. Report these investments on Lines 1599999 and 1699999.

~~Any investments deemed by the reporting entity to possess the underlying characteristics of fixed income instruments~~ Investments that have not been assigned an NAIC designation by the Securities Valuation Office (SVO) pursuant to the policies in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* ~~for this category~~. Designations received from an SEC NRSRO are permitted to be reported but are not required. Report these investments on Lines 1799999 and 1899999.

Common Stocks

Include: Venture Capital Funds or other underlying equity investments.

Real Estate

Include: Real estate development interest. Reporting should be consistent with the detailed property analysis appropriate for the corresponding risk-based capital factor for this investment category. If the requisite details are not available for reporting, report under “Other” subcategory.

Mortgage Loans

Include: Mortgage obligations. Reporting should be consistent with the detailed property analysis appropriate for the corresponding risk-based capital factor for this investment category. If the requisite details are not available for reporting, report under “Other” subcategory.

Other

Include: Limited partnership interests in oil and gas production.

Forest product partnerships.

Investments within the Joint Venture and Partnership Interests category that do not qualify for inclusion in the “Fixed Income Instruments,” “Common Stocks,” “Real Estate” or “Mortgage Loans” subcategories.

~~Reporting should be consistent with the corresponding risk-based capital factor for this investment category (i.e., Other Long Term Assets).~~

Surplus Debentures, etc.

Include: That portion of any subordinated indebtedness, surplus debenture, surplus note, debenture note, premium income note, bond, or other contingent evidence of indebtedness that is reported in the surplus of the issuer.

Collateral Loans

Include: Refer to *SSAP No. 21R—Other Admitted Assets* for a definition of collateral loans. Loans that are backed by any form of collateral, regardless of if the collateral is sufficient to fully cover the loan, shall be captured in this category. Guidance in SSAP No. 21R shall be followed to determine nonadmittance

_____ In the description column, the name of the actual borrower and state if the borrower is a parent, subsidiary, affiliate, officer or director. Also include the type of collateral held.

Non-collateral Loans

Include: ~~For purposes of this section, n~~Non-collateral loans are considered the unpaid portion of loans previously made to another organization or individual in which the reporting entity has a right to receive money for the loan, but for which the reporting entity has not obtained collateral to secure the loan.

_____ Non-collateral loans shall not include those instruments that meet the definition of a bond, per *SSAP No. 26R—Bonds*, a mortgage loan per *SSAP No. 37—Mortgage Loans*, ~~loan-backed or structured~~asset-backed securities per *SSAP No. 43R—Loan-Backed and Structured Securities*, or a policy or contract loan per *SSAP No. 49—Policy Loans*.

In the description column, provide the name of the actual borrower. For affiliated entities, state if the borrower is a parent, subsidiary, affiliate, officer or director. Refer to *SSAP No. 20—Nonadmitted Assets* and *SSAP No. 25—Affiliates and Other Related Parties* for accounting guidance.

Capital Notes

Include: The portion of any capital note that is reported on the line for capital notes of the issuing insurance reporting entity.

Low Income Housing Tax Credit

Note: These instructions will be updated in accordance with the SAPWG tax credit agenda item.

- Include: All Low Income Housing Tax Credit Investments (LIHTC or affordable housing) that are in the form of a Limited Partnership or a Limited Liability Company including those investments that have the following risk mitigation factors:
- A. Guaranteed Low Income Housing Tax Credit Investments. There must be an all-inclusive guarantee from a CRP-rated entity that guarantees the yield on the investment.
 - B. Non-guaranteed Low Income Housing Tax Credit Investments.
 - I. A level of leverage below 50%. For a LIHTC Fund, the level of leverage is measured at the fund level.
 - II. There is a Tax Credit Guarantee Agreement from General Partner or managing member. This agreement requires the General Partner or managing member to reimburse investors for any shortfalls in tax credits due to errors of compliance, for the life of the partnership. For a LIHTC Fund, a Tax Credit Guarantee is required from the developers of the lower tier LIHTC properties to the upper tier partnership and all other LIHTC investments.
 - III. There are sufficient operating reserves, capital replacement reserves and/or operating deficit guarantees present to mitigate foreseeable foreclosure risk at the time of the investment.

Non-qualifying LIHTCs should be reported in the “All Other” category

Working Capital Finance Investment

- Include: Investments in an interest in a Confirmed Supplier Receivables (CSR) under a Working Capital Finance Program (WCFP) that is designated by the SVO as meeting the criteria specified in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* for an NAIC “1” or “2.”

Working Capital Finance Program (WCFP)

Open account program under which an Investor may purchase interests, or evidence thereof, in commercial non-insurance receivables. A WCFP is created for the benefit of a commercial investment grade obligor and its suppliers of goods or services and facilitated by a financial intermediary.

Confirmed Supplier Receivables (CSR)

A first priority perfected security interest claim or right to payment of a monetary obligation from the Obligor arising from the sale of goods or services from the Supplier to the Obligor the payment of which the Obligor has confirmed by representing and warranting that it will not protest, delay, or deny, nor offer nor assert any defenses against, payment to the supplier or any party taking claim or right to payment from the supplier.

See SSAP No. 105R—*Working Capital Finance Investments* for accounting guidance.

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~~ Asset-Backed 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.

Any Other Class of Assets

Include: Investments that do not fit into one of the other categories. An example of items that may be included are reverse mortgages.

All structured settlement income streams acquired as investments where the reporting entity acquires the legal right to receive payments. (Valuation and admittance provisions are detailed in *SSAP No. 21R—Other Admitted Assets*.)

[This category shall also include oil and gas leases, aircraft owned under leveraged lease arrangements, investments in extractive materials and timber deeds that are not owned within a partnership, LLC or joint venture structure.](#)

**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 do closer 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 SixEight~~. 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.

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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

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-E1825-33~~.

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 GAAP standards with modifications.

The additional exposed revisions to SSAP No. 16X 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 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.

<https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/NationalMeetings/A.NationalMeetingMaterials/2023/8-13-23SummerNationalMeeting/Hearing/21-22-01ConceptualFramework.docx>

Statutory Issue Paper No. 16X

Updates to the Definition of a Liability

STATUS

Exposure Draft – March 22, 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 is exposed this issue paper for public comment.

16. During the 2022 Summer National Meeting, the Working Group is 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.

RELEVANT STATUTORY ACCOUNTING AND GAAP GUIDANCE

Statutory Accounting

19. 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

20. 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 to repay the amount borrowed, acquiring assets on credit obligates an entity to pay for the assets,

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.

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.

21. 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.

22. 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

23. 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 **TBD**.

EXHIBIT A – SAP Clarification Revisions to *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets*

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 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

¹ ~~The guidance in this Statement regarding the definition of a liability is applicable unless another authoritative statement of statutory accounting principles provides more topic specific contradictory guidance. In such cases the topic specific guidance shall apply.~~

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. 16X – Updates to the Definition of a Liability*

[https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/NationalMeetings/A.NationalMeetingMaterials/2023/8-13-23SummerNationalMeeting/Hearing/22-22-01B-IPNo.16X-Liability\(3-22\).docx](https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/NationalMeetings/A.NationalMeetingMaterials/2023/8-13-23SummerNationalMeeting/Hearing/22-22-01B-IPNo.16X-Liability(3-22).docx)

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

Issue: Collateral for Loans

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 address an inconsistency regarding the collateral loan guidance in *SSAP No. 20—Nonadmitted Assets* and *SSAP No. 21—Other Admitted Assets* (See excerpts in Authoritative Literature). These two statements contain guidance about unsecured and secured loans which is complementary.

SSAP No. 20 details the **nonadmitted assets status** of unsecured loans and loans secured by assets which do not qualify as investments. SSAP No. 20 also references write off and impairment guidance in *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets* for impaired and uncollectible loans. SSAP No. 20 provides that improperly collateralized loans include loans that do not have underlying assets that would otherwise qualify as **admitted assets** and stated that such loans are nonadmitted assets because the collateral would be of questionable economic value if needed to fulfill policyholder obligations. SSAP No. 20 includes similar nonadmission guidance regarding loans on personal security, cash advances to officers or agents and for travel advances.

SSAP No. 21 details the requirements for collateral loans which **can qualify to be admitted assets**. It provides that the collateral loan must be secured by the pledge of an investment. A footnote further describes that investment collateral would be of a type that would be in Section 3 of *Appendix A-001—Investments of Reporting Entities*. **SSAP No. 21 also references the nonadmission guidance in SSAP No. 20 for** collateral loans secured by assets that do not qualify as investments. The referenced guidance in SSAP No. 20 notes that the underlying assets must qualify as admitted assets.

Both SSAP No. 20 and SSAP No. 21 identify the need for adequate collateral that qualifies as an invested asset. SSAP No. 20 is explicit that the investment asset collateral must qualify as an admitted asset. Recent discussions with state regulators have highlighted that although SSAP No. 21 references the guidance in SSAP No. 20, that it would be beneficial to also note the need for the collateral to qualify as an admitted invested asset. This agenda item recommends a clarification to SSAP No. 21 that the acceptable invested asset collateral, for collateral loans must qualify as admissible invested assets.

Existing Authoritative Literature:

***SSAP No. 20—Nonadmitted Assets* (Bolding added for emphasis):**

4. Consistent with paragraph 2, the following assets shall be nonadmitted:
 - a. Deposits in Suspended Depositories—Amounts on deposit with suspended depositories may not be fully recoverable. Any amounts not reasonably expected to be recovered shall be written off in accordance with *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets*. Amounts in excess of that written off shall be nonadmitted as they are not available to satisfy obligations to policyholders;

- b. **Bills Receivable Not for Premium and Loans Unsecured or Secured by Assets That Do Not Qualify As Investments**—In accordance with SSAP No. 5R, amounts determined to be uncollectible or otherwise impaired shall be written off. Amounts in excess of that written off are not considered to be properly collateralized **as there are no underlying assets which would otherwise be admitted assets. Such amounts shall be nonadmitted as they may be of questionable economic value if needed to fulfill policyholder obligations. Receivables arising from working capital finance programs designated by the Securities Valuation Office are subject to the guidance in SSAP No. 105R—Working Capital Finance Investments;**
- c. **Loans on Personal Security, Cash Advances To, Or In The Hands Of, Officers Or Agents And Travel Advances**—In accordance with SSAP No. 5R, amounts determined to be uncollectible or otherwise impaired shall be written off. Amounts in excess of that written off typically are **unsecured and as such have no underlying assets which would otherwise be admitted assets. Such amounts shall be nonadmitted as they may be of questionable economic value if needed to fulfill policyholder obligations. Some of these items may also be considered prepaid expenses which, per SSAP No. 29—Prepaid Expenses, are nonadmitted;**
- d. All “Non-Bankable” Checks—Examples of “non-bankable” checks are NSF (non-sufficient funds) checks, post-dated checks, or checks for which payment has been stopped. Although these checks may still maintain probable future benefits (and thus meet the definition of assets), at the date on which they are non-bankable they are not available for policyholder obligations and shall be nonadmitted until the uncertainty related to the probable future benefit is resolved and the checks are converted to available funds;
- e. Trade Names And Other Intangible Assets¹—These assets, by their nature, are not readily marketable and available to satisfy policyholder obligations and shall be nonadmitted;
- f. Automobiles, Airplanes and Other Vehicles—Automobiles, airplanes and other vehicles meet the definition of assets established in SSAP No. 4. However, they are not readily available to satisfy policyholder obligations and as a result the undepreciated portion shall be nonadmitted. The accounting for these assets shall be consistent with the accounting for equipment provided in *SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements* or for commercial airplane leveraged leases, refer to the guidance in *SSAP No. 22R—Leases*;
- g. Company’s Stock as Collateral for Loan—When a reporting entity lends money and accepts its own stock as collateral for the loan, it shall report the amount of the loan receivable and any related accrued interest on the loan as a nonadmitted asset. The asset is nonadmitted as the collateral could not be used to satisfy the obligation in the event of default.

Footnote 1: Defensible intangible assets are defined as an intangible asset acquired in a business combination or an asset acquisition that an entity does not intend to actively use but does intend to prevent others from using. These may also be referred to as a “locked-up asset” because while the asset is not being actively used, it is likely contributing to an increase in the value of other assets owned by the entity. These assets are not readily available to satisfy policyholder obligations and shall be nonadmitted.

SSAP No. 21 – Revised—Other Admitted Assets (Bolding added for emphasis)

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:

- a. Loan Impairment—Determination as to the impairment of a collateral loan shall be based on current information and events. When it is considered probable that any portion of amounts due under the contractual terms of the loan will not be collected the loan is considered impaired. The impairment shall be measured based on the fair value of the collateral less estimated costs to obtain and sell the collateral. The difference between the net value of the collateral and the recorded asset shall be written off in accordance with *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets*;
- b. **Nonadmitted Asset—In accordance with SSAP No. 20—Nonadmitted Assets, collateral loans secured by assets that do not qualify as investments shall be nonadmitted. Further, any amount of the loan outstanding which is in excess of the permitted relationship of fair value of the pledged investment to the collateral loan shall be treated as a nonadmitted asset.**

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 (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 that are also secured with collateral shall continue to be captured within scope of SSAP No. 26R.

Footnote 2: Investment defined as those assets listed in Section 3 of *Appendix A-001—Investments of Reporting 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

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 Review Completed by: Robin Marcotte – NAIC Staff – July 2022

Staff Recommendation: NAIC staff recommends that the Working Group move this item to the active listing, categorized as a SAP clarification, and expose the revisions to SSAP No. 21, illustrated below, which clarify that the invested assets pledged as collateral for admitted collateral loans must qualify as admitted invested assets.

Proposed revisions to *SSAP No. 21 – Revised—Other Admitted Assets*

Collateral Loans

4. Collateral loans are unconditional obligations¹ for the payment of money secured by the pledge of an qualifying 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:

- a. Loan Impairment—Determination as to the impairment of a collateral loan shall be based on current information and events. When it is considered probable that any portion of amounts due under the contractual terms of the loan will not be collected the loan is considered impaired. The impairment shall be measured based on the fair value of the collateral less estimated costs to obtain and sell the collateral. The difference between the net value of the collateral and the recorded asset shall be written off in accordance with *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets*;
- b. Nonadmitted Asset—In accordance with *SSAP No. 20—Nonadmitted Assets*, collateral loans secured by assets that do not qualify as investments which would otherwise be admitted shall be nonadmitted. Further, any amount of the loan outstanding which is in excess of the permitted relationship of fair value of the pledged investment to the collateral loan shall be treated as a nonadmitted asset.

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 (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 that are also secured with collateral shall continue to be captured within scope of SSAP No. 26R.

Footnote 2: A qualifying investment defined as those assets listed in Section 3 of Appendix A-001—Investments of Reporting Entities which would if held by the insurer would qualify for admittance. For example, if the collateral would not qualify for admittance under SSAP No. 4 due to encumbrances or other third-party interests, then it does not meet the definition of "qualifying" and the collateral loan, or any portion thereof which is not adequately collateralized, is not permitted to be admitted.

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. 21R to clarify that invested assets pledged as collateral for admitted collateral loans must qualify as admitted invested assets.

On December 13, 2022, the Working Group re-exposed revisions to SSAP No. 21R to clarify that invested assets pledged as collateral for admitted collateral loans must qualify as admitted invested assets.

On March 22, 2023, the Statutory Accounting Principles (E) Working Group exposed revisions to *SSAP No. 21 – Revised—Other Admitted Assets* which clarify that the invested assets pledged as collateral for admitted collateral loans must qualify as admitted invested assets. These revisions clarify that for specific investments, the comparison for admittance is between the net equity audited value of the pledged collateral to the collateral loan balance. In addition, a consistency revision to *SSAP No. 20—Nonadmitted Assets*, paragraph 4.b. was exposed.

Exposed revisions to *SSAP No. 20—Nonadmitted Assets*:

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

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

Exposed revisions to *SSAP No. 21 – Revised—Other Admitted Assets* (new wording shown tracked and shaded)

Collateral Loans

4. Collateral loans are unconditional obligations¹ for the payment of money secured by the pledge of an qualifying 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:

- a. Loan Impairment—Determination as to the impairment of a collateral loan shall be based on current information and events. When it is considered probable that any portion of amounts due under the contractual terms of the loan will not be collected the loan is considered impaired. The impairment shall be measured based on the fair value of the collateral less estimated costs to obtain and sell the collateral. The difference between the net value of the collateral and the recorded asset shall be written off in accordance with *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets*;

- b. Nonadmitted Asset—In accordance with *SSAP No. 20—Nonadmitted Assets*, collateral loans secured by assets that do not qualify as investments which would otherwise be admitted shall be nonadmitted. Further, any amount of the loan outstanding which is in excess of the permitted relationship of fair value of the pledged investment to the collateral loan shall be treated as a nonadmitted asset. For qualifying investments which are pledged as collateral that would be in the scope of SSAP No. 48 or SSAP No. 97 if held directly by the reporting entity, such as joint ventures, partnerships and limited liability companies and investments that would qualify as SCAs if held directly, the proportionate audited equity valuation shall be used for the comparison for the adequacy of pledged collateral. If the collateral loan exceeds the audited equity valuation of these pledged investments, then the excess shall be nonadmitted.

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 (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 that are also secured with collateral shall continue to be captured within scope of SSAP No. 26R.

Footnote 2: A qualifying investment defined as those assets listed in Section 3 of Appendix A-001—Investments of Reporting Entities which would if held by the insurer qualify for admittance. For example, if the collateral would not qualify for admittance under SSAP No. 4 due to encumbrances or other third-party interests, then it does not meet the definition of "qualifying" and the collateral loan, or any portion thereof which is not adequately collateralized, is not permitted to be admitted. In the cases where the collateral is an equity/unit investment in a joint venture, partnership, limited liability company, and or SCA is pledged as collateral in a collateral loan, audited financial statements on a consistent annual basis are always required in accordance with SSAP No. 48 and or SSAP No. 97.

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

Issue: Review of INT 03-02: *Modification to an Existing Intercompany Pooling Arrangement*

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 provides a review of Interpretation (INT) 03-02: *Modification to an Existing Intercompany Pooling Arrangement*, because of conflicts between INT 03-02 and *SSAP No. 25—Affiliates and Other Related Parties*. This agenda item was prompted by the recent focus of Statutory Accounting Principles (E) Working Group on related party transactions, recent queries to NAIC about how broadly to apply the guidance in INT 03-02 and the review of the SSAP No. 62R, paragraph INT 03-02 addresses the valuation of bonds in instances when bonds are used instead of cash for the payment among affiliates for amounts due on modifications to existing intercompany reinsurance pooling contracts. The discrepancy between the INT 03-02 and SSAP No. 25 has been identified through recent discussions evaluating related party transactions. Key excerpts of INT 03-02 are in the Authoritative Literature section below.

The primary accounting question that is a concern for this agenda item is INT 03-02, paragraph 11b which asks, “What is the appropriate valuation basis to be used for assets and liabilities that are transferred among affiliates in conjunction with the execution of a new reinsurance agreement(s) that serves to substantively modify an existing intercompany pooling arrangement?” The response provided in INT 03-02, paragraph 13 is, “The appropriate valuation basis to be used for assets and liabilities that are transferred among affiliates in conjunction with the execution of a new reinsurance agreement(s) that serves to substantively modify an existing intercompany pooling arrangement is statutory book value for assets and statutory value for liabilities. Book value is defined in the glossary of the *Accounting Practices and Procedure Manual*.”

INT 03-02 lists that it is an interpretation of the following three reinsurance statements: *SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance*, *SSAP No. 62R—Property and Casualty Reinsurance* and *SSAP No. 63—Underwriting Pools*. *SSAP No. 25—Affiliates and Other Related Parties* is not listed as an interpreted statement. However, as described below, the consensus in INT 03-02, paragraph 13 is not consistent with the guidance in SSAP No. 25 regarding economic transactions between related parties.

The result of the consensus in INT 03-02, paragraph 13 allows assets used in affiliated payments for reinsurance contracts, which modify existing intercompany reinsurance pooling agreements, to be transferred using statutory book value. Note that in most cases, this means that bonds which are likely the primary assets that would be used, would typically have a statutory book value that reflects amortized cost. The valuation of assets using statutory book value on transfer to an affiliate, can result in substantial differences from the cash equivalent (fair value) for the payment due. For example, bonds reported at amortized cost book value could have a corresponding fair value that is materially higher or lower. This difference in valuation can result in an unacknowledged dividend or with the passing on of an investment loss.

SSAP No. 25 describes economic transactions and non-economic transactions (See Authoritative Literature). Economic transactions are defined as arm’s-length transactions which results in the transfer of the risks and rewards of ownership and represents a consummated act thereof, i.e., “permanence.” SSAP No. 25, paragraph 18 indicates that economic transactions between related parties shall be recorded at fair value at the date of the transaction and also notes that to the extent that the related parties are affiliates under common control, the controlling reporting

entity shall defer the effects of such transactions that result in gains or increases in surplus until such time that the asset is sold outside the group.

It is quite possible, by using transfers at book value instead of fair value, to design a transaction with a very significant economic effect. The following example illustrates the concern with the results of the guidance in INT 03-02. For this example, \$100 million is due on an existing intercompany reinsurance pooling agreement. INT 03-02 would allow bonds to be settled using statutory book value which may not be reflective of the fair value equivalent of a cash settlement.

Asset used to settle	Book Value (millions) measurement for settlement	Fair Value (millions)	Result	Consistent with SSAP No. 25 for an economic transaction?
Cash	\$100	\$100	No difference in basis	Yes
Bonds	\$100	\$ 85	\$15 difference in fair value means the paid party received an amount less than what is actually owed. This approach could allow reporting entities to transfer impaired assets to affiliates in lieu of assessing OTTI.	No
Bonds	\$100	\$110	\$10 difference in fair value means the paid party has received an asset greater than what was owed. This dynamic could result in an unrecognized gain or dividend.	No

The INT 03-02 direction to use statutory book value for the transfer of bonds between affiliated entities in most instances would conflict with the primary guidance on affiliated transactions contained in *SSAP No. 25—Affiliates and Other Related Parties*. For example, economic transactions between related parties are valued using fair value. (There are more nuances in SSAP No. 25 when payments have the possibility of being economic for one entity and noneconomic for an upper-level parent). NAIC staff recommends that the treatment of transfers of assets between affiliates should be consistent for all intercompany transactions and there is not a compelling need to be different if assets are transferred instead of cash for intercompany reinsurance.

Under INT 03-02, for intercompany reinsurance transactions, takes an approach that either SSAP No. 25 or SSAP No. 62R may apply, but multiple Working Group discussions have noted that SSAP No. 25 provides the overarching guidance that is relevant in evaluating all related party transactions. INT 03-02, paragraph 8 indicates that the statutory accounting intention is to avoid surplus gains for the ceding entity as a result of implementing a modification to an intercompany pooling arrangement. However, the guidance in SSAP No, 62R, paragraph 37 uses a more punitive method of accounting if there is a gain in surplus to the ceding entity as a result of the intercompany reinsurance transaction. Therefore, NAIC staff would characterize the SSAP No. 62R guidance as imposing an accounting penalty if there is a gain, rather than seeking to avoid recognizing such a gain. The INT also characterizes SSAP No. 25 as being for isolated transactions, which is inconsistent with discussions of the Working Group on the applicability of SSAP No. 25.

SSAP No. 62R, paragraph 36d (see Authoritative Literature) includes an exception to retroactive reinsurance accounting which allows prospective accounting treatment for intercompany reinsurance agreements and any amendments thereto, among companies 100% owned by a common parent or ultimate controlling person provided there is no gain in surplus as a result of the transaction. Paragraph 37 provides that if there is a gain to the ceding entity that a more restrictive method of accounting is required which is less beneficial to the financial statements. Whereas the INT tries to argue that statutory intent is to avoid surplus gain, NAIC staff would note that the goal is not to avoid gain as a result of the reinsurance transaction, but to impose a different accounting if there is a gain.

NAIC staff would characterize evaluating reinsurance agreements for SSAP No. 62R, paragraph 36d or paragraph 37 as using the cash flows or corresponding equivalent fair value (cash equivalent) of the amounts payable or receivable in the reinsurance transactions to determine if there is a gain or loss to the ceding entity. The reinsurance cash flows evaluated should be the same as if the bond was sold for fair value and resulting cash equivalent obligation was paid. The fact that the bond sold has a gain or loss is not part of the reinsurance contract evaluation, the reinsurance contract that is an economic transaction evaluation is based on the cash equivalent value of the assets transferred less the liabilities transferred. The evaluation of gain or loss on the intercompany reinsurance transaction should give the same answer if either cash or assets were transferred.

Existing Authoritative Literature:

03-02: *Modification to an Existing Intercompany Pooling Arrangement* is attached in full. The following excerpts are from INT 03-02:

8. Therefore, based on the foregoing guidance and background, the statutory accounting intent is to avoid surplus gains for the ceding entity as a result of implementing a modification to an intercompany pooling arrangement. On that basis, such a modification does not represent an economic transaction to the insurance group or to the impacted companies. As such, the transfer of both the assets and the liabilities valued at statutory book value ensures that there is no impact to surplus as a result of implementing a modification to an existing pooling arrangement.
11. The accounting issues are:
 - a. What is the relevant guidance for modifications to intercompany pooling arrangements?
 - b. What is the appropriate valuation basis to be used for assets and liabilities that are transferred among affiliates in conjunction with the execution of a new reinsurance agreement(s) that serves to substantively modify an existing intercompany pooling arrangement?

The Working Group reached a consensus as follows:

12. SSAP No. 62R provides accounting for property and casualty reinsurance agreements including specific guidance on intercompany pooling agreements. SSAP No. 62R provides two methods of accounting for changes in intercompany pooling agreements, depending on whether or not the pooling results in a gain in surplus.
13. The appropriate valuation basis to be used for assets and liabilities that are transferred among affiliates in conjunction with the execution of a new reinsurance agreement(s) that serves to substantively modify an existing intercompany pooling arrangement is statutory book value for assets and statutory value for liabilities. Book value is defined in the glossary of the *Accounting Practices and Procedure Manual*.

SSAP No. 25—Affiliates and Other Related Parties

Transactions Involving the Exchange of Assets or Liabilities

14. An arm's-length transaction is defined as a transaction in which willing parties, each being reasonably aware of all relevant facts and neither under compulsion to buy, sell, or loan, would be willing to participate. A transaction between related parties involving the exchange of assets or liabilities shall be designated as either an economic transaction or non-economic transaction. An economic transaction is defined as an arm's-length transaction which results in the transfer of the risks and rewards of ownership and represents a consummated act thereof, i.e., "permanence." The appearance of permanence is also an important criterion in assessing the economic substance of a transaction. In order for a transaction to have economic substance and thus warrant revenue (loss) recognition, it must appear unlikely to be reversed. If subsequent events or transactions reverse the effect of an earlier transaction prior to the issuance of the financial statements, the reversal shall be considered in determining whether economic substance existed

in the case of the original transaction. Subsequent events are addressed in SSAP No. 9—Subsequent Events. An economic transaction must represent a bonafide business purpose demonstrable in measurable terms. A transaction which results in the mere inflation of surplus without any other demonstrable and measurable betterment is not an economic transaction. The statutory accounting shall follow the substance, not the form of the transaction.

15. In determining whether there has been a transfer of the risks and rewards of ownership in the transfer of assets or liabilities between related parties, the following—and any other relevant facts and circumstances related to the transaction—shall be considered:

- a. Whether the seller has a continuing involvement in the transaction or in the financial interest transferred, such as through the exercise of managerial authority to a degree usually associated with ownership;
- b. Whether there is an absence of significant financial investment by the buyer in the financial interest transferred, as evidenced, for example, by a token down payment or by a concurrent loan to the buyer;
- c. Whether repayment of debt that constitutes the principal consideration in the transaction is dependent on the generation of sufficient funds from the asset transferred;
- d. Whether limitations or restrictions exist on the buyer's use of the financial interest transferred or on the profits arising from it;
- e. Whether there is retention of effective control of the financial interest by the seller.

16. A transaction between related parties may meet the criteria for treatment as an economic transaction at one level of financial reporting, but may not meet such criteria at another level of financial reporting. An example of such a transaction is a reporting entity purchasing securities at fair value from an affiliated reporting entity that carried the securities at amortized cost. This transaction meets the criteria of an economic transaction at this level of financial reporting, and therefore, the selling reporting entity would record a gain and the acquiring reporting entity would record the securities at their cost (fair value on the transaction date). At the common parent level of reporting, this transaction has resulted in the mere inflation of surplus, and therefore, is a non-economic transaction. The parent reporting entity shall defer the net effects of any gain or increase in surplus resulting from such transactions by recording a deferred gain and an unrealized loss. The deferred gain shall not be recognized by the parent reporting entity unless and until arms-length transaction(s) with independent third parties give rise to appropriate recognition of the gain.

17. A non-economic transaction is defined as any transaction that does not meet the criteria of an economic transaction. Similar to the situation described in paragraph 16, transfers of assets from a parent reporting entity to a subsidiary, controlled or affiliated entity shall be treated as non-economic transactions at the parent reporting level because the parent has continuing indirect involvement in the assets.

18. When accounting for a specific transaction, reporting entities shall use the following valuation methods:

- a. Economic transactions between related parties shall be recorded at fair value at the date of the transaction. To the extent that the related parties are affiliates under common control, the controlling reporting entity shall defer the effects of such transactions that result in gains or increases in surplus (see paragraph 16);
- b. Non-economic transactions between reporting entities, which meet the definition of related parties above, shall be recorded at the lower of existing book values or fair values at the date of the transaction;
- c. Non-economic transactions between a reporting entity and an entity that has no significant ongoing operations other than to hold assets that are primarily for the direct or indirect benefit or use of the reporting entity or its affiliates, shall be recorded at the fair value at

the date of the transaction; however, to the extent that the transaction results in a gain, that gain shall be deferred until such time as permanence can be verified;

- d. Transactions which are designed to avoid statutory accounting practices shall be reported as if the reporting entity continued to own the assets or to be obligated for a liability directly instead of through a subsidiary.

Examples of transactions deemed to be non-economic include security swaps of similar issues between or among affiliated companies, and swaps of dissimilar issues accompanied by exchanges of liabilities between or among affiliates.

Transactions Involving Services

19. Transactions involving services between related parties can take a variety of different forms. One of the significant factors as to whether these transactions will be deemed to be arm's length is the amount charged for such services. In general, amounts charged for services are based either on current market rates or on allocations of costs. Determining market rates for services is difficult because the circumstances surrounding each transaction are unique. Unlike transactions involving the exchange of assets and liabilities between related parties, transactions for services create income on one party's books and expense on the second party's books, and therefore, do not lend themselves to the mere inflation of surplus. These arrangements are generally subject to regulatory approval.

20. Transactions involving services provided between related parties shall be recorded at the amount charged¹. Regulatory scrutiny of related party transactions where amounts charged for services do not meet the fair and reasonable standard established by Appendix A-440, may result in (a) amounts charged being recharacterized as dividends or capital contributions, (b) transactions being reversed, (c) receivable balances being nonadmitted, or (d) other regulatory action. Expenses that result from cost allocations shall be allocated subject to the same fair and reasonable standards, and the books and records of each party shall disclose clearly and accurately the precise nature and details of the transaction. See *SSAP No 70—Allocation of Expenses* for additional discussion regarding the allocation of expenses.

SSAP No. 62R—Property and Casualty Reinsurance provides the following (**bolding added for emphasis**):

36. The accounting principles for retroactive reinsurance agreements in paragraph 34 shall not apply to the following types of agreements (which shall be accounted for as prospective reinsurance agreements unless otherwise provided in this statement):

- a. Structured settlement annuities for individual claims purchased to implement settlements of policy obligations;
- b. Novations, (i.e., (i) transactions in which the original direct insurer's obligations are completely extinguished, resulting in no further exposure to loss arising on the business novated or (ii) transactions in which the original assuming entity's obligations are completely extinguished) resulting in no further exposure to loss arising on the business novated, provided that (1) the parties to the transaction are not affiliates (or if affiliates, that the transaction has the prior approval of the domiciliary regulators of the parties) and (2) the accounting for the original reinsurance agreement will not be altered from retroactive to prospective;

¹ The amount charged shall be reviewed when there are any modifications or waivers subsequent to the establishment of the contract terms. If waivers or modifications to amounts charged occur, the related party transaction shall be reassessed to determine whether the contract continues to reflect fair and reasonable standards. If the transaction was with a parent or other stockholder and the charge for services has been fully waived, then the guidance in *SSAP No. 72* for recognition as contributed capital (forgiveness of reporting entity obligation) or as a dividend (forgiveness of amount owed to the reporting entity) shall apply.

- c. The termination of, or reduction in participation in, reinsurance treaties entered into in the ordinary course of business;
 - d. **Intercompany reinsurance agreements, and any amendments thereto, among companies 100% owned by a common parent or ultimate controlling person provided there is no gain in surplus as a result of the transaction; or**
 - e. Reinsurance/retrocession agreements that meet the criteria of property/casualty run-off agreements described in paragraphs 102-105.
37. **Retroactive reinsurance agreements resulting in surplus gain to the ceding entity (with or without risk transfer)** entered into between affiliates or between insurers under common control (as those terms are defined in Appendix A-440) shall be reported as follows:
- a. The consideration paid by the ceding entity shall be recorded as a deposit and reported as a nonadmitted asset; and
 - b. No deduction shall be made from loss and loss adjustment expense reserves on the ceding entity's balance sheet, schedules, and exhibits.

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):

INT 03-02 was exposed in March of 2003 and adopted in June 2003. The interpretation was not subsequently amended. The final vote on this consensus had three members opposed. The March 2003 exposure received six different comment letters to the Emerging Accounting Issues (E) Working Group from: 1) Ohio (EAIWG member); 2) New Hampshire (EAIWG member); 3) Interested parties, 4) Liberty Mutual and 5) PriceWaterhouseCoopers (one of the very few letters ever submitted directly by the firm.) and 6) CNA. Five out of the six commenters noted concerns that the proposed guidance (which was ultimately adopted) would conflict with SSAP No. 25 guidance regarding economic transactions. While the interested parties comment letter was more neutral, the verbal comments provided supported the use of SSAP No. 25.

Several commenters recommended not adopting the guidance regarding the use of book value and instead following SSAP No. 25 guidance for economic and non-economic transactions. The commenters noted that SSAP No. 25 directs the use of fair value when such transactions meet the definition of an economic transactions and that tax regulations would provide a result similar to SSAP No. 25. Multiple comments noted concerns similar to those highlighted in the illustration above. Commenters also noted that intercompany pooling reinsurance transaction are economic transactions. They noted that when assets (such as bonds valued at amortized cost) are transferred, if the assets have a different fair value than book value, that difference should be recognized since the transferor no longer controls the assets. Commenters also noted that treatment for reinsurance transactions for asset transfers should not be different than the treatment for other intercompany transactions.

CNA comments were supportive of adopting the exposed consensus, the comment letter provided illustrations and noted that intercompany reinsurance agreements were subject to regulatory approval. The comments tried to illustrate concerns possibly having premature gain / surplus recognition. .

The June 2003 minutes Emerging Accounting Issues (E) Working Group discussion on the INT 03-02 are excerpted below.

The working group was referred to INT 03-02: *Modification to an existing intercompany pooling arrangement* (Attachment D). Written comments were received from Ohio, New Hampshire and interested parties. Ohio and New Hampshire believe that the transfer of assets and liabilities in an intercompany pooling arrangement constitute an economic transaction and the accounting guidance in SSAP No. 25—*Accounting for and Disclosures about Transactions with Affiliates and Other Related Parties* (SSAP No. 25), should be followed. As such, the assets should be transferred at fair value and the ceding entity should record a

realized gain or loss. Keith Bell (Travelers) spoke on behalf of interested parties. Interested parties commented that if the transaction was considered to be an economic transaction, SSAP No. 25 should be followed. If the modification of an intercompany pooling arrangement is considered a noneconomic transaction, the guidance in SSAP No.62—*Property and Casualty Reinsurance*(SSAP No. 62) is applied, as such, statutory book value should be used for assets and statutory value should be used for liabilities. Jeff Alton (CNA) presented his comments by summarizing the statements made in his comment letter. Mr. Alton stated that no revenue recognition should occur and suggested using a modified statutory book value for transferring assets and liabilities. Mr. Clark stated that the Statutory Accounting Principles Working Group must address the recommended transfer at modified statutory book value as this recommendation would require substantive adjustments to statutory accounting principles. Shelly Zimmerman (Liberty Mutual) provided comments which supported that intercompany pooling changes should follow the accounting guidance in SSAP No. 25 as these are economic transactions between affiliates. Jean Connelly (PriceWaterhouseCoopers) provided comments that summarize those outlined in the comment letter. Ms. Connelly stated that intercompany pooling arrangements are economic transactions and that INT 03-01 provides a substantive change to SSAP No. 25.

Mr. Johnson then stated that he believes there is a stronger case for non-economic transaction treatment and as such, statutory book value is appropriate for valuation purposes. Additionally, all these transactions are subject to regulatory review under the Insurance Holding Company Act, affording regulators some control over the approval of these transactions. Mr. Fritsch commented that if this guidance is not adopted in the form of a new interpretation, SSAP No. 25 should be followed. Mr. Alton stated that he believes the current guidance in effect for intercompany pooling arrangements exists in SSAP No. 62, paragraph 30d which supports surplus neutrality: hence, the need is for an interpretation of paragraph 30d. Mr. Johnson stated that language clarification in SSAP No.61—*Life, Deposit-Type and Accident and Health Reinsurance*(SSAP No. 61) and SSAP No. 62 should be addressed as a project of the reinsurance subgroup of the SAPWG. Mr. Johnson made a motion to adopt Interpretation 03-02 with deletion of the first two sentences in paragraph 11. Mr. Stolte seconded the motion. Mr. Johnson requested a roll call vote. There were 9 yeas from Alabama, Connecticut, Florida, Illinois, Louisiana, Michigan, Texas, Pennsylvania and Virginia. There were 3 nays from New York, Ohio, and Wisconsin. Therefore, the working group adopted Interpretation 03-02 by consensus. Mr. Johnson also made a motion to refer to the Reinsurance Subgroup of the SAPWG, review of the current guidance in SSAP No. 61, SSAP No. 62 and SSAP No. 63—*Underwriting Pools and Associations Including Intercompany Pools*. Mr. Ford seconded the motion. The working group unanimously adopted the referral.

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 Review Completed by: Robin Marcotte – NAIC Staff, July - 2022

Staff 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 nullify INT 03-02, as it is inconsistent with SSAP No. 25 guidance regarding economic and non-economic transactions between related parties. The guidance in INT 03-02 can result with in essence, unrecognized gains (dividends) or losses through the using the statutory book valuation when using assets (bonds) to make payments to affiliates for modifications to existing intercompany reinsurance pooling agreements. Treatment of transfers of assets between affiliates should be consistent for all intercompany transactions and there is not a compelling need to be different when valuing assets for intercompany reinsurance transactions.

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 the intent to nullify INT 03-02.

On December 13, 2022, the Working Group moved this agenda item to the active listing, categorized as a SAP clarification, and re-exposed the intent to nullify INT 03-02. This re-exposure requested industry to provide comments on specific instances in which the interpretation was being applied. In addition, the following key points were noted for consideration during the exposure in response to some of the comments received.

1. In the current interest rate environment, the fair value of many bonds is below book value. For example, a bond with an amortized cost of 100 with a fair value of 85. The way INT 03-02 is written a bond with a fair value of 85 could be used to settle an intercompany reinsurance pooling obligation of 100. If the reporting entity paid with cash, they would be required to pay \$100. The actual cash value of obligations when they are extinguished is a relevant measure of the transaction.
2. Using book value for measurement of payments between affiliates can result in either unrecognized of in effect dividend or losses. SSAP No. 25 requires such transfers of assets between affiliates to use fair value. If a subsidiary can pay the parent with assets that have a lower fair value than book value (ex, owes \$100 but pays with a bond of 85), this has a similar effect as an unrecognized capital contribution to the subsidiary. SSAP No. 72 requires a capital contribution to be valued using fair value.
3. At the ultimate parent level such transfer of assets (in accordance with SSAP No. 25 guidance) may be noneconomic in that the parent continues to hold an interest in the same assets. Therefore, at the parent level, such transfers of assets may result in the deferral of gains. Staff believes that losses would not be deferred at the ultimate parent level.
4. While it may be more expedient to pay intercompany reinsurance pooling transactions with assets, the valuation used should be similar to if the obligation was extinguished with cash. Therefore, an entity can still choose to pay with assets, they just need to be valued consistently with SSAP No. 25 guidance.
5. SSAP No. 62R, paragraph 36d provides an exception to retroactive reinsurance accounting guidance which allows for prospective accounting treatment for intercompany reinsurance among 100% owned affiliated provided there is no gain to the ceding entity. If there is again to the ceding entity, there is guidance in SSAP No. 62R, paragraph 37 which requires a more punitive method of accounting than either prospective or retroactive reinsurance accounting. Therefore, NAIC staff comment is that the statutory accounting objective is to provide different treatment for retroactive reinsurance contracts if there is a gain to the ceding entity. This is another reason that the guidance in INT 03-02 is problematic. The object is to correctly measure the effects of the contract, which drives the accounting. The objective is not to obscure whether there is a gain to the ceding entity, which can happen in the event that the assets used in payment are not measured correctly.
6. Interested parties noted that modifications to intercompany pooling arrangements are typically effective retroactive to the beginning of the year. Staff notes that the payment value when the transaction is settled should be equivalent to the cash value of what is owed on the date of extinguishment of the liability.
7. Many of the interested parties' comments regarding GAAP use of book value are more relevant to consolidated basis accounting which is not consistent with the legal entity basis of statutory accounting.
8. Interested parties' comments noted that there is a difference in treatment for intercompany pooling participants who are not 100% owned by a common parent. NAIC staff notes that retroactive pooling agreement changes with participants that are not 100% under common control do not meet the exception to retroactive accounting provided in SSAP No. 62R, paragraph 36d. NAIC staff notes that SSAP No. 62R, paragraph 37 provides guidance for retroactive reinsurance agreements among affiliates where there is a gain to the ceding entity. Therefore, the regulatory objective is not to avoid gain but to properly account for intercompany retroactive contracts that include gains.

On March 22, 2023, the Working Group re-exposed the intent to nullify INT 03-02, effective December 31, 2023. The nullification is proposed as INT 03-02 is inconsistent with SSAP No. 25 guidance regarding economic and non-economic transactions between related parties. The guidance in INT 03-02 can result with, in essence, unrecognized gains (dividends) or losses through the using the statutory book valuation when using assets (bonds) to make payments to affiliates for modifications to existing intercompany reinsurance pooling agreements. Treatment of transfers of assets between affiliates should be consistent for all intercompany transactions and there is not a compelling need to be different when valuing assets for intercompany reinsurance transactions.

<https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/NationalMeetings/A.NationalMeetingMaterials/2023/8-13-23SummerNationalMeeting/Hearing/24-22-12-ReviewINT03-02.docx>

Interpretation of the Emerging Accounting Issues (E) Working Group

INT 03-02: Modification to an Existing Intercompany Pooling Arrangement

NOTE: The Statutory Accounting Principles (E) Working Group has exposed the intent to nullify this Interpretation effective December 31, 2023.

INT 03-02 Dates Discussed

March 9, 2003; June 22, 2003; [August 10, 2022](#); [December 13, 2022](#), [March 22, 2023](#)

INT 03-02 References

Current:

SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance

SSAP No. 62R—Property and Casualty Reinsurance

SSAP No. 63—Underwriting Pools

INT 03-02 Issue

1. Insurance groups that utilize intercompany pooling arrangements often modify these arrangements from time to time for various business reasons. These business reasons commonly include mergers, acquisitions, dispositions or a restructuring of the group's legal entity structure. As an insurance group's business objectives and strategies evolve, it may be necessary for the insurance group's legal entity structure to similarly evolve in order to address the insurance group's business needs.
2. SSAP No. 63, paragraphs 5 and 7, defines and describes intercompany pooling as an arrangement among affiliated entities whereby "all of the pooled business is ceded to the lead entity and then retroceded back to the pool participants in accordance with their stipulated shares." This arrangement is established through "a conventional quota share reinsurance agreement..." Arrangements whereby there is one lead company that retains 100% of the pooled business and all or some of the affiliated companies have a 0% net share of the pool may qualify as intercompany pooling."
3. Therefore, in order to effectuate a modification to the existing intercompany pooling arrangement, companies must either 1) amend the existing reinsurance agreement, or 2) execute new agreements. The latter scenario may entail executing at least two agreements: a commutation of the existing agreement, and a new quota share agreement(s) that covers both past and future periods.
4. To illustrate, in order to effectuate a relatively simple modification, such as changing pooling participation percentages without changing the pool participants, companies often simply amend the existing pooling agreement. Alternatively, in order to effectuate a more complex modification, such as changing (by adding or removing) the number of pool participants, a company must commute the existing pooling agreement and execute a new quota share agreement(s). In conjunction with executing the appropriate reinsurance agreements, a transfer of assets and liabilities amongst the impacted affiliates is also required in order to implement the new reinsurance agreement(s). At issue is the appropriate valuation basis to be used for assets and liabilities that are transferred pursuant to the new reinsurance agreement(s).
5. Since SSAP No. 63 does not specifically address modifications to intercompany pooling arrangements, insurance groups that modify their intercompany pooling arrangements must refer elsewhere in Statutory Accounting Principles (SAP) for relevant guidance. The obvious guidance for such transactions is SSAP No. 62R since an intercompany pooling arrangement is, by definition, affiliated

reinsurance. There is, however, a minority opinion that *SSAP No. 25—Affiliates and Other Related Parties* appears to apply due to the affiliated nature of these transactions. Since the guidance and intent of SSAP No. 62R and SSAP No. 25 provide for different valuation bases, this interpretation serves to provide definitive guidance as to which SSAP is relevant for these transactions and, therefore, clarify the appropriate valuation basis to be used for assets and liabilities transferred pursuant to a modification to an intercompany pooling arrangement.

SSAP No. 62R Approach:

6. This approach refers to the guidance and statutory accounting intent from SSAP No. 62R since intercompany pooling arrangements are defined and established through reinsurance. Further, since modifications to intercompany pooling agreements typically involve the transfer of net liabilities incurred since the inception of the existing pooling agreement (i.e., prior to the effective date of the new agreement), the retroactive reinsurance accounting guidance in paragraphs 33-39 of SSAP No. 62R is applicable. Paragraph 33 states that this special accounting treatment is warranted “due to the potential abuses involving the creation of surplus to policyholders and the distortion of underwriting results...” However, paragraph 36.d. specifically applies to intercompany reinsurance arrangements, and amendments to intercompany reinsurance agreements, since the reinsurance agreement is among companies 100% owned by a common parent. This paragraph allows prospective accounting treatment for intercompany reinsurance agreements that do not result in a gain in surplus as a result of the transaction.

7. To provide historical perspective, prior to the adoption (with modification) of FASB *Statement No. 113, Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts* (FAS 113) as SAP, paragraph 36.d. was added as one of the SAP modifications. The intent of adding paragraph 36.d. was to specifically exclude intercompany reinsurance agreements among entities 100% owned by a common parent from retroactive reinsurance accounting requirements as a result of amending or modifying these agreements, provided there is no surplus gain. The presumption in this intent was that there would be no gains to the ceding entity resulting from implementing amendments or modifications to these types of reinsurance agreements.

8. Therefore, based on the foregoing guidance and background, the statutory accounting intent is to avoid surplus gains for the ceding entity as a result of implementing a modification to an intercompany pooling arrangement. On that basis, such a modification does not represent an economic transaction to the insurance group or to the impacted companies. As such, the transfer of both the assets and the liabilities valued at statutory book value ensures that there is no impact to surplus as a result of implementing a modification to an existing pooling arrangement.

SSAP No. 25 Approach:

9. An approach different from that which refers to reinsurance accounting guidance is to refer to the guidance in SSAP No. 25 since some may view a modification to an intercompany pooling agreement as a related party transaction involving the exchange of assets or liabilities. In this case, paragraphs 14-18 of SSAP No. 25 would appear applicable. This guidance specifies differing valuation bases, depending on whether the transaction is considered an economic or a non-economic transaction. SSAP No. 25, paragraph 14, states that “...The appearance of permanence is also an important criterion in assessing the economic substance of a transaction. In order for a transaction to have economic substance and thus warrant revenue (loss) recognition, it must appear unlikely to be reversed ...” Since insurance groups often modify intercompany pooling arrangements, this type of transaction is not permanent, and may be construed as a non-economic transaction. SSAP No. 25, paragraph 18.b., states that “non-economic transactions ... shall be recorded at the lower of existing book value or fair value at the date of the transaction.”

10. It appears that this guidance is intended to address matters involving discrete or isolated transfers of assets and/or liabilities between affiliates rather than transfers of assets and liabilities effected in

Modification to an Existing Intercompany Pooling Arrangement

relation to executing reinsurance transactions (the guidance for which is SSAP No. 62R). Additionally, application of this guidance would result in a change to the surplus of the insurance group as a result of implementing a modification to an existing intercompany pooling arrangement. As previously stated, the statutory accounting intent is to avoid surplus gains for the insurance group as a result of implementing a modification to an intercompany pooling arrangement.

11. The accounting issues are:
 - a. What is the relevant guidance for modifications to intercompany pooling arrangements?
 - b. What is the appropriate valuation basis to be used for assets and liabilities that are transferred among affiliates in conjunction with the execution of a new reinsurance agreement(s) that serves to substantively modify an existing intercompany pooling arrangement?

INT 03-02 Discussion

The Working Group reached a consensus as follows:

12. SSAP No. 62R provides accounting for property and casualty reinsurance agreements including specific guidance on intercompany pooling agreements. SSAP No. 62R provides two methods of accounting for changes in intercompany pooling agreements, depending on whether or not the pooling results in a gain in surplus.

13. The appropriate valuation basis to be used for assets and liabilities that are transferred among affiliates in conjunction with the execution of a new reinsurance agreement(s) that serves to substantively modify an existing intercompany pooling arrangement is statutory book value for assets and statutory value for liabilities. Book value is defined in the glossary of the *Accounting Practices and Procedure Manual*.

INT 03-02 Status

14. No further discussion is planned.

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

Issue: New Market Tax Credits

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 New Market Tax Credits (NMTC) Program was established by Congress in December 2000 and permits individual and corporate taxpayers to receive a non-refundable tax credit against federal income taxes for making equity investments in financial intermediaries known as Community Development Entities (CDEs). CDEs that receive the tax credit allocation authority under the program are domestic corporations or partnerships that provide loans, investments, or financial counseling in low-income urban and rural communities. The tax credit provided to the investors total 39% of the total cost of the investment and is claimed over a seven-year period. The CDEs in turn use the capital raised to make investments in low-income communities. CDEs must apply annually to the CDFI Fund to compete for NMTC allocation authority. The NMTC program is currently subject to expiration but has been extended to Dec. 31, 2025. The NMTC Extension Act of 2021 (introduced February 2021) would make the NMTC program permanent, modify the credit to provide for an inflation adjustment to the limitation amount for the credit after 2021, and allow an offset against the alternative minimum tax for the credit.

The success of the federal NMTC program has led to states adopting their own NMTC legislation. Per one noted article, majority of state NMTC programs follow the federal rules with some modifications that vary from state to state. State modifications have been noted to specifically target smaller business, simplifying the application process, prohibiting the use of real estate business, and capping the amount of tax credits that can be allocated to one project. The economic impact of the state NMTC programs is typically less than the impact of federal NMTC programs because the economic return to investors for state tax credits is generally lower than what they receive for federal credits. Some states require that state tax credits can only be used in conjunction with federal credits. Pairing federal and state programs is beneficial to the qualifying business as they keep more of the investment without an obligation to return as the investors gets more tax credits.

Overview of Federal Program:

- Federal government authorizes an annual credit authority for NMTCs (amount of tax credits available).
- The Community Development Fund Institutions (CDFI fund) is a division of the U.S. Treasury responsible for implementing the NMTC program. Since there are limited tax credits each year, the CDFI fund has a competitive application process for the right to grant tax credits to investors and to make qualified NMTC investments.
- The right to grant tax credits is referred to as “NMTC Allocation” and is awarded to Community Development Entities (CDEs) that invest in low-income communities. The CDEs offer the tax credits to cash investors, and then use the cash to make investments (typically loans to a qualifying project – a “Qualifying Active Low-Income Community Business” - QALICB) that further the mission and objectives of the NMTC program.

- The program specifies that the investor must provide cash as an equity investment (qualified equity investment – QEI) and it must stay invested in the CDE and the resulting NMTC qualifying project (QALICB) for a period of seven years.
 - The restrictions are specific that the investment is an equity investment as stock (other than nonqualified preferred) in an entity that is a corporation for federal tax purposes or any capital interest in an entity that is a partnership for federal tax purposes. (The investor is generally a 99.99% or 100% equity owner.)
- NMTC investments must remain in a qualified business for a seven-year period. Any principal amount repaid during that period must be reinvested by the CDE until the seven-year period expires. Most CDEs and investors avoid the reinvestment requirement and structure interest-only loans that prohibit principal repayment within the seven-year timeframe.
 - The 39% tax credit is provided as 5% of the investment in the first 3 years and then 6% of the investment for the next 4 years.
 - For tax purposes, the basis adjustment in the qualified equity investment is reduced by the amount of any new market tax credits on each credit allowance date.
 - Programs that cease to qualify are subject to tax credit recapture.
- Investors enter these transactions recognizing that the original investment amount will not be fully returned. Rather, a portion (or perhaps all) of the equity investment will be unpaid without an obligation to return from the borrowing business. NMTC investments with these terms have specific maturing terms / actions. One approach could be that an option (put/call) is held by the investor that gives them the right to sell its equity investment to the borrower for a nominal price.
- The designs are often complex and introduce leverage lenders to maximize tax credits to the equity investor:
 - Equity investor provides \$3M to acquire 100% equity interest in an investment fund.
 - Investment fund borrows \$7M from a leverage lender.
 - This results with a \$10M qualifying NMTC transaction, resulting with the equity investor receiving \$3.9M in tax credits over 7 years from an initial \$3M investment.
 - The investment fund provides two loans to the qualified low-income business (QALICB). The first loan is for the \$7M leverage loan, the second is for the \$3M equity investment.
 - Both loans only pay interest for the seven-year period to meet the NMTC terms.
 - At the conclusion of the 7 years, the project sponsor purchases the second loan via a ‘put/call’ agreement, converting the \$3M into a permanent subsidiary for the project.
 - The borrower / project sponsor refinances the \$7M loan to repay the leverage lender.
 - The ultimate result is that the equity investor received \$3.9M over 7 years in tax credits for \$3M.
- Example without leverage lender:
 - Investor provides a \$10M NMTC Investment
 - Investor receives \$3.9M in tax credits over seven years.
 - Investors receives \$7.4M of original investment at the end of the seven years.
 - Borrower keeps \$2.6M of the original investment to further their low-income qualifying activities.
 - Investor receives a net return of \$1.3M. (\$10M less \$3.9M tax credits less return of 7.4M principal.)

FASB Discussion

The FASB has a current Emerging Issues Task Force project to assess whether the proportional amortization method of accounting, which is used for Low-Income Housing Tax Credits (LIHTC), should be expanded to investments in tax credit structures beyond LIHTC. The proportional amortization method results in the tax credit investment being amortized in proportion to the allocation of tax credits in each period and allows the investment amortization and tax credits to be presented on a net basis within the income tax line item. Currently, investments in other tax credit structures are typically accounted for using the equity method or the cost method. Under the equity and cost methods, investment gains/losses and tax credits are presented on a gross basis on an entity's income statement. The FASB has received two requests asking that the proportional amortization method be made applicable to New Market Tax Credit Structures as well as other investment structures that are made primarily for the purpose of receiving tax credits and other tax benefits. The FASB added a project to the Emerging Issues Task Force agenda on Sept. 22, 2021. The FASB Task Force reached a consensus-for-exposure on June 16, 2022, that the proportional amortization method can be elected on a tax credit program by tax credit program basis. This proposed ASU was exposed in August 2022, with comments due Oct. 6, 2022. A final ASU is expected later in 2022 or early in 2023 (ASU 2023-02 was issued in March of 2023).

IRS Provisions – The NMTC is captured as a nonrefundable 'general business credit' and is limited to tax liability. If tax liability is not sufficient to take the credit, then the tax credit is subject to carryforward / carryback provisions. Per instructions from the *2021 Instructions for Form 3800 – General Business Credit*, general business credits that cannot be used because of a tax liability limit are first carried-back 1 year through an amended return. If there are unused credits after carrying back 1 year, the tax credit can be carried forward to each of the 20 tax years after the year of the credit.

Inflation Reduction Act Provisions – The Inflation Reduction Act was signed by President Biden on Aug. 16, 2022. Although there are several elements within the Act, it includes a 15% corporate minimum tax rate for corporations with at least \$1 billion in income and includes numerous investments in climate protection, clean energy production and tax credits aimed at reducing carbon emissions. Although the Act has been signed, several elements are pending further application guidance. From preliminary information, the act allows for general business credits, such as the low-income housing tax credit (LIHTC), new markets tax credit (NMTC), historic tax credit (HTC) and renewable energy tax credits (RETCs) to be taken against the minimum tax. **However, further monitoring of application / interpretation guidance that is still forthcoming is required to assess the actual application and impact of tax credits on companies subject to the minimum tax.**

Statutory Accounting Considerations:

- Although the design is an equity investment of stock or interest in a corporation or partnership, which would normally be subject to *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*, the intent of NMTC investments is for tax credits and not equity returns. As such, this structure is closer to the existing low-income housing tax credits guidance in *SSAP No. 93* than the partnership / LLC guidance in *SSAP No. 48*.
- Although *SSAP No. 93—Low Income Housing Tax Credit Property Investments* provides guidance for an equity investment, that provides tax credits with a limited (or zero) residual investment value, the guidance in *SSAP No. 93* is specific to LIHTC programs.
- It has been identified that there are structures that have been designed to resemble fixed-income notes that do not pay regular cash interest, but rather provide NMTC tax credits as interest returns. These structures are in substance that same as other investments in NMTC, with an underlying equity interest in the CDE that generates tax credits. However, they have been structured with a guarantee for compensatory interest in the form of cash for the amount of the tax credit expected to have been received that year. These structures are also being considered within scope of this agenda item. Such structures have to meet specific criteria to qualify for tax credits under the IRS rules.

Existing Authoritative Literature:

SSAP Authoritative Guidance:

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

This statement establishes accounting principles for investments in federal certain state sponsored Low Income Housing Tax Credit (LIHTC) properties owned through limited liability entities that are flow-through entities for tax purposes. The guidance requires LIHTC investments to be initially recorded at cost and carried at proportional amortized cost unless the investment is identified as impaired. Under the proportional amortization method, amortization of the LLC investment is recognized in the income statement as a component of net investment income/expense and the current tax credit is accounted for as a component of income tax expense:

- Federal tax credits are recognized in the income statement as an offset to federal taxes in the tax reporting year in which the tax credit is utilized in accordance with *SSAP No. 101—Income Taxes*.
- State tax credits shall be recognized in the income statement as an offset to state premium tax or state income tax, whichever is applicable, in the tax-reporting year in which the credit is utilized.
- Tax benefits received, other than tax credits, shall be accounted for pursuant to SSAP No. 101.

SSAP No. 93 indicates that immediate recognition of the entire benefit of the tax credit to be received during the term of the investment in a low-income housing project is not appropriate. It also indicates that low-income housing tax credits shall not be recognized in the financial statements before their inclusion in the investor's tax return.

- **SSAP No. 94R—Transferable and Non-Transferable State Tax Credits**

This statement establishes accounting principles for investments transferable and non-transferable state tax credits, with an explicit exclusion for LIHTCs (or similar tax credits) captured in scope of SSAP No. 93.

Guidance for admittance of state tax credits under this statement varies based on whether it is transferable or non-transferable:

Transferable – Per the SSAP, all the following criteria must be met for admittance:

- 1) The holder of the transferable state tax credit may sell or otherwise transfer the transferable state tax credit to another entity, which can likewise sell or transfer the credit;
- 2) The transferable state tax credit will expire is not used by a predetermined date; and
- 3) The transferable state tax credit can be applied against either state income tax or state premium tax.

Non-Transferable – Per the SSAP, all the following criteria must be met for admittance:

- 1) Successive holder of a state tax credit must redeem the credit by April 15 of the subsequent year to the entity's acquisition of the state tax credit and is not permitted to carry-over, carry-back, obtain a refund, sell or assign the credit;
- 2) The non-transferable state tax credit will expire if not used by the predetermined date; and
- 3) The non-transferable state tax credits can be applied against either state income tax or state premium tax.

Review of Existing Statutory Accounting Guidance for NMTC and Overall Application:

- Existing statutory accounting guidance does not encompass federal NMTC (or other federal tax credits), as SSAP No. 93 is limited to LIHTC and SSAP No. 94 is specific to state tax credits.
- Provisions in SSAP No. 93 do not fully address earned (received) tax credits that carryforward for future use.
- The admittance criteria in SSAP No. 94 are applied to characteristics that perhaps may not be factors that would impact admittance:
 - A tax credit that does not expire would be precluded as an admitted asset under the guidance.
 - A non-transferable tax credit that can be carried-forward, carried-back, able to be refunded or that can be sold or assigned is precluded as an admitted asset under the guidance.

Statutory Accounting Reporting Guidance:

Guaranteed and non-guaranteed federal low-income housing tax credits have separate reporting lines on Schedule BA along with an “all other” low-income housing tax credit line. The guidance is specific that these lines are only for low-income tax credits (or tax credits for affordable housing) that are in the form of a partnership or limited liability company. Non-qualifying LIHTC are to be reported in the “All Other” category. With this current guidance, there is no explicit reporting provision for tax credits that are not captured in LIHTC.

Reporting Lines and Instructions:

Guaranteed Federal Low Income Housing Tax Credit	
Unaffiliated	3599999
Affiliated	3699999
Non-Guaranteed Federal Low Income Housing Tax Credit	
Unaffiliated	3799999
Affiliated	3899999
Guaranteed State Low Income Housing Tax Credit	
Unaffiliated	3999999
Affiliated	4099999
Non-Guaranteed State Low Income Housing Tax Credit	
Unaffiliated	4199999
Affiliated	4299999
All Other Low Income Housing Tax Credit	
Unaffiliated	4399999
Affiliated	4499999

Low Income Housing Tax Credit

- Include: All Low Income Housing Tax Credit Investments (LIHTC or affordable housing) that are in the form of a Limited Partnership or a Limited Liability Company including those investments that have the following risk mitigation factors:
- A. Guaranteed Low Income Housing Tax Credit Investments. There must be an all-inclusive guarantee from a CRP-rated entity that guarantees the yield on the investment.
 - B. Non-guaranteed Low Income Housing Tax Credit Investments.
 - I. A level of leverage below 50%. For a LIHTC Fund, the level of leverage is measured at the fund level.

- II. There is a Tax Credit Guarantee Agreement from General Partner or managing member. This agreement requires the General Partner or managing member to reimburse investors for any shortfalls in tax credits due to errors of compliance, for the life of the partnership. For a LIHTC Fund, a Tax Credit Guarantee is required from the developers of the lower tier LIHTC properties to the upper tier partnership and all other LIHTC investments.
- III. There are sufficient operating reserves, capital replacement reserves and/or operating deficit guarantees present to mitigate foreseeable foreclosure risk at the time of the investment.

Non-qualifying LIHTCs should be reported in the “All Other” category

Statutory Accounting RBC Impact:

Life: The RBC factor for LIHTC are captured as part of the real estate on LR007:

(17)	Federal Guaranteed Low Income Housing Tax Credits	AVR Equity Component Column 1 Line 75	0.0014
(18)	Federal Non-Guaranteed Low Income Housing Tax Credits	AVR Equity Component Column 1 Line 76	0.0260
(19)	State Guaranteed Low Income Housing Tax Credits	AVR Equity Component Column 1 Line 77	0.0014
(20)	State Non-Guaranteed Low Income Housing Tax Credits	AVR Equity Component Column 1 Line 78	0.0260
(21)	All Other Low Income Housing Tax Credits	AVR Equity Component Column 1 Line 79	0.1500
(22)	Total Schedule BA Real Estate	Lines (16) + (17) + (18) + (19) + (20) + (21)	

P/C and Health: The RBC factors for LIHTC are captured as components of other long-term assets. The reporting lines and factors are the same as they are for life (as shown above).

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): NA

Recommendation:

NAIC staff recommend that the Working Group expose additional revisions described below to SSAP No. 93 and SSAP No. 94R. Additionally, NAIC staff recognizes that revisions to the annual statement Schedule BA reporting lines will need to be considered, as well as how those reporting lines flow through to the AVR. NAIC staff recommends that the Working Group direct staff to work with interested parties throughout the interim to discuss to allow subsequent (or interim) exposure.

Staff Review Completed by: William Oden and Julie Gann - NAIC Staff, May 2023

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 a discussion document to expand current statutory accounting guidance for low-income housing tax credits to capture all tax equity investments that provide general federal business tax credit and state premium tax credits if they meet specified criteria.

On March 22, 2023, the Statutory Accounting Principles (E) Working Group directed NAIC staff to draft statutory accounting guidance in the form of a new or revised SSAP that expands the current LIHTC guidance for equity investments that general federal business tax credit and state premium tax credits.

On May 16, 2023, the Statutory Accounting Principles (E) Working Group exposed revisions to SSAP No. 93 and 94R. The revisions to SSAP No. 93 propose adoption with modification of *ASU 2023-02–Accounting for Investments in Tax Credit Structures Using the Proportional Amortization Method* and expansion of the SSAP scope to include all tax credit programs and tax investment structures. The revisions to SSAP No. 94R expand the scope of the SSAP to include all state and federal tax credits whether purchased or allocated, and that tax received should be recorded at face value with losses realized immediately and gains deferred.

On June 20, 2023, NAIC staff received Interested Parties' comment letter on the exposed revisions to SSAP No. 93 and 94R. Interested Parties provided several comments on both SSAPs which are summarized below along with NAIC Staff responses.

The comments provided on SSAP No. 93 were:

1. Interested Parties noted that paragraph 3 does not provide specific direction for which SSAPs would be applicable for tax credit investment which do not fall within SSAP No. 93.
 - a. NAIC Staff agreed with the recommendation and updated paragraph 3 to provide readers with specific SSAPs which could apply to non-qualifying equity or debt structure tax credit investments.
2. Interested Parties noted that the current draft directed readers to refer to SSAP 94R for how to account for tax credits allocated from tax credit investments. They felt that this cross-reference was confusing and could potentially lead to conflicting interpretations.
 - a. To reduce confusion, NAIC Staff opted to remove the paragraph directing readers to SSAP 94R and instead pulled in the specific paragraphs from SSAP 94R which would be applicable to tax credits allocated from tax credit investments.
3. Interest Parties noted that they were unclear on whether the tax credits earned, or the tax credit investments were subject to the admittance criteria detailed in Paragraphs 18(a)-(c). Interested Parties feels that admissibility concerns are adequately addressed by the tax opinion and audit requirements. Additionally, if NAIC Staff's concern is the admittance of tax credits carried forward to a future period, then this should be adequately addressed by the admittance rules detailed in *SSAP No. 101–Income Taxes* for Deferred Tax Assets. Interested Parties suggested that paragraphs 18(a)-(c) be deleted in full.
 - a. NAIC Staff noted that the admittance rules detailed in paragraphs 18(a)-(c) do NOT provide guidance on the admittance of allocated tax credits. For tax credit investment structures to fall within the scope of SSAP 93, substantially all benefits must be from tax credits or other tax benefits which essentially means that balance of a tax credit investment represents a future stream of tax credits and tax benefit. As such, the admittance rules in paragraph 18(a)-(c) would require a company to assess its ability to utilize that future stream of tax credits to what amount of the tax credit investment would be non-admitted. If the company's projections determine it will be unable to substantially utilize the future stream of tax credits (i.e., the tax credit investment balance) then potentially all or a portion of the tax credit investment would be considered non-admitted as the company is unable to utilize the future stream of tax credits to offset tax liabilities.
4. Interested Parties noted that GAAP requires retrospective adoption of ASU 2023-02 and that this would result in GAAP vs. Statutory accounting differences.
 - a. NAIC Staff noted that prospective adoptions of accounting updates are often simpler to implement than retrospective adoptions. However, since this would lead to unintended variance between GAAP and Stat NAIC Staff has updated SSAP 93 to be adopted on the retrospective basis to conform with the GAAP adoption requirements.

The comments provided on SSAP No. 94R were:

1. Interest Parties requested that paragraph 1 of the scope of statement section be amended to clarify which types of tax credits are within scope of SSAP No. 94R. Interested Parties feel that the key difference between SSAP 94R and SSAP 93 is that the former is for purchased tax credits and the latter is for tax credits earned from investments.

- a. NAIC Staff generally agree with the comments provided but opted to remove the term “certificate” from the requested changes. The intent of SSAP No. 94R is to provide guidance on all purchased state and federal tax credits, not just certificated tax credits. NAIC Staff also included language to clarify the scope of SSAP No. 94R for allocated tax credits, as detailed in the next bullet point.
2. Interested Parties noted that they do not believe allocated tax credits from SSAP No. 93 investments should be within the scope of SSAP No. 94R as the guidance was confusing and could potentially lead to conflicting interpretations. Additionally, Interested Parties believe that tax credits from investments vs. purchased tax credits are distinctly different assets. The only similarity in accounting for the tax credits relates to instances when the credits earned under a SSAP No. 93 investment cannot be utilized in the current year. Under that scenario, a DTA would be recorded, which would be subject to the admissibility rules under SSAP No. 101.
 - a. NAIC Staff elected to remove tax credits allocated from SSAP No. 93 investments from the scope of SSAP No. 94R to avoid confusion. However, NAIC Staff note that tax credits earned from investments bear many similarities to purchased tax credits. Irrespective of how the tax credit are acquired, they represent the same type of financial instruments which can be utilized as an offset to tax liabilities, sold, or redeemed for cash as a tax refund. Additionally, irrespective of how the tax credits are earned they are recorded at face value upon acquisition. The only significant difference is that tax credits purchased at a premium or discount may result in a recognized loss or deferred gain, respectively, whereas any premium or discount on an allocated tax credit is recognized as part of proportional amortization calculation.
 - b. NAIC Staff amended the draft to exclude tax credits allocated from SSAP No. 93 investments in response to the Interested Party comments on SSAP No. 93. However, NAIC Staff did include language noting that allocated tax credits earned from tax credit investments NOT within the scope of SSAP No. 93 should refer to SSAP 94R for guidance on how to record allocated tax credits. NAIC staff noted that without this language there would be no guidance within Accounting Practices and Procedures Manual for allocated tax credits from investments which fall outside the scope of SSAP No. 93.
3. Interested Parties noted that most tax certificates reduce a reporting entity’s tax liability and do not directly impact the income statement at the time they are used. In addition, interested parties believe that upon purchase, the tax credits should be reported as an other-than-invested asset since the asset represents a right to receive future benefits. As the tax credits become available for use, a reduction to the insurer’s income tax payable or premium/state taxes payable should take place.
 - a. NAIC Staff disagrees with this proposed change as purchased federal tax credits would be reported as other-than-invested assets, versus allocated federal tax credits which would reported as a deferred tax asset. This would result in the same type of asset being reported on two separate lines based on the manner in which it was acquired. As noted above, NAIC Staff’s position is that allocated and purchased tax credits are substantially the same assets irrespective of the way in which they are acquired. Additionally, the Interested Parties also proposes that if a tax credit cannot be utilized in the same period in which it was purchased it should be transferred to Deferred Tax Assets. NAIC Staff notes that this does not resolve the short-term reporting discrepancy noted previously and adds further complications to the accounting process by requiring a reporting line transfer if the asset is held for longer than a year.
4. Interested Parties noted that the accounting for purchased tax credits in the SSAP No. 94R exposure is different from the current guidance in that the credits will be recorded at face value instead of at cost. This is not an issue perse but Interested Parties did want to point out this discrepancy as compared to the accounting treatment for other assets like bonds and mortgage loans.
 - a. NAIC Staff’s position is that tax credits, whether received via purchase or allocation, do not represent investments, and has opted to propose accounting guidance that differs from bonds or mortgage loans. The position that tax credits do not represent investments was the main reason for the original SSAP No. 94R guidance which required state tax credits be recorded to Other Than Invested Assets and effectively required companies tax credits purchased at a discount at cost and effectively defer the gain off the balance sheet. NAIC Staff felt that it would be less confusing and

- provide a more accurate financial picture to record the tax credit at face value and defer any gains from discount purchases on the balance sheet.
5. Interested Parties proposed changes to Exhibit B to reflect a pro-rata utilization of purchased tax credits in relation to the quarterly accrual of income tax liabilities. The main purpose of these changes were to reflect Interested Parties' proposed changes in item #2.
 - a. NAIC Staff made these changes to Exhibit B and believe that this method of recognizing tax credit utilization is applicable to exposed draft of SSAP No. 94R.

Outside of the changes made in response to Interested Parties' Comment Letter, both Exhibits in SSAP No. 93 were revised to provide example journal entries of the Proportional Amortization method. Additionally, the assumptions in Exhibit B were revised so it would provide a journal entry example for a residual sale at the end of the proportional amortization period. A new footnote was also added to SSAP No. 94R on page 2 based verbal comments received from the public. The new footnote provides clarification on what processes constitute a purchase vs an allocation of tax credits.

<https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/NationalMeetings/A.NationalMeetingMaterials/2023/8-13-23SummerNationalMeeting/Hearing/26-22-14-NMTC.docx>

Note: The revisions made to SSAP No. 93—Low-Income Housing Tax Credit Property Investments were exposed on May 16, 2023, in a clean format rather than through tracked changes to prioritize readability for initial comment as the revisions are for all intent and purposes comprehensive; changes made to the exposed draft have been shown as tracked changes below.

All revisions made to SSAP No. 93 will be included in the Issue Paper as tracked changes, which is anticipated to be drafted in the fall of 2023.

Statements of Statutory Accounting Principles No. 93 - Revised

Investments in Tax Credit Structures

STATUS

Type of Issue.....	Common Area
Issued	June 13, 2005; Substantively revised XX XX , 2023
Effective Date	January 1, 2006; Substantive revisions detailed in Issue Paper No. xxx effective XX XX , 2023
Affects.....	No other pronouncements
Affected by	No other pronouncements
Interpreted by	INT 06-07
Relevant Appendix A Guidance	None

STATUS	1
SCOPE OF STATEMENT	2
SUMMARY CONCLUSION	2
Accounting	3
Application of Proportional Amortization Method.....	4
Admittance Requirements.....	4
Future Contributions and Additional Tax Credits.....	6
Impairment.....	7
Disclosures.....	7
Relevant Literature.....	8
Effective Date and Transition	9
REFERENCES	9
Relevant Issue Papers	9
EXHIBIT A – APPLICATION OF PROPORTIONAL AMORTIZATION METHOD	10

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for qualifying tax credit investments¹ in programs made primarily for the purpose of receiving allowable general business federal tax credits and or state tax credits, including state premium tax credit programs. Although these investments are often in the form of equity, this statement shall be applied to all investments (regardless of the structure of the investment) that qualify pursuant to **paragraph 1**.

2. A reporting entity that invests in projects or programs that generate general business federal tax credits, corresponding state tax credits or state premium tax credits that meet the following conditions at the time of initial investment are required to capture the investment in scope of this statement:

- a. It is probable that the tax credits allocable to the investor will be available.
- b. Reporting entity investor does not have the ability to exercise significant influence over the operating and financial policies of the underlying projects.
- c. Substantially all the projected benefits are from tax credits and other tax benefits, determined on a discounted basis using a discount rate that is consistent with the cash flow assumptions utilized by the reporting entity for the purpose of deciding to invest in the project.
- d. The reporting entity's projected yield based solely on the cash flows from the tax credits and other tax benefits is positive.

3. Tax credit investments that do not meet the conditions in **paragraph 2** shall be captured within the statutory accounting statement that addresses the underlying investment structure. Equity structured tax credit investments would generally fall within SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies. Debt structured tax credit investments should be assessed in accordance with SSAP No. 26R—Bonds to determine eligibility for reporting as a bond. ~~Investments in tax credit structures that do not meet the conditions in **paragraph 2** shall be captured within the statutory accounting statement applicable to the investment held.~~

4. Investments in a CAPCO (Certified Capital Company), organized as a partnership or an LLC, which is a company, authorized by state statute that borrows from investors, to make venture capital investments in “qualified” businesses, are not within the scope of this statement. Although associated with tax credits, the reporting entity is paid principal and interest on its investment with the CAPCO. Depending upon the terms of the CAPCO offering, principal and interest payments to the reporting entity will come from the CAPCO and/or the state. The CAPCO will make cash payments directly to the investors while the state will make payments in the form of premium or income tax credits. Investments in a CAPCO shall be accounted for in accordance with *Interpretation (INT) 06-02: Accounting and Reporting for Investments in a Certified Capital Company (CAPCO)* and specific statutory accounting guidance addressing CAPCOs.

SUMMARY CONCLUSION

5. Investments in tax credit structures are generally acquired to obtain a positive yield through tax credits and other tax benefits. The value of the investment is primarily based on the value of the remaining stream of tax credits and deductible expenses available to the reporting entity investor. The primary purpose of investing in these tax credit structures is to generate tax credits which benefit reporting entities most

¹ The scope of *ASC 323-740—Investments—Equity Method and Joint Ventures—Income Taxes—Proportional Amortization Method* only extends to tax equity investments, whereas this statement is intended to capture all tax credit investments which meet criteria 2.a-2.d, regardless of structure. This includes, but is not limited to, tax equity investments and tax credit debt investments.

commonly through a reduction in tax liability or, when transferability is permitted, through the sale/transfer of the tax credits.

6. Investments in tax credit structures held by reporting entities meet the definition of an asset as specified in *SSAP No. 4—Assets and Nonadmitted Assets* and are admissible assets to the extent that they comply with the requirements of this statement.

Accounting

7. At initial recognition, investments in scope of this statement shall be recorded at cost. This guidance addresses the methodology for measuring an investment that is accounted for using the proportional amortization method.

8. Subsequent to initial recognition, the investment shall be carried at proportional amortized cost. Under the proportional amortization method, the reporting entity amortizes the initial cost of the investment in proportion to the tax credits and other tax benefits allocated to the investor. The amortization amount shall be calculated as follows (ASC 323-740-35-2):

- a. The initial investment balance less any expected residual value of the investment, multiplied by,
- b. The percentage of actual tax credits and other tax benefits allocated to the reporting entity in the current period divided by the total estimated tax credits and other tax benefits expected to be received by the reporting entity over the amortization timeframe (life of the investment)~~the life of the investment~~.

9. Reporting entities shall recognize tax credits in the period they are allocated to the investor for tax purposes. Unless all tax credits are allocated to the reporting entity at the date of initial investment, immediate recognition of the entire benefit of the tax credits to be received during the term of the investment project that generates tax credits and other tax benefits is not permitted. Tax credits shall not be recognized in the financial statements before the year in which the credit arises. (ASC 323-740-25-5)

10. Any expected residual value of the investment shall be excluded from the proportional amortization calculation. Non-tax related benefits received from the investment shall be included as a component of net investment income when realized or realizable. Gains or losses on the sale of the investment, if any, shall be included as a capital gain or loss at the time of the sale. (ASC 323-740-35-5) Determination of gain or loss will depend on the reported value (e.g., residual value at the end of the amortization timeframe) compared to the amount received in exchange for the investment. Liquidation of the investment commonly occurs at the end of the tax credit timeframe through a put or call agreement, often reflecting a nominal residual value that was established at the time of acquisition. The liquidation amount from such agreements shall reflect the expected residual value when available.

11. At the end of the amortization timeframe (life of the investment), if the reporting entity retains the investment, the investment shall be subsequently measured and assessed within the statutory accounting statement applicable to the investment held. Retained investments will remain on Schedule BA until disposal and cannot exceed the initial expected residual value.

12. Exhibit A illustrates the application of accounting guidance in two examples that generate tax credit and tax benefits using the proportional amortization method. The first example illustrates the application of a standard project. The second example illustrates the application of accounting guidance in a project that generates non-tax related benefits in addition to tax credits and other tax benefits using the proportional amortization method. (ASC 323-740-35-3)

Application of Proportional Amortization Method

13. Under the proportional amortized cost method, the amortization of the investment is to be recognized in the income statement as an expense component of the net investment income calculation. Non-tax related benefits received from operations, or sale of the investment should be accounted for in accordance with paragraph 10.

14. Tax credits and other tax benefits, not to include amortization of the investment, shall be reflected as follows:

- a. ~~Tax credits allocated are to be recorded, and assessed for admittance, in accordance with SSAP No. 94R Transferable and Non Transferable Tax Credits.~~ Tax credits shall be recognized in the period that they are allocated to the reporting entity for tax purposes:
 - i. ~~Federal tax credits that can be utilized in the year allocated shall be reported in the income statement as an offset to federal taxes in accordance with SSAP No. 101—Income Taxes. Federal tax credits that cannot be utilized in the year allocated are carried forward to a future tax year shall be reported net of deferred tax asset (DTA) in accordance with SSAP No. 101.~~
 - ii. ~~State tax credits that can be utilized in the year allocated shall be reported in the income statement as an offset to state premium tax or state income tax, whichever is applicable, in the tax-reporting year in which the credit is utilized. State tax credits that cannot be utilized in the year allocated are carried forward to a future tax year shall be reported gross of any related state tax liabilities and reported in the category of other-than-invested-assets (not to be reported net).~~
 - iii. ~~Tax credits carried forward to a future period shall be reflected as an offset to the corresponding income or premiums tax in the tax reporting year in which the tax credit is utilized. The admissibility of tax credits are subject to SSAP No. 101.~~
- b. Federal tax benefits other than tax credits (e.g., tax benefits from investment depreciation) shall be recognized in the year allocated pursuant to SSAP No. 101—~~Income Taxes~~. When utilized the federal tax benefits are recognized as a component of income tax expense.
- c. State tax benefits other than tax credits shall be recognized in the year allocated shall be recognized in the year allocated gross of any related state tax liabilities pursuant to SSAP No. 101. When utilized, the state tax benefits are recognized as a component of taxes, licenses, and fees.

Admittance Requirements of Tax Credit Investments

15. Although investments in tax credit programs do not represent investments that can be directly liquidated for policyholder claims, the reduction of tax liability or transfer of tax credits represents a benefit that supports admittance of these investments, but only if the tax credit will be received and can be utilized by the reporting entity. Investments in tax credit programs that will not result in any of the anticipated tax credits or that will result in tax credits which cannot be utilized or transferred by the reporting entity shall be considered impaired and should refer to paragraphs 25 and 26.

16. Reporting entities shall, at initial investment, obtain a clean² fund level tax opinion³ on the validity of the credits and structure of the underlying program and investment fund. Investments not supported by an initial tax opinion shall be nonadmitted. If the program is a permitted syndicated program with a yield guarantee, the opinion must verify that the investment and guarantee has been properly structured under IRS rules and the guarantee does not disqualify the reporting entity from obtaining federal general business tax credits.

17. Reporting entities shall annually obtain U.S. GAAP or U.S. tax basis audited financial statements on the investment fund. In the event audited U.S. GAAP or U.S. tax basis financial statements are not obtained or the audit receives an opinion other than unqualified, the asset shall be nonadmitted. If the audited financial statements are in-process but not completed as of the annual statement filing deadline, the reporting entity may admit the investment based on the results of the immediately preceding prior year audited financial statements. A lag in reporting shall be consistent from period to period.

- a. Other tax credit investments – If the reporting entity has a tax credit investment which by virtue of its structure cannot be audited, the investment is exempt from the annual audit requirement. One example of this type of investments would be tax credit debt investments⁴ which do not involve any amount of equity ownership as a component of the investment. This type of tax credit debt investment is exempt from the annual audit requirement, but the reporting entity is still required to obtain a clean tax opinion to support admittance at initial investment.

18. ~~A~~ Reporting entities ~~is~~ are required to annually assess ~~tax credit investments for the future realization utilization of the investment's current portion of unallocated~~ tax credits against ~~the estimated~~ tax liabilities~~y~~ for both the tax year in which the ~~tax credits~~ can be initially utilized as well as ~~any~~ ~~in~~ ~~accordance with applicable carry forward and/or~~ carryback periods ~~to determine the extent the investments can be admitted.~~ Based on this assessment, if a the reporting entity does not expect to ~~fully substantially~~ utilize ~~the current portion of unallocated~~ investment tax credits ~~in the upcoming tax year or for a carryback year~~, the reporting entity shall ~~perform an~~ perform an expanded assessment to determine the extent that it will be able to utilize all of the ~~the~~ investment's unallocated tax credits over the life of the investment. If assessment projections identify that the investment's unallocated tax credits ~~from investments in tax credit programs~~ will exceed what can be utilized under IRS or state tax provisions (current and other applicable tax periods), the reporting entity shall nonadmit investments as necessary so that investments in scope of this statement (in aggregate) are only admitted to the extent tax credits are expected to be utilized. Additionally, if the assessment indicates that the next three years of investment tax credits cannot be substantially utilized then the entire investment shall be nonadmitted. In making this assessment, the reporting entity is not permitted to assume increased operations (e.g., expanded product sales) beyond actual experience to conclude that additional federal or state tax liability will exist that would allow additional utilization of tax credits. A reporting entity ~~can~~ may subsequently admit a previously nonadmitted tax credit investment, based on subsequent assessments in which the reporting entity determines that they will be able to utilize the tax credits. As an exception to the admittance assessment detailed above, if the tax credit investment allocates tax credits with the following features the reporting entity may perform a secondary assessment to determine if additional amounts of the tax credit investment may be admitted:

² While not quantified or defined in either the Internal Revenue Code or state regulations, common industry standards consider a “should” opinion to be the minimum degree of confidence associated with a clean tax opinion. For the purposes of this statement, a “should” opinion must represent a probability of success no less 70%. Any tax opinion with a degree of confidence less than “should” is to be nonadmitted.

³ A fund level tax opinion for the purposes of this statement is defined as a full IRS Circular 230 tax opinion which covers from the fund level through to the underlying assets generating the tax credit benefits. The fund level is defined as the entity, or level, at which the investor comes directly into the investment without any intermediaries.

⁴ Common examples of tax credit debt investments are Tax Credit Strips, Qualified Tax Credit Bonds, and Build America Tax Credit Bonds. Tax opinions received on these tax credit investments are also referred to as “bond counsels.”

- a. Tax credit investments which allocate tax credits which are certificated or transferable in accordance with permitted IRS or state tax provisions ~~are may~~ admitted up to the lesser of the proportional amortized cost, or fair value of the tax credits. If the fair market value is not determinable, then the reporting entity may only admit the amount calculated in paragraph 18.
- b. Tax credit investments which allocate tax credits eligible for direct payment ~~are may~~ admitted up to the lesser of the proportional amortized cost, or the estimated proceeds.
- ~~c. For all other tax credits, if a reporting entity does not expect to fully utilize investment tax credits in the upcoming tax year or for a carryback year, the reporting entity shall perform an assessment to determine the extent it will be able to utilize the tax credits over the life of the investment. If assessment projections identify that the tax credits from investments in tax credit programs will exceed what can be utilized under IRS or state tax provisions (current and other applicable tax periods), the reporting entity shall nonadmit investments as necessary so that investments in scope of this statement (in aggregate) are only admitted to the extent tax credits are expected to be utilized. Additionally, if the assessment indicates that the next three years of investment tax credits cannot be substantially utilized then the entire investment shall be nonadmitted. In making this assessment, the reporting entity is not permitted to assume increased operations (e.g., expanded product sales) beyond actual experience to conclude that additional federal or state tax liability will exist that would allow additional utilization of tax credits. A reporting entity can subsequently admit a previously nonadmitted tax credit investment, based on subsequent assessments in which the reporting entity determines that they will be able to utilize the tax credits.~~

19. For tax credit investments which have an amortization timeframe greater than the tax credit allocation timeframe (as demonstrated in ~~both examples within~~ Exhibits A and B), the reporting entity would perform the same assessment detailed in ~~paragraph 1818.e~~ but on the reporting entity's ability to utilize the remaining stream of anticipated tax benefits.

Future Contributions and Additional Tax Credits

20. Many tax credit investments require future contributions by the investor, that may be contingent on a variety of conditions, such as receiving representations, contract performance, meeting occupancy requirements, etc. A liability shall be recognized for delayed equity contributions which result in additional tax credits that are unconditional and legally binding, and a liability shall also be recognized for equity contributions which result in additional tax credits that are contingent upon a future event when that contingent event becomes probable pursuant to the loss contingency guidance in *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets*. (ASC 323-740-25-3) Liabilities or loss contingencies recognized for future contributions which result in additional tax credits shall be reported as 'Payable for Securities' until remitted or until the obligation is otherwise eliminated.

21. If a commitment to provide future contributions is not required to be recognized pursuant to paragraph 20, the commitment shall be disclosed in the notes to the financial statements with other commitments.

22. Additional contributions that do not result in additional tax credits for the reporting entity investor shall be immediately expensed as a component of net investment income.

23. If additional contributions result in additional tax credits for the reporting entity, the proportional amortization method for the tax credit investment shall be adjusted, on a prospective basis, to reflect the increased cost with the revised expected income tax credits and income tax benefits.

24. In the event a reporting entity obtains additional tax credits without the reporting entity making additional contributions, the reporting entity shall not adjust the value of the tax credit investment. (The proportional amortization method shall not be adjusted to reflect the expected additional tax credits.) Rather, the tax credit shall be recognized when allocated pursuant to [paragraph 14](#).

Impairment of Tax Credit Investments

25. Reporting entities with investments in tax credit programs shall complete and document an impairment analysis at each reporting period. For this analysis, the reporting entity shall compare the current book adjusted carrying value to the fair value of the investment. (In lieu of fair value, an entity can compare book adjusted carrying value to the present value of future tax credits and other tax benefits discounted at a risk-free rate of return.) If book adjusted carrying value is higher, the difference between book adjusted carrying value and fair shall be recognized as an other-than-temporary impairment^(INT 06-07) to the tax credit investment. This will result in a new cost basis 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 (discounted value present value).

26. An other-than-temporary impairment shall also be considered to have occurred if a previously allocated tax credit has been recaptured or if it is probable that future tax credits will not be allocated as expected. If a project no longer qualifies for tax credits, the entire investment, less any residual established at initial recognition, shall be written off as other-than-temporarily impaired. If the reporting entity experiences a tax credit recapture, the reporting entity shall assess whether future tax credits and other benefits will qualify for use by the reporting entity. If future credits will not be generated or will be subject to future recapture, then the reporting entity shall write-off the investment as other-than-temporarily impaired so that the resulting investment value only reflects expected qualifying tax credits and other benefits expected to be allocated. This will result in a new cost basis 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 or revision to tax credit expectations.

Disclosures

27. A reporting entity shall disclose information that enables users of its financial statements to understand the following information about its tax investments in projects that generate tax credits and other tax benefits from tax programs captured in scope of this statement: [\(ASC 323-740-50-1\)](#)

- a. The nature of its investments in projects that generate tax credits and other tax benefits.
- b. The effect of the recognition and measurement of its investments in projects that generate tax credits and other tax benefits and the related tax credits on its financial position and results of operations.

28. To meet the objective of [paragraph 27](#), a reporting entity shall disclose the following information about its tax investments in projects that generate tax credits and other tax benefits from a tax credit program in scope of this statement:

- a. The amount of tax credits and other tax benefits recognized during the period.
- b. The balance of the investments recognized in the statement of financial position for the reporting period(s) presented.
- c. The amount of investment amortization and non-income tax related activity recognized as a component of net investment income, and other returns allocated that were recognized outside of income tax expense.

- d. An aggregate schedule of tax credits expected to be generated each year for the subsequent five years and thereafter, disaggregated by transferable/certificated and non-transferable.
 - e. Any commitment or contingent commitment (e.g., guarantees or commitments to provide additional capital contributions) including the amount of contributions that are contingent commitments related to tax credit investments and the year(s) that contingent commitments are expected to be paid shall be disclosed.
29. The following disclosures shall be included if applicable to tax credit investments:
- a. If the underlying property is currently subject to any regulatory reviews and the status of such review. (Example: Investigations by the housing authority.)
 - b. Significant modifications or events that resulted in a change in the nature of the investment or a change in the relationship with the underlying project for investments in scope. (ASC 323-740-50-1A)
30. A reporting entity that recognizes an impairment loss shall disclose the following in the financial statements that include the period of the impairment write-down:
- a. A description of the impaired assets and the facts and circumstances leading to the impairment; and
 - b. The amount of the impairment and how fair value was determined.
31. Refer to the Preamble for further discussion regarding disclosure requirements.

Relevant Literature

32. This statement adopts with modification *Accounting Standards Update (ASU) 2023-02, Accounting for Investments in Tax Credit Structures Using the Proportional Amortization Method*. The ASU is modified for the following statutory concepts:
- a. This statement is applicable to all federal and state tax credit programs earned through any tax credit investment structure that meets the requirements in paragraph 2. Under the ASU, use of the proportional amortization method is an election and only pertains to income tax equity investment structures in which the reporting entity does not exercise significant influence. With this statement, the U.S. GAAP election to use the proportional amortization method is rejected and use of proportional amortization for investments within the scope of this statement is required. The guidance is expanded for state premium tax credits.
 - b. Investments that meet the criteria of this statement are required to use a proportional amortization method as prescribed in this statement. This method requires the tax credits and benefits to be recognized in proportion to the percentage of actual tax credits and other tax benefits allocated to the reporting entity in the current period divided by the total estimated tax credits and other tax benefits expected to be allocated by the reporting entity over the life of the investment. This statement requires a gross presentation on the financial statements. Under the ASU, a practical expedient is allowed for the calculation of proportional amortization but has been rejected with this statement.
 - c. Federal tax credits shall be recognized in the income statement as an offset to federal income taxes in the tax reporting year in which the tax credit is utilized in accordance with SSAP No. 101. State tax credits shall be recognized in the income statement as an offset to

state premium tax or state income tax, whichever is applicable, in the tax reporting year in which the credit is utilized.

- d. Tax benefits allocated, other than tax credits, shall be accounted for pursuant to SSAP No. 101. Amortization shall be reported as a component of net investment income.
- e. Reporting entities shall follow the guidance in paragraphs 20 and 21 regarding the recognition of contingent commitments from SSAP No. 5R to equity contributions.
- f. This statement has specific impairment and nonadmittance requirements.
- g. For statutory accounting purposes, deferred taxes are not reported as a component of income from continuing operations in the income statement; rather deferred taxes are recognized as a separate component of gains and losses in unassigned funds (surplus).
- h. Disclosures should be followed as indicated in the disclosures section in this statement.
- h.i. The examples detailed in Exhibits A and B were modified to better illustrate the statutory accounting method for tax credit investments.

Effective Date and Transition

33. This statement is effective for reporting periods beginning on or after January 1, 2006. Early adoption is permitted. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*. The guidance previously in paragraph 3 of this statement superseded paragraph 1 of SSAP No. 48. In 2011, this guidance was moved to SSAP No. 48 and deleted from this statement. The original guidance included in this standard is retained for historical purposes in Issue Paper No. 125. The guidance from ASU 2014-01 is effective for reporting periods beginning on or after January 1, 2015, with early adoption permitted.

34. In XXX 2023, new SAP concept revisions, as detailed in Issue Paper No. XXX, were adopted. These revisions, effective January 1, 2023, expanded the scope of SSAP No. 93 to include all federal and state tax credit investment structures and provide new guidance on the accounting, recognition, and reporting of tax credit investment structures. As of the effective date, reporting entities shall prospectively retrospectively modify the recognition, accounting, and reporting of tax credit investment structures to reflect the guidance in the conceptual revisions. Additionally, all tax credit investment structures which fall within the scope of this statement not currently reported on Schedule BA are to be transferred to Schedule BA as of the effective date.

REFERENCES

Relevant Issue Papers

- Issue Paper No. 125—Accounting for Low-Income Housing Tax Credit Property Investments
- Issue Paper No. XX—XXX

EXHIBIT A – APPLICATION OF PROPORTIONAL AMORTIZATION METHOD

Example 1: ~~Application of Proportional Amortization Method for Qualifying Investment~~ Qualifying Tax Credit Investment Structure

~~This example is based on paragraph 323-740-55-5 of the Accounting Standards Codification which illustrates the application of a standard project. The amount and timing of amortization in the proportional amortization method is consistent with the statutory modifications; therefore, the table incorporated in this exhibit is based on the proportional amortization table. The statutory income statement requires a gross presentation on the income statement, with proportional amortization of the initial cost of the investment in investment income and the tax credits and benefits included in income tax expense.~~

Terms:

~~Date of Investment: January 1, 20X1~~

~~Purchase Price of Investment: \$100,000~~

On January 1, 20X1, ABC Insurance Company purchases a 5% equity stake in a tax credit investment structure for \$100,000. The allocated tax credits are transferable, and ABC anticipates that all tax credits received will be fully utilized prior to expiration of the tax credit carryover period.

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.
7. For simplicity, the project will operate with break-even pretax cash flows including debt service during the first 15 years of operations.
8. The project's taxable loss will be equal to depreciation expense. The cumulative book loss (and thus the cumulative depreciation expense) recognized by the investor is limited to the \$100,000 investment.
9. It is assumed that all requirements are met to retain allocable tax credits so there will be no recapture of tax credits.
10. The investor expects that the estimated residual value of the investment will be zero.

Proportional Amortization Method with Statutory Modifications

Year	Net Investment (1)	Amortization of Investment (2)	Tax Credits (3)	Net Losses/Tax Depreciation (4)	Other Tax Benefits from Tax Depreciation (5)	Tax Credits and Other Tax Benefits (6)
	100,000					
1	90,909	9,091	8,000	7,273	2,909	10,909
2	81,818	9,091	8,000	7,273	2,909	10,909
3	72,727	9,091	8,000	7,273	2,909	10,909
4	63,636	9,091	8,000	7,273	2,909	10,909
5	54,545	9,091	8,000	7,273	2,909	10,909
6	45,454	9,091	8,000	7,273	2,909	10,909
7	36,363	9,091	8,000	7,273	2,909	10,909
8	27,272	9,091	8,000	7,273	2,909	10,909
9	18,181	9,091	8,000	7,273	2,909	10,909
10	9,090	9,091	8,000	7,273	2,909	10,909
11	6,666	2,424		7,273	2,909	2,909
12	4,242	2,424		7,273	2,909	2,909
13	1,818	2,424		7,273	2,909	2,909
14	0	1,818		5,451	2,183	2,183
15	0					0
Total		100,000	80,000	100,000	40,000	120,000

- (1) End-of-year investment for a 5 percent limited liability interest in the project net of amortization in Column (2).
- (2) Initial investment of \$100,000 x (total tax benefits allocated during the year in Column (6)/total anticipated tax benefits over the life of the investment of \$120,000).
- (3) Four percent tax credit on \$200,000 tax basis of the underlying assets.
- (4) Depreciation (on \$200,000 tax basis of the underlying assets) using the straight-line method over 27.5 years up to the amount of the initial investment of \$100,000.
- (5) Column (4) x 40% tax rate.
- (6) Column (3) + Column (5).

Initial Year

<u>Tax credit investment</u>	<u>100,000</u>	
<u>Cash</u>		<u>100,000</u>
<i>To record the purchase of tax credit investment</i>		

Years 1-10

<u>Amortization expense</u>	<u>9,091</u>	
<u>Tax credit investment</u>		<u>9,091</u>
<u>Federal tax credits</u>	<u>8,000</u>	
<u>Income tax expense</u>		<u>8,000</u>
<i>To record annual receipt of allocated tax credits and proportional amortization of investment.</i>		

	<u>Income taxes payable</u>	<u>8,000</u>	
	<u>Federal tax credits</u>		<u>8,000</u>
	<u>To record annual utilization of allocated tax credits.</u>		
<u>Year 11-13</u>			
	<u>Amortization expense</u>	<u>2,424</u>	
	<u>Tax credit investment</u>		<u>2,424</u>
	<u>To record annual proportional amortization of tax credit investment.</u>		
<u>Year 14</u>			
	<u>Amortization expense</u>	<u>1,818</u>	
	<u>Tax credit investment</u>		<u>1,818</u>
	<u>To record annual proportional amortization of tax credit investment.</u>		

Example 2: Qualifying Tax Equity-Credit Investments Structure with Non-Income Tax Related Benefits

~~This example is based on paragraphs 323-740-55-11 through 323-740-55-14 of the Accounting Standards Codification and illustrates a tax equity investment that generates non-income tax related benefits in addition to tax credits and other income tax benefits.~~

~~The amount and timing of amortization in the proportional amortization method is consistent with the statutory modifications; therefore, the table incorporated in this exhibit is based on the proportional amortization table. The statutory income statement requires a gross presentation on the income statement, with proportional amortization of the initial cost of the investment in investment income and the tax credits and benefits included in income tax expense.~~

Terms:

~~Date of Investment: January 1, 20X1~~

~~Purchase Price of Investment: \$100,000~~

~~On January 1, 20X1, T&A Insurance Company purchased a 5% equity stake in a tax credit investment structure for \$100,000. The allocated tax credits are non-transferable, and T&A anticipates that all tax credits received will be fully utilized prior to expiration of the tax credit carryover period.~~

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 will receive production tax credits based on the energy the project produces. The credits will be allocated over a four-year period.
5. The tax equity investor will receive cash proceeds based on 2 percent of the project's cash generated during the life of the project.
6. The investor's tax rate is 40 percent.
7. All requirements are met to retain allocable income tax credits such that there will be no recapture of income tax credits.
- ~~8. The investor expects that the estimated residual value of the investment will be zero.~~
- ~~9.8.~~ All of the conditions are met to require use of the proportional amortization method.
- ~~9.~~ After 10 years, the tax equity investor has a right to require that the project sponsor purchase the tax equity investor's equity interest for a nominal amount. It is assumed that the Put option will be exercised and has a contractually agreed upon residual value of \$1,000.
10. In Years 1-3 the investor is able to utilize all allocated tax credits in the same period they were received. In Year 4, the investor is only able to utilize half of that year's allocated tax credit and defers the remainder for utilization in Year 5.

Proportional Amortization Method with Statutory Modifications

Year	Net Investment (1)	Amortization of Investment (2)	Tax Credits (3)	Net Losses/Tax Depreciation (4)	Other Tax Benefits from Tax Depreciation (5)	Tax Credits and Other Tax Benefits (6)	Non-Tax Related Cash Returns (7)
	100,000						
1	79,399	20,601	20,000	8,300	3,320	23,320	58
2	58,799	20,601	20,000	8,300	3,320	23,320	58
3	38,198	20,601	20,000	8,300	3,320	23,320	58
4	17,597	20,601	20,000	8,300	3,320	23,320	58
5	14,664	2,933		8,300	3,320	3,320	58
6	11,731	2,933		8,300	3,320	3,320	58
7	8,799	2,933		8,300	3,320	3,320	58
8	5,866	2,933		8,300	3,320	3,320	58
9	2,933	2,933		8,300	3,320	3,320	58
10	0	2,933		8,300	3,320	3,320	58
Total		100,000	80,000	83,000	33,200	113,200	580

- (1) End-of-year investment for a 5 percent limited liability interest in the project net of amortization in Column (2).
- (2) Initial investment of \$100,000 x (total tax benefits allocated during the year in Column (6)/total anticipated tax benefits over the life of the investment of \$113,200).
- (3) These tax credits have been generated through the production of electricity, which generates production tax credits. The tax equity investor is not receiving renewable energy credits or carbon offsets.
- (4) Depreciation /other tax losses passed on to the investor.
- (5) Column (4) x 40% tax rate.
- (6) Column (3) + Column (5).
- (7) Non-income-tax-related benefits recognized in current-period pre-tax earnings when allocated. This represents the cash proceeds allocated by the tax equity investor based on the cash generated from the project-

Initial Year

<u>Tax credit investment</u>	<u>100,000</u>	
<u>Cash</u>		<u>100,000</u>
<u>To record the purchase of tax credit investment</u>		

Years 1-3

<u>Amortization expense</u>	<u>20,601</u>	
<u>Tax credit investment</u>		<u>20,601</u>
<u>Federal tax credits</u>	<u>20,000</u>	
<u>Income tax expense</u>		<u>20,000</u>
<u>Cash</u>	<u>58</u>	
<u>Investment Income</u>		<u>58</u>

To record annual receipt of allocated tax credits, proportional amortization of investment, and receipt of non-tax cash returns.

<u>Income taxes payable</u>	<u>20,000</u>	
<u>Federal tax credits</u>		<u>20,000</u>

To record annual utilization of allocated tax credits.

Year 4

<u>Amortization expense</u>	<u>20,601</u>	
<u>Tax credit investment</u>		<u>20,601</u>
<u>Federal tax credits</u>	<u>20,000</u>	
<u>Income tax expense</u>		<u>20,000</u>
<u>Cash</u>	<u>58</u>	
<u>Investment Income</u>		<u>58</u>

To record annual receipt of allocated tax credits, proportional amortization of investment, and receipt of non-tax cash returns.

<u>Income taxes payable</u>	<u>10,000</u>	
<u>Federal tax credits</u>		<u>10,000</u>
<u>Income tax expense</u>	<u>10,000</u>	
<u>Deferred tax expense</u>		<u>10,000</u>

To record the portion of allocated tax credits utilized in the current year and defer the remainder. (Federal tax credit account should be mapped the DTA reporting line as any balance remaining at year-end would be a DTA)

Year 5

<u>Amortization expense</u>	<u>2,933</u>	
<u>Tax credit investment</u>		<u>2,933</u>
<u>Cash</u>	<u>58</u>	
<u>Investment Income</u>		<u>58</u>

To record annual proportional amortization of tax credit investment and receipt of non-tax cash returns.

<u>Income taxes payable</u>	<u>10,000</u>	
<u>Federal tax credits</u>		<u>10,000</u>

To record utilization of deferred tax credit.

Years 6-9

<u>Amortization expense</u>	<u>2,933</u>	
<u>Tax credit investment</u>		<u>2,933</u>
<u>Cash</u>	<u>58</u>	
<u>Investment Income</u>		<u>58</u>

To record annual proportional amortization of tax credit investment and receipt of non-tax cash returns.

Year 10

<u>Amortization expense</u>	<u>2,933</u>	
<u> Tax credit investment</u>		<u>2,933</u>
<u>Cash</u>	<u>58</u>	
<u> Investment Income</u>		<u>58</u>
<u><i>To record annual proportional amortization of tax credit investment and receipt of non-tax cash returns.</i></u>		
<u>Cash</u>	<u>1,000</u>	
<u> Gain on sale of investment</u>		<u>1,000</u>
<u><i>To record sale of interest in tax credit investment at stated residual value.</i></u>		

[https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2023/8-13-23 Summer National Meeting/Hearing/27 - 22-14c - SSAP No. 93R - Investments in Tax Credit Structures.docx](https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/NationalMeetings/A.NationalMeetingMaterials/2023/8-13-23SummerNationalMeeting/Hearing/27-22-14c-SSAPNo.93R-InvestmentsinTaxCreditStructures.docx)

Note: Revisions made after the May 16, 2023 exposure draft of SSAP No. 94R have been shown as tracked changes highlighted in grey.

Statements of Statutory Accounting Principles No. 94 - Revised

~~Transferable and Non-Transferable State~~ and Federal Tax Credits

STATUS

Type of Issue	Common Area
.....	
Issued	June 12, 2006; Substantively revised December 7, 2011.
.....	<u>Conceptually revised -XXXX.</u>
Effective Date	December 31, 2006; Substantive revisions detailed in Issue Paper No. 145 effective December 31, 2011; <u>New SAP concept revisions detailed in Issue Paper No. XXX effective XXX.</u>
.....	
Affects	No other pronouncements
.....	
Affected by	No other pronouncements
.....	
Interpreted by	No other pronouncements
.....	
Relevant Appendix A Guidance	None
.....	

STATUS.....	1
SCOPE OF STATEMENT.....	2
SUMMARY CONCLUSION	2
Accounting.....	3
Admittance.....	5
Impairment.....	5
Disclosures.....	5
Effective Date and Transition	5
REFERENCES.....	6
Relevant Issue Papers	6
EXHIBIT A – ACCOUNTING FOR TRANSFERABLE TAX CREDITS PURCHASED AT A DISCOUNT	7
EXHIBIT B – ACCOUNTING FOR NON-TRANSFERABLE TAX CREDITS PURCHASED AT A DISCOUNT	8

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for ~~transferable and non-transferable~~ state and federal tax credit ~~that are purchased¹ by the reporting entity without being an investor in the entity from which the tax credit were purchased.~~ Additionally, tax credits allocated from investments NOT within the scope of *SSAP 93R—Investments in Tax Credit Structures* should refer to this statement for tax credit accounting guidance, ~~s that are consistent with the Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy (Statement of Concepts).~~

2. Investments in ~~Low Income Housing Tax Credits credits credits~~ as discussed in SSAP No. 93R—*Low Income Housing Tax Credit Property Investments Investments in Tax Credit Structures*, which involve ~~investments in projects or programs that generate general business federal tax credits or state tax credits,~~ are not within the scope of this statement. ~~However, the tax credits received from tax credit investments are within the scope of this statement.~~

3. Investments in a CAPCO (Certified Capital Company), organized as a partnership or an LLC, which is a company, authorized by state statute that borrows from investors ~~(insurance companies)~~, in order to make venture capital investments in “qualified” businesses, are not within the scope of this statement. Although associated with tax credits, the insurance company is paid principal and interest on its investment with the CAPCO. Depending upon the terms of the CAPCO offering, principal and interest payments to the ~~insurance company investors~~ will come from the CAPCO and/or the state. The CAPCO will make cash payments directly to the ~~insurance company investors~~ while the state will make payments in the form of premium or income tax credits. Investments in a CAPCO shall be accounted for in accordance with Interpretation (INT) 06-02: Accounting and Reporting for Investments in a Certified Capital Company (CAPCO) and specific statutory accounting guidance addressing CAPCOs.

SUMMARY CONCLUSION

4. Both state and federal governments have enacted laws that create programs by which tax credits are granted to entities under certain specified conditions. The terms of these tax credits vary based on the issuing jurisdiction and from program to program. The criteria in paragraphs 5 and 6 are for transferable state tax credits (i.e., credits which may be sold or assigned). The criteria in paragraphs 7 and 8 are for non-transferable state tax credits (i.e., those which cannot be sold or assigned to other parties).

~~5. Some states have enacted laws that create programs by which transferable state tax credits are granted to entities under certain specified conditions (e.g., an entity makes an investment in a particular industry). The terms of these state tax credits vary from state to state and, within a state, from program to program. However, many of these transferable state tax credit programs share the following four characteristics:~~

- ~~a. The tax credit is nonrefundable;~~
- ~~b. The holder of the transferable state tax credit may sell or otherwise transfer the transferable state tax credit to another entity, which can likewise resell or transfer the credit;~~
- ~~c. The transferable state tax credit will expire if not used by a predetermined date; and~~

¹ The process to purchase a tax credit typically involves the acquisition of a tax credit certificate (certificated tax credits) or the execution of a state or federal transfer form (transferable tax credits). Tax credits which have been received through other means are indicative of tax credits allocated from an investment (For example, if the tax credits are received through a schedule K-1) and may be within scope of SSAP No. 93.

~~Transferable and Non-Transferable State and Federal State-Tax Credits~~

~~d. The transferable state tax credit can be applied against either state income tax or state premium tax.~~

~~6. For purposes of this statement, such programs will be referred to as “transferable state tax credits.” The criteria in paragraphs 5.b., 5.c. and 5.d. must be present in order for the transferable state tax credit to receive the accounting treatment described in this statement. When a reporting entity purchases a transferable state tax credit from another entity, the transaction does not result in a continuing investment in a business entity (i.e. limited partnership).~~

~~Non-Transferable State Tax Credits~~

~~7. If the original or subsequent holder of the transferable tax credit is not able to transfer the tax credit, then the admissibility criteria in paragraph 8 for non-transferable tax credits apply. These non-transferable state tax credits share the following characteristics:~~

~~a. The tax credit is nonrefundable;~~

~~b. The successive holder of a state tax credit must redeem the credit by April 15 of the subsequent year to the entity’s acquisition of the state tax credit and is not permitted to carry-over, carry-back, obtain a refund, sell or assign the credit;~~

~~c. The non-transferable state tax credit will expire if not used by the predetermined date; and~~

~~d. The non-transferable state tax credit can be applied against either state income tax or state premium tax.~~

~~5. The criteria in paragraphs 7.b., 7.c. and 7.d. must be present in order for the non-transferable state tax credit to receive the accounting treatment described in this statement. For the purposes of this statement, “tax credits” must be issued by either a federal or state governmental entity and must be refundable² or can be applied against income tax or premium tax in accordance with permitted IRS or state tax provisions. Tax credits which may be sold or otherwise transferred to another entity are referred to as “transferable tax credits” whereas all other tax credits are referred to as “non-transferable.”~~

~~6. When a reporting entity purchases a transferable or certificated tax credit from another entity, the transaction does not result in a continuing investment in a business entity (i.e., limited partnership). Direct payment elections are non-revocable and supersede the transferability of tax credits, as such, once the election has been made the tax credit would be considered a non-transferable tax credit.~~

~~Transferable and non-transferable state tax credits as defined within this SSAP held by reporting entities meet the definition of assets as specified in SSAP No. 4 Assets and Nonadmitted Assets and are admissible assets to the extent that they comply with the requirements of this statement. If the criteria in paragraphs 6 or 8 are not met, the tax credits are nonadmitted.~~

~~Acquisition Accounting~~

~~7. All tax credits within the scope of the statement must be recognized in the period they are allocated to or purchased by the reporting entity for tax purposes and must be recorded at face value upon receipt. Transferable and non-transferable state tax credits are recorded at cost at the date of acquisition. Tax credits acquired at a premium or discount to their face value must record the gain/loss as follows:~~

² Direct payment tax credits are synonymous with refundable tax credits, as such the terms are used interchangeably within this statement.

- a. Tax credits acquired at a discount must defer the gain as a miscellaneous liability upon receipt of the tax credit.
- b. Tax credits acquired at a premium must realize the loss within the income statement upon receipt of the tax credit.

8. Deferred gains on transferable and nontransferable tax credits are deferred until the value of the state tax credits utilized exceeds the initial acquisition cost of the tax credits, or until the state tax credits are transferred to other entities or the direct payment election is utilized and the payment(s) or refund is greater than exceed the initial carrying acquisition value cost.

Balance Sheet Treatment

9. Tax credits shall be recognized in the period that they are purchased or allocated to the reporting entity for tax purposes:

- a. Federal tax credits that can be utilized in the year allocated or purchased shall be reported in the income statement as an offset to federal taxes in accordance with SSAP No. 101—Income Taxes. Federal tax credits that cannot be utilized in the year allocated or purchased and are carried forward to a future tax year shall be reported net of deferred tax asset (DTA) in accordance with SSAP No. 101.
- b. State tax credits that can be utilized in the year allocated or purchased shall be reported in the income statement as an offset to state premium tax or state income tax, whichever is applicable, in the tax-reporting year in which the credit is utilized. State tax credits that cannot be utilized in the year allocated or purchased and are carried forward to a future tax year shall be reported gross of any related state tax liabilities and reported in the category of other-than-invested-assets (not to be reported net).

10. Use of carried forward tax credits in a future period shall be reflected as an offset to the corresponding income or premiums tax in the tax reporting year in which the tax credit is utilized.

~~8. Transferable and non-transferable state tax credits shall be established gross of any related state tax liabilities and reported in the category of other than invested assets (not reported net).~~

~~9. As transferable and non-transferable state tax credits are redeemed, the carrying value of the tax credits is reduced dollar for dollar by the amount of state tax credits applied toward the reporting entity's applicable state tax liability.~~

Income Statement Treatment

~~10. Gains on transferable and non-transferable state tax credits are deferred until the value of the state tax credits utilized exceeds the cost of the state tax credits or until the state tax credits are sold to other entities and the payment received is greater than the book value.~~

~~11. Losses on transferable and non-transferable state tax credits are recognized when known.~~

11. Gains and losses on transferable and non-transferable state tax credits are reflected in other income when realized.

~~Transferable and Non-Transferable State and Federal State~~-Tax Credits

Admittance

~~12.~~ 12. ~~Transferable and non-transferable~~ Tax credits as defined within this SSAP held by reporting entities meet the definition of assets as specified in *SSAP No. 4—Assets and Nonadmitted Assets* and are admissible assets to the extent that they comply with the requirements of this statement. The admissibility of tax credits are subject to SSAP No. 101.

Impairment

~~12.~~13. An impairment shall be considered to have occurred if it is probable that the reporting entity will be unable to recover the book adjusted carrying value amount of the ~~transferable or non-transferable state~~ tax credits. ~~State~~ tax credits should be evaluated for impairment at each reporting date.

~~13.~~14. When there is a decline in the realizability of a ~~transferable or non-transferable state~~ tax credit owned by the reporting entity that is other than temporary, the asset shall be written down to the expected realizable amount and the amount of the write down shall be accounted for as a realized loss. The expected realizable value is the new cost basis.

~~14.~~15. The new cost basis shall not be changed for subsequent recoveries in realizability.

Disclosures

~~15.~~16. The following disclosures shall be made in the financial statements. For purposes of this disclosure, total unused ~~transferable and non-transferable state~~ tax credits represent the entire ~~transferable and non-transferable state~~ tax credits available:

- a. Carrying value of ~~transferable and non-transferable state~~ tax credits, disaggregated by transferable and non-transferable, gross of any related ~~state~~ tax liabilities by state jurisdiction and in total.;
- b. Total unused ~~transferable and non-transferable state~~ tax credits by state jurisdiction, disaggregated by transferable and non-transferable.;
- c. Method of estimating utilization of remaining ~~transferable and non-transferable state~~ tax credits or other projected recovery of the current carrying value.
- d. Impairment amount recognized in the reporting period, if any.
- e. Identify ~~state~~ tax credits by transferable/certificated and non-transferable classifications, and identify the admitted and ~~Non~~nonadmitted portions of each classification.

Effective Date and Transition

17. This statement is effective for reporting periods ending on or after December 31, 2006. Early adoption is permitted. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with SSAP No. 3. Substantive revisions to 1) revising the title; 2) incorporating the criteria for non-transferable state tax credits as described in paragraphs 7 and 8; 3) adding a disclosure; and 4) updating terminology throughout the document as appropriate, are effective for reporting periods ending on or after December 31, 2011.

18. In XXX, 20XX, new SAP concept revisions, as detailed in Issue Paper No. XXX, were adopted. These revisions, effective January 1, 2023, expanded the scope of SSAP No. 94R to include all state and federal tax credits and provide new guidance on the accounting, recognition, and reporting for state and

federal tax credits. As of the effective date, reporting entities shall prospectively modify the recognition, accounting, and reporting of tax credits within the scope of this statement to reflect the guidance in the conceptual revisions. For unutilized tax credits which were carried forward from prior to the effective date:

- a. Federal tax credits in other-than-invested assets are to be transferred and reported net of deferred tax asset (DTA) in accordance with SSAP No. 101.
- a.b. Tax credits previously recorded at acquisition cost should be adjusted to reflect the face value of the acquired tax credits with the corresponding loss immediately recognized or the gain deferred.

REFERENCES

Relevant Issue Papers

- Issue Paper No. 126—Accounting for Transferable State Tax Credits
- Issue Paper No. 145—Accounting for Transferable and Non-Transferable State Tax Credits
- Issue Paper No. XXX—XXX

~~Transferable and Non-Transferable~~ State and Federal State-Tax Credits

EXHIBIT A – ACCOUNTING FOR TRANSFERABLE ~~STATE~~-TAX CREDITS PURCHASED AT A DISCOUNT

On 1/1/X1 SAM Insurance Company purchased transferable state tax credits for a cost of \$100,000. The transferable state tax credits are redeemable for \$160,000 and expire at the end of 12/31/X4. SAM initially expects to utilize the tax credits before expiration in their state of domicile in the amount of \$40,000 per year. In year X4, SAM sells the remaining \$30,000 in transferable state tax credits for \$20,000.

1/1/x1	Transferable state tax credits	100 160,000	
	<u>Deferred gains on acquired tax credits</u>		<u>60,000</u>
	Cash		100,000
	<i>To record the purchase of the tax credits</i>		
6/30/x1	Premium tax expense	40,000	
	Premium taxes payable to domiciliary state		40,000
	<i>To record premium tax expense and accrue the liability in Year 1.</i>		
10/1/x1	Premium tax payable	40,000	
	Transferable state tax credits		40,000
	<i>To record the use of tax credits in Year 1. The reporting entity expects to be able to utilize remaining tax credits before expiration.</i>		
6/30/x2	Premium tax expense	60,000	
	Premium taxes payable to domiciliary state		60,000
	<i>To record premium tax expense and accrue the liability in Year 2.</i>		
9/30/x2	Premium tax payable	60,000	
	Transferable state tax credits		60,000
	<i>To record the use of taxes credits in Year 2. The reporting entity expects to be able to utilize remaining tax credits before expiration.</i>		
6/30/x3	Premium tax expense	30,000	
	Premium taxes payable to domiciliary state		30,000
	<i>To record premium tax expense and accrue the liability in Year 3.</i>		
9/30/x3	Premium tax payable	30,000	
	<u>Transferable state tax credits</u> Other income		30,000
	<u>Deferred gains on acquired tax credits</u>	<u>30,000</u>	
	<u>Other income</u>		<u>30,000</u>
	<i>To record the use of premium tax credits in excess of cost and recognize a gain on premium tax credits in other income. The Company intends to sell the remaining tax credits in year 4.</i>		
6/30/x4	Cash	20,000	
	<u>Other income</u>	<u>10,000</u>	
	<u>Transferable state tax credits</u>		<u>30,000</u>
	<u>Deferred gains on acquired tax credits</u>	<u>30,000</u>	
	Other income		20 30,000
	<i>To record the sale of the remaining tax credits.</i>		

EXHIBIT B – ACCOUNTING FOR NON-TRANSFERABLE ~~STATE~~—TAX CREDITS PURCHASED AT A DISCOUNT

On 7/1/X1 LJW Insurance Company purchased non-transferable ~~state-federal~~ tax credits for a cost of \$100,000. The ~~state-federal~~ tax credits are redeemable for \$110,000, ~~are not transferable~~ and expire on, April 15, 20x2. LJW expects to utilize the tax credits before expiration ~~in their state of domicile~~ in the amount of \$110,000. ~~Tax credits are utilized pro-rata, approximately \$36,666 every quarter, from acquisition date to expiration date.~~ The illustration below assumes that LJW Insurance Company's quarterly income tax liability equals the amount of credits that were purchased.

7/1/x1	State-Federal tax credits	100,000	
	Deferred gains on acquired tax credits		10,000
	Cash		100,000
	<i>To record the purchase of the tax credits</i>		
9/30/x1	Premium Income tax expense	200,000 36,666	
	Income Premium taxes payable to domiciliary state		200,000 36,666
	<i>To record quarterly premium tax expense and accrue the income tax liability.</i>		
10/1/x1	Income taxes payable	36,666	
	Federal tax credits		36,666
	<i>To record the use of tax credits in the quarter.</i>		
12/31/x1	Income tax expense	36,666	
	Income taxes payable		36,666
	<i>To record quarterly income tax liability.</i>		
1/1/x2	Income taxes payable	36,666	
	Federal tax credits		36,666
	<i>To record the use of tax credits in the quarter.</i>		
3/31/x2	Income tax expense	36,668	
	Income taxes payable		36,668
	<i>To record quarterly income tax liability.</i>		
3/15/x2	Premium tax payable	110,000	
4/1/x2	Income taxes payable	36,668	
	Deferred gains on acquired tax credits	10,000	
	Other Income		10,000
	Federal tax credits		36,668
	Other Income		10,000
	Federal tax credits		100 110,000
	<i>To record the use of premium tax credits in the quarter in excess of cost and recognize a gain on premium tax credits in other income. (The additional \$90,000 of premium taxes payable would still be due.)</i>		

**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 shortterm 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.

<https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/NationalMeetings/A.NationalMeetingMaterials/2023/8-13-23SummerNationalMeeting/Hearing/29-22-19-NegativeIMR.docx>

Interpretation of the Statutory Accounting Principles (E) Working Group

~~2023~~ Net Negative (Disallowed) Interest Maintenance Reserve

INT 23-01T Dates Discussed

April 10, 2023, June 28, 2023

INT 23-01T References

Current:

*SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve
Annual Statement Instructions*

INT 23-01T 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:

<u>General Account IMR Balance</u>	<u>Separate Account IMR Balance</u>	<u>Net IMR Balance</u>
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 ~~both~~ a 2023 solution and to begin work towards a long-term solution.

INT 23-01T Discussion

8. This tentative 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 ~~in the general account~~ as a short-term solution ~~for 2023~~. ~~This interpretation is specific for general account treatment only and assessment of possible revisions for the separate account will be considered as part of the long-term solution.~~ Specifically, this interpretation impacts the annual statement instruction rules regarding disallowed negative IMR ~~in the general account~~, detailed in rules 'b,' 'd' and 'f' shown in paragraph 4. ~~(As detailed within, admittance in the general account does not impact the determination or reporting of IMR in the separate accounts.)~~ **As this interpretation overrides existing guidance, it will require a 2/3rd vote.**

Reporting entities are permitted to admit net negative (disallowed) IMR ~~in the general account~~ with the following restrictions:

9.

- a. Reporting entities ~~with an RBC greater than 300% that qualify pursuant to paragraph 9b,~~ are permitted to admit net negative (disallowed) IMR, ~~as defined in paragraph 9b,~~ up to 105% 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. Reporting entities with a 300% or lower RBC are not permitted to admit net negative (disallowed) IMR.

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.

- b. Reporting entities applying this interpretation are required to have a risk-based capital (RBC) greater than 300% 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 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% or lower are not permitted to admit net negative (disallowed) IMR in the general account or recognize IMR assets in the separate accounts. ~~Negative (disallowed) IMR admitted pursuant to paragraph 9a is limited to IMR generated from losses incurred from the sale of bonds, or other qualifying fixed income investments, that were reported at amortized cost prior to the sale, and for which the proceeds of the sale were immediately used to acquire bonds, or other qualifying fixed income investments, that will be reported at amortized cost. (This provision intends to explicitly exclude derivative losses from derivatives reported at fair value that have been allocated to IMR from being admitted under this guidance³.)~~
- c. The net negative (disallowed) IMR permitted for admittance shall not include losses from derivatives that were reported at fair value prior to derivative termination⁴ 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.

³~~It has been identified that some reporting entities have allocated derivative losses to IMR for derivatives that were reported at fair value throughout the derivative life, as they did not qualify as effective hedges under statutory accounting, and that were not hedging assets with offsetting amounts to the IMR. As detailed in paragraph 9b, these losses shall be removed from the IMR balance in determining the net negative (disallowed) IMR balance permissible for admittance.~~

⁴ 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.

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 9a.

9.11. Reporting entities that admit net negative (disallowed) IMR in the general account pursuant to paragraph 9 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 9a, 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) to special surplus(named as “Admitted Disallowed IMR”). Although dividends are 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.

10.13. 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 ~~closing / termination / settlement / expiration~~ of the derivative shall disclose the ~~non-unamortized impact balances to~~ in IMR from these allocations separately between gains and losses. ~~This disclosure shall illustrate the removal of these balances from the total general account IMR to determine the net negative amount that is permitted to be admitted under paragraph 9b.~~
- b. Reporting entities shall complete a note disclosure that details the following:
 - i. ~~gross~~ Net negative (disallowed) IMR in aggregate and allocated between the general account, insulated separate account and non-insulated account,
 - ii. ~~the a~~ 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 ~~and nonadmitted,~~ adjusted capital and surplus per paragraph 9a, and

~~iv. and the pPercentage 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 were not compelled by liquidity pressures (e.g., to fund significant cash outflows including, but not limited to excess withdrawals and collateral calls).~~

~~11. The provisions in this interpretation intend to be specific on the following prohibitions:~~

- ~~a. Negative IMR permitted to be admitted shall not include losses from derivatives that were reported at fair value prior to settlement / termination / expiration / closing of the derivative. (Only derivative losses from derivatives that qualified as effective hedges (and reported under 'hedge accounting' as detailed in SSAP No. 86 - Derivatives), which hedged an item that had offsetting adjustments to IMR, are permitted to be included in the admittance calculation.) The allocation of derivative losses to IMR, for derivatives held at fair value and were not offset by a hedged asset that was also subject to IMR, is not in line with the original intent of the IMR guidance in SSAP No. 86 or the annual statement instructions. Consideration of this industry interpretation and clarification of derivatives through the IMR will be addressed as part of the long term proposal.~~
- ~~b. The admittance of net negative (disallowed) IMR in the general account shall have no impact on the reporting of IMR in the separate account. The comparison of general account and separate account IMR shall occur on the gross positive and negative balances prior to any admittance in the general account. Disallowed negative IMR in the separate account shall continue to be fully disallowed as a direct charge to surplus. The IMR annual statement instructions predate current guidance that requires insulated and non-insulated separate account blanks. Consideration of separate account treatment of IMR will be addressed in a long term proposal that will assess the concepts of insulated separate accounts and whether the balances of the general account shall have any influence on how IMR shall be reported in those separate account statements.~~

INT 23-01T Status

14. The consensuses in this interpretation were adopted on _____, to provide limited-time exception guidance to SSAP No. 7 and the annual statement instruction for the reporting of net negative (disallowed)

IMR ~~in the general account~~. 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.

12-15. 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. 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 an 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 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: Review Annual Statement Instructions for Accounting Guidance

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 establish a project to review the annual and quarterly statement instructions to ensure that all accounting guidance is properly reflected within the Statements of Statutory Accounting Principles (SSAPs). Although duplication or reference of accounting guidance may occur for ease of application the reporting guidance, the focus of this project is to ensure that the annual or quarterly statement instructions are not the source of statutory accounting guidance. For purposes of this agenda item, accounting guidance is intended to refer to measurement, valuation, admittance / nonadmittance, as well as when assets and liabilities should be recognized or derecognized within the statutory financial statements.

This agenda item and project is proposed due to limited situations in which the annual statement instructions have been identified to reflect more detailed accounting guidance than the SSAPs. Under the Statutory Hierarchy, the SSAPs are Level 1 and are the authoritative source for accounting provisions. If guidance does not exist in the SSAPs, then other sources of guidance can be considered based on the statutory hierarchy, but it is not intended that guidance purposely be captured in the annual statement instructions (which are level 3) in lieu of the inclusion of guidance in the SSAPs.

Although it is anticipated that only limited situations will be identified, this agenda item proposes a broad project of the Statutory Accounting Principles (E) Working Group, in collaboration with industry, to review the instructions and identify where accounting guidance may need to be captured in the SSAPs.

Existing Authoritative Literature:

The Preamble of the NAIC Accounting Practices and Procedures Manual includes the statutory hierarchy:

- 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 Codification¹ (FASB Codification or GAAP guidance)*

¹ Effective September 15, 2009, the FASB Codification is the source of authoritative U.S. generally accepted accounting principles. As of that date, the FASB Codification superseded all then-existing non-SEC accounting and reporting standards. All other nongrandfathered, non-SEC accounting literature not included in the FASB Codification is nonauthoritative. As of September 15, 2009, AICPA Statements of Position are no longer reviewed as part of the statutory maintenance process as they are no longer considered authoritative GAAP literature. If the AICPA were to address an issue that affects the FASB Codification, an accounting standard update (ASU) would be issued and reviewed for applicability to statutory accounting.

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 Concepts²*

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

² The Statutory Accounting Principles Statement of Concepts incorporates by reference FASB Concepts Statements Five and 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.

authoritative than any other sources of accounting literature. Similarly, FASB Concepts Statements would normally be more influential than other sources of nonauthoritative GAAP pronouncements.

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):

- Pursuant to the discussion on agenda item 2022-01: Conceptual Framework, interested parties have identified that accounting guidance resides in the annual statement instructions.
- Pursuant to the discussion on agenda item 2022-19: Negative IMR, it has been identified that the accounting guidance for IMR, including the provisions on negative IMR, are currently captured in the Annual Statement Instructions. *SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve*, points to the Annual Statement Instructions for the IMR and AVR calculation.

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 with a request for regulator and industry viewpoints on situations in which guidance in the annual statement instructions should be captured within a SSAP.

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, with a request for regulator and industry viewpoints on situations in which guidance in the annual statement instructions should be captured within a SSAP.

<https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/NationalMeetings/A.NationalMeetingMaterials/2023/8-13-23SummerNationalMeeting/Hearing/31-23-01-ASItoSSAPProject.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 Quar 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, company may elect to consider or disregard its AMT status as long as it is consistent. If company elects to consider AMT, must book the valuation allowance in the period of enactment (period that includes August of 2022). If material, 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.

<https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/NationalMeetings/A.NationalMeetingMaterials/2023/3-22-23-Spring/Exposures/D23-04-CAMT.docx>

Interpretation of the

Statutory Accounting Principles (E) Working Group

INT 23-03: Inflation Reduction Act - Corporate Alternative Minimum Tax

Note: Drafting notes will not be in the final document and are only included to facilitate exposure review. Tracking reflects minor updates and corrections identified after initial posting. These tracked changes will not be shown as tracked if exposed at the Summer Meeting.

INT 23-03 Dates Discussed

August 13, 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 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 high-level summary of CAMT is below.

- 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 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 tax 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 - 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 tax liability.

INT 23-03: Inflation Reduction Act - Corporate Alternative Minimum Tax

- 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 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 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 could 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) will reduce the tentative minimum CAMT. Note that unused FTCs can be carried forward for 5 years. General business credits can generally be offset up to 75% 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

¹ As used herein, an “unaffiliated” corporation is one that is not a member of a tax-controlled group.

INT 23-03: Inflation Reduction Act - Corporate Alternative Minimum Tax

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.

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 sharing agreement (TSA) 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. ~~If a~~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.

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.

INT 23-03: Inflation Reduction Act - Corporate Alternative Minimum Tax

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 TSA 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 TSA Exclusions

11. Applicable reporting entities with TSA exclusions are reporting entities that qualify as an applicable corporation as a member of a tax-controlled group of corporations pursuant to paragraphs 9 and 10 of this interpretation, and is a party to a TSA 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.
- c. The reporting entity reasonably expects or has knowledge that the parties liable for the CAMT payables under the TSA are meeting their obligations.

12. Reporting entities with TSA CAMT 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 TSA exclusions, the guidance for joint and several liabilities pursuant to SSAP No. 5, paragraph 5 continues to apply. This guidance requires the reporting entity to recognize the amount the reporting entity has agreed to pay with the agreements of their co-obligors and any additional amount the reporting entity expects to pay on behalf of its co-obligors.

NAIC Staff Note: NAIC staff do not believe it is possible for an insurer to completely remove themselves from the joint and several tax liability under the tax law. There is guidance in SSAP No. 5, paragraph 5, that addresses joint and several liabilities. Under that guidance, reporting entities are required to measure and report the liability as the sum of 1) the amount the reporting entity agrees to pay on the basis of agreements among co-obligors and 2) 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 expected to be paid by the reporting entity and the corresponding CAMT credits expected 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 or TSA) that governs allocation of consolidated taxes to individual members of the group.

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.

INT 23-03: Inflation Reduction Act - Corporate Alternative Minimum Tax

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; are pursuant to a written TSA; 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 TSA ~~which is~~, consistent with [paragraphs 16 and 17 of](#) SSAP No. 101, the amount of CAMT payable (expense) or CAMT tax credit carryforward is recognized in accordance with the TSA.

NAIC Staff Note: NAIC staff is aware that reporting entities plan to enter into updated TSA agreements based on the results of the guidance from this INT.

Recognition of CAMT Payable

16. Reporting entities that are applicable corporations, excluding those captured as having qualifying TSA 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~~ as ~~an individual unaffiliated entity~~ [separate return filer](#) or in accordance with the amount allocated through the tax-controlled group's tax sharing agreement [pursuant to paragraph 15 of this INT](#).

17. Consistent with SSAP No. 101, paragraph 8, changes in DTAs and 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 TSA allocation of liability.

Recognition of CAMT Deferred Tax Asset (Future Tax Credit)

19. Reporting entities shall initially recognize a corresponding DTA which represents the indefinite tax credit carryover ~~when earned~~ [equal and offsetting to the current CAMT accrued](#). The CAMT tax credit can be used to reduce regular tax in future years when the regular tax liability is in excess of the CAMT tax liability as permitted under the tax law.

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.

INT 23-03: Inflation Reduction Act - Corporate Alternative Minimum Tax

21. The determination of a statutory valuation allowance⁵ for CAMT credit carryforwards depends on whether the reporting entity is part of a ~~tax-controlled group or a stand-alone unaffiliated corporation~~ consolidated tax return group or a separate tax return filer:

- a. ~~Tax-Controlled~~ Consolidated Tax Return Group: A reporting entity that is an applicable entity ~~through a tax-controlled and a member of consolidated tax return~~ group shall utilize the statutory valuation assessment for the CAMT credit carryforward completed at the consolidated tax return group ~~entity~~-level. A reporting entity is not required to adjust the group statutory valuation allowance for CAMT credit carryforwards⁶. Rather, the group determined statutory valuation allowance and the resulting credit carryforward deemed to be more likely than not to be realized, is permitted to be allocated to the reporting entity and reflected as an “CAMT adjusted gross DTA.” The reporting entity shall continue to have a separate statutory valuation allowance calculation for non-CAMT DTAs as required under SSAP No. 101. The combination of the CAMT adjusted gross DTA (as received from the group) and the adjusted gross DTAs from non-CAMT DTAs shall equal the total adjusted gross DTAs reviewed for admittance within the scope of this interpretation.
- b. Separate Tax Return Filer ~~Stand-Alone Unaffiliated Corporation~~: A reporting entity that is an applicable entity and files a separate tax return ~~as a stand-alone unaffiliated corporation~~, is required to complete a statutory valuation allowance for all deferred tax assets, including CAMT credit carryforwards, in determining their total adjusted gross DTAs. (The CAMT DTA can be assessed separately from non-CAMT DTAs in determining whether the DTA is more likely than not to be realized.) The total adjusted gross DTAs 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 regular tax DTAs.⁷ The accounting policy election applies for valuation allowance purposes only – that is, in the determination of adjusted gross DTAs other than CAMT-related DTAs. This accounting policy election cannot be used to avoid a valuation allowance analysis for CAMT credit carryforward 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)

⁵ Although reporting entities may conclude that the indefinite CAMT 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, ~~and~~ or the tax consolidated-controlled group of corporations if the reporting entity is a member of such group affiliated with, are no longer CAMT payors and have sufficient tax liability that permits the group the ability to use the CAMT tax credits.

⁶ ~~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 regular tax DTAs.⁶ The accounting policy election applies for valuation allowance purposes only – that is, in the determination of adjusted gross DTAs other than CAMT-related DTAs. This accounting policy election cannot be used to avoid a valuation allowance analysis for CAMT credit carryforward DTAs. The accounting policy election must be disclosed in the notes to the financial statements and applied consistently in subsequent reporting periods.~~

⁷ ASC 740 does not specifically address whether future years’ CAMT should be anticipated in a valuation allowance assessment for regular tax 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 regular tax DTAs.

INT 23-03: Inflation Reduction Act - Corporate Alternative Minimum Tax

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 tax credit, through the actions of their tax-controlled group related parties. (As noted in footnote 5, although a reporting entity may have earned an indefinite tax credit through payment of CAMT, the reporting entity is not eligible to utilize that tax credit until the tax-controlled 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 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 deferred tax assets (future tax credits) earned from the payment of the CAMT. However, it is recognized that under the existing statutory accounting guidance in SSAP No. 4 a reporting entity recognizing CAMT tax credits would not be permitted to admit those assets if part of a tax-controlled group as the ability to receive those 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 as a reduction of tax liability, 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 tax 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 deferred tax assets allocated to the reporting entity to be permitted as admitted assets, 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

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 tax credits, specific admittance guidance for the CAMT tax credit DTAs has been established:

- a. The CAMT tax credit is an indefinite tax credit carryforward, ~~which can only be used when the reporting entity has sufficient tax liability that permits its use.~~ As long as the reporting entity is a CAMT payor or is part of a tax-~~controlled-consolidated~~ group that is a CAMT payor, the reporting entity cannot utilize the tax credit.
- b. The ability to utilize the CAMT tax credit is contingent on the actions and tax paying behaviors of the tax-controlled 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

INT 23-03: Inflation Reduction Act - Corporate Alternative Minimum Tax

similar manner, putting the group below the CAMT threshold, then the CAMT tax 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 ~~include admit~~ CAMT tax credits ~~as part of the SSAP No. 101, 11b calculation (realization threshold table)~~ 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) which includes group tax assessments~~ indicate that the CAMT tax credit will be realizable within the stated timeframes using the applicable SSAP No. 101, paragraph 11 realization table thresholds. This means that the tax projections ~~of the reporting entity, and of the tax-controlled group~~, will have sufficient tax liability that permits utilization of the CAMT tax credits. For example, a reporting entity with greater than 300% RBC can only ~~include admit~~ CAMT tax credits ~~in the admittance calculation~~ that are expected to be realized in three years. Reporting entities that have RBC between 200-300% can only ~~include admit~~ CAMT tax credits ~~in the admittance calculation~~ that are expected to be realized in ~~two-one~~ years. 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) that the group will have~~ sufficient tax liability that allows them to utilize the CAMT tax credit within the realizable timeframes for admittance, then the portion of all CAMT tax credits that cannot be utilized are required to be nonadmitted.

29. CAMT tax credits included in the SSAP No. 101, paragraphs 11 and 11.b. calculation as they are expected to be realized within the applicable 2-1 or 3 year permitted timeframes ~~indicated in SSAP No. 101~~ shall then be combined with non-CAMT ~~adjusted gross deferred tax assets tax credits~~ 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 11b 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 ~~for SSAP No. 101, paragraph 11.b. and its subparagraphs~~. 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 carryforward.

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 “with and without⁸” tax liability for purposes of determining the amount expected to be realized under SSAP No. 101, paragraph 11. b. i. However, any admitted CAMT tax credits in this step must be realizable within the applicant time period specified in the applicable Realization Threshold Limitation Table (Ex, top line - 3 years). The post-valuation allowance adjusted gross DTA for any CAMT credit carryforward 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 carryforward.

32. A reporting entity which meets the second line of the applicable Realization Threshold Limitation Table (Ex. 2-1 years 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

⁸ “With and without” is further described in SSAP No. 101. ~~Because expected future CAMT obligations creates a tax credit, the realization of existing DTAs is reduced because of the mechanical “with and without” calculation. The application of with and without for the CAMT refers to whether future CAMT is required to be considered or not for the determination of future DTA realization.~~

INT 23-03: Inflation Reduction Act - Corporate Alternative Minimum Tax

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 TSA. 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.

NAIC Staff Note: The use of the realization threshold limitation tables is consistent with the treatment of other DTAs in SSAP No. 101, paragraph 11b (most entities will use 3 years 15%). NAIC staff suggest this is simpler than trying to argue new financial thresholds and realization periods. Overall, the SSAP No. 101 11b admissibility treatment proposed in this INT is the same as existing guidance. This INT allows an exception allowing entities over 300% ex DTA RBC (3 year 15%) to avoid doing “with and without” calculations which determine the impact of CAMT for use of “normal” DTA. This was requested by industry for the higher threshold entities, and we think it makes sense for these entities.

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 carryforwards or DTAs under SSAP No. 101, paragraph 11.b.

NAIC Staff Note: Working Group discussion at the Summer National Meeting is planned for which version of paragraph 34 to expose:

34.

Note -Yes, full paragraph 11c offset – Proposed to admit CAMT credits under paragraph 11c. This would treat the CAMT prepay similar to other DTAs.

- a. The adjusted gross DTA for any CAMT tax credit carryforward which does not qualify for admission under SSAP No. 101, paragraph 11. a. or 11. b. is permitted to be recognized as an offset against applicable deferred tax liabilities (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.

Note- No, paragraph 11c offset - Proposes not to admit any CAMT \ credits under paragraph 11c which is the third step of the DTA admissibility test. This is a departure from SSAP No. 101, paragraph 11c.:

- 34.b.** The DTA for any CAMT tax credit carryforward which does not qualify for admission under SSAP No. 101, paragraph 11. a. or 11. b. is not permitted to be recognized as an offset against applicable deferred tax liabilities (DTLs) in SSAP No. 101, paragraph 11.c. This restriction is consistent with the noted elements of CAMT tax credits and their restrictions on utilization. It is not permissible to reduce DTLs for a tax credit that the reporting is not eligible to use.

Admittance - Projections

INT 23-03: Inflation Reduction Act - Corporate Alternative Minimum Tax

35. Projections of CAMT liability, if any, (and CAMT credit utilization) during the applicable period involve forward-looking data, groupings, 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 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 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 ~~as that are part of a consolidated tax return tax-controlled~~ 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 ~~unaffiliated corporations~~ 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 TSA amendment or a new TSA for the 2023 taxable year.

- a. Because the CAMT was newly enacted effective for 2023, TSAs 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 TSA exclusions) may need to amend TSAs to deal with the CAMT effective for the entire 2023 taxable year. A reporting entity would file a request for amendment to a TSA or a new TSA 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 TSA amendments or a new TSA 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 TSA amendment or a new TSA prior to the end of 2023 to address the CAMT for 2023 and subsequent taxable years, and the domiciliary regulatory has confirmed that they have no objections to using the new TSA amendment or new TSA, while under review. The reporting entity shall be allowed to account for the TSA as applicable for the entire 2023 reporting period.

NAIC staff note: Application of an unsigned agreement prior finalization and approval is inconsistent with statutory accounting contract boundary principles. In addition, we have concerns with providing any guidance which might be perceived as a limitation of the state authority. We

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.

INT 23-03: Inflation Reduction Act - Corporate Alternative Minimum Tax

have proposed language in paragraph 37b which explicitly defers to the will of the domiciliary state and also requires filing by year end. While we understand the industry's desire for certainty, we don't think it can be provided for an unapproved contract and would alternatively be supportive of deleting this section.

- c. If the final approved TSA differs in its treatment of the CAMT allocation from the TSA 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.
 - 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 TSA amendment or a new TSA within 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 non-applicable reporting entity; an applicable reporting entity with TSA exceptions 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 TSA 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 regular tax DTAs described in paragraph 22 of this interpretation.
- b. Application of the Realization Threshold Limitations Tables for the CAMT described in paragraphs 31-33 of this interpretation.
- c. Any disclosure of material modifications to projections is 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

INT 23-03: Inflation Reduction Act - Corporate Alternative Minimum Tax

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 carryforwards, 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 tax-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. Further discussion is planned.

NAIC Staff Note: Comments requested regarding whether to add references in SSAP No. 101 scope and / or disclosures section to this INT.

INT 23-03: Inflation Reduction Act - Corporate Alternative Minimum Tax**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 regular tax 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 carryover DTA (pursuant to the consolidated group's TSA, 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 carryforward DTA, resulting in an 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 regular tax 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.

INT 23-03: Inflation Reduction Act - Corporate Alternative Minimum Tax

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 apply the “with and without” tax liability for purposes of determining the amount expected to be realized under SSAP No. 101, paragraph 11.b.i. calculation (from SSAP No. 101, paragraph 11.b.i.) for the determination of the impact of the CAMT on the realization of DTAs.
- b. The reporting entity has assessed and determined that the CAMT tax credit carry forward amounts after the valuation allowance of \$30x is expected to be utilized in 20x4, 20x5 and 20x6. Thereby meeting redeemable within 3 years criteria in SSAP No. 101, paragraph 11b for entities which meet or exceed the top line of the applicable realization threshold limitation.

46. The reporting entity admits the \$30x adjusted gross DTA for its portion of the allocated CAMT credit carryover expected to be utilized within three years and admits the \$150x regular tax adjusted gross DTA after valuation allowance than can be utilized within three years of. Therefore, the admitted DTA and CAMT tax credit would be \$180x ($\$150 + \$30 = \180).

47. The \$180 is less than the \$300 15% of surplus limitation in paragraph 11bii., 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	Regular DTA Admitted Standalone	Impact of Consol. DTA and VA	Admitted DTA under 11bi	15% surplus limitation under 11bii	Non-admitted DTAs
DTAs	240	-40	-50	150		150		50
CAMT credit DTA (excluded)	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. 2-1 years 10%).

48. 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 21-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 reporting entity has assessed and determined that the CAMT tax credit carry forward amounts after the valuation allowance of \$30 is expected to be utilized at \$16 in 20x4 and zero in 20x5. Therefore, \$14 ($30 - 16 = 14$) is not redeemable within 2 years the criteria in~~

INT 23-03: Inflation Reduction Act - Corporate Alternative Minimum Tax

~~SSAP No. 101, paragraph 11b for entities which meet or exceed the second line of the applicable realization threshold limitation table.~~

e.b. The consolidated group of which the reporting entity is a member expects to incur CAMT ~~in~~ in ~~20x5~~20x4, of which \$10 ~~year~~ is expected to be allocated under the TSA to reporting entity. The reporting entity reduces its \$150x of regular tax admitted adjusted gross DTAs by its \$10x share of the consolidated CAMT expected to be incurred in ~~20x5~~20x4.

49. The reporting entities admitted DTA would be ~~\$156x~~140x. The result is an adjusted gross regular DTA of \$150x, minus the \$10 impact of the consolidated DTA (with and without) equals 140 regular DTA. ~~The adjusted CAMT credit carry forward of \$30 is reduced by \$14 for the amount not expected to be realized within 2 years to be 16. Resulting in an admitted total DTA of \$156 (\$140 + 16 = 156).~~

50. The resulting ~~\$140~~156x 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 11bii., so it is not a limiting factor.

	DTA	Valuation Allowance	Not Recoverable Within 2 <u>1</u> Years	Regular DTA Admitted Standalone	Impact of Consol. DTA and VA	Admitted DTA under 11bi	10% surplus limitation under 11bii	Non-admitted DTAs
DTAs	240	-40	-50	150	-10	140		60
CAMT credit DTA (excluded)	50	-20	-1430		<u>16</u>	<u>16</u>		<u>3014</u>
totals	290	-60	-6480	150	-106	<u>140156</u>	200	<u>7490</u>

INT 23-03: Inflation Reduction Act - Corporate Alternative Minimum Tax

Example 3 Applicable entity with qualifying TSA exclusions

51. 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 TSA from any allocation of CAMT or CAMT credit utilization in a qualifying TSA as described in paragraph 11 of this interpretation.

52. 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.

53. The \$~~180~~150 is less than the \$300 15% of surplus limitation in paragraph 11bii., so it is not a limiting factor.

	DTA	Valuation Allowance	Not Recoverable Within 3 Years	Regular DTA Admitted Standalone	Impact of Consol. DTA and VA	Admitted DTA under 11bi	15% surplus limitation under 11bii	Non-admitted DTAs
DTAs	240	-40	-50	150		150		50
CAMT credit DTA (excluded)	0							
totals	240	-40	-50	150		150	300	50

[https://naiconline.sharepoint.com/teams/frsstatutoryaccounting/national meetings/a. national meeting materials/2023/8-13-23 summer national meeting/hearing/33a -23-04 -int 23-03 camt 8-3-23 edits.docx](https://naiconline.sharepoint.com/teams/frsstatutoryaccounting/national%20meetings/a.%20national%20meeting%20materials/2023/8-13-23%20summer%20national%20meeting/hearing/33a-23-04-int%2023-03%20camt%208-3-23%20edits.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.

<https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/NationalMeetings/A.NationalMeetingMaterials/2023/3-22-23-Spring/Exposures/23-06-ASU2021-10GovtAssistance.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:
 - 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^{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 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.

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.

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 the 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.~~

<https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/NationalMeetings/A.NationalMeetingMaterials/2023/8-13-23SummerNationalMeeting/Hearing/35-23-12-Residuals.docx>

**Statutory Accounting Principles (E) Working Group
Summer National Meeting
Comment Letters Received**

TABLE OF CONTENTS

COMMENTS / DOCUMENT	PAGE REFERENCE
Comment Letters Received for Items Exposed for the Summer National Meeting	
Interested Parties – May 31, 2023 <ul style="list-style-type: none"> ○ Corporate Alternative Minimum Tax (CAMT) 	1-13
Interested Parties – June 9, 2023 <ul style="list-style-type: none"> ○ Principles-Based Bond Definition ○ Ref #2022-01: Conceptual Framework – Updates ○ Ref #2022-11: Collateral for Loans ○ Ref #2022-12: Review of INT 03-02: Modification to an Existing Intercompany Pooling Arrangement ○ Ref #2022-19: Negative IMR ○ Ref #2023-01: Review Annual Statement Instructions for Accounting Guidance ○ Ref #2023-02: SSAP No. 43R – CLO Financial Modeling ○ Ref #2023-05: <i>ASU 2022-06, Reference Rate Reform (Topic 848), Deferral of the Sunset Date of Topic 848</i> ○ Ref #2023-06: Additional Updates on ASU 2021-10, Government Assistance ○ Ref #2023-07: ASU 2019-08, Codification Improvements to Topic 718 and Topic 606 ○ Ref #2023-08: ASU 2019-07, Codification Updates to SEC Sections ○ Ref #2023-09: <i>ASU 2020-09—Amendments to SEC Paragraphs Pursuant to SEC Release No. 33-10762—Debt (Topic 470)</i> ○ Ref #2023-10: ASU 2022-05, Long-Durations Contracts 	14-31
Security Benefit Life Insurance Company – June 9, 2023 <ul style="list-style-type: none"> ○ Ref #2022-11: Collateral for Loans 	32-33
Interested Parties – June 30, 2023 <ul style="list-style-type: none"> ○ Ref #2022-14: New Market Tax Credits ○ Ref #2019-21e - Principles-Based Bond Definition: Schedule BA ○ Ref #2023-13: PIK Interest Disclosure Clarification ○ Ref #2023-12: Residuals in SSAP No. 48 Investments 	34-48
Interested Parties – July 14, 2023 <ul style="list-style-type: none"> ○ Ref #2023-12: Residuals in SSAP No. 48 Investments 	49-50

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May 31, 2023

Mr. Dale Bruggeman, Chairman
Statutory Accounting Principles Working Group
National Association of Insurance Commissioners
1100 Walnut Street, Suite 1500
Kansas City, MO 64106-2197

RE: Interested Parties' Proposal for Statutory Accounting for CAMT

Dear Mr. Bruggeman:

Interested parties would like to thank you for the continued meetings with the Statutory Accounting Principles Working Group (SAPWG) staff to discuss the interested parties' proposal for accounting for the Corporate Alternative Minimum Tax (CAMT). Over the past five months, interested parties has provided materials illustrating its proposal.

Interested parties is now providing a draft of suggested language for a recommended Interpretation addressing the statutory accounting for the CAMT. This draft is intended to aid the SAPWG staff by providing the interested parties' proposal in direct language suitable for an Interpretation. The draft Interpretation is more detailed than the previously provided material and also includes transitional guidance, as well as suggested disclosures. We believe this detailed language should help prevent different interpretations among the industry and the accounting firms.

In drafting this proposal, interested parties followed the guiding principles that you previously communicated. First, given that CAMT only applies to a limited number of large and profitable companies, *SSAP No. 101 – Income Taxes* does not need to, and should not, be opened and rewritten. Although guidance is necessary to address how the consolidated tax should be accounted for under statutory accounting, revising *SAAP No. 101* is not necessary as this draft clarifies the existing guidance in *SSAP No. 101*. Following this guiding principle, interested parties drafted guidance through an Interpretation, leaving *SSAP No. 101* intact. Next, given that the CAMT is calculated based on consolidated book income and not taxable income, you suggested the use of the tax sharing agreement to bridge the CAMT calculation to the separate company statutory statements. As such, the proposed Interpretation relies on tax sharing

agreements to allocate the consolidated CAMT for purposes of the admittance calculation. In addition, all insurance companies will have different organizational structures, various book income starting points (U.S. GAAP, STAT or IFRS), and other facts and circumstances that will lead to unique situations under the CAMT. To avoid situational guidance, you indicated the solution should be principles-based and cover all insurance companies. By using a hierarchy of filers, the proposal covers all insurance companies without the need to address company specific issues. Finally, you suggested the solution should be developed between the working group and the industry, not external audit firms. Utilizing industry and working group representatives to develop the guidance prevents external audit firms from deviating in how they require insurance companies to account for the CAMT.

Thank you for the attention you have given to the impact that CAMT will have on statutory accounting and for considering the interested parties' proposed treatment.

Please feel free to contact either one of us with any questions you may have.

Sincerely,

D. Keith Bell

Rose Albrizio

cc: Interested parties
NAIC staff

Interpretation of the Statutory Accounting Principles (E) Working Group

INT 23-XX: Inflation Reduction Act – Corporate Alternative Minimum Tax

INT 23-XX References

Current:

SSAP No. 3 – Accounting Changes and Corrections of Errors

SSAP No. 9 – Subsequent Events

SSAP No. 101 – Income Taxes

INT 23-XX 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 December 31, 2022. Reporting entities shall refer to the Act and the related regulations and other tax guidance to determine application, but a non-authoritative high-level summary regarding the CAMT is as follows:
 - a. The tentative CAMT is 15% of the corporation’s “adjusted financial statement income” for the taxable year, reduced by the CAMT foreign tax credit for the taxable year.
 - b. The CAMT applies only to corporations (determined on a controlled group basis as defined for Federal income tax purposes) 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.
 - c. A corporation’s adjusted financial statement income is the amount of net income or loss the corporation reports on its applicable financial statement, adjusted by various enumerated adjustments.
 - d. The Act 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 governmental body is 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.

- 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 sum of the regular corporate income tax plus the base erosion anti-abuse tax (BEAT). Any CAMT paid is available indefinitely as a credit carryover that would reduce regular tax in future years when the regular tax liability is in excess of CAMT tax liability.
- f. The Act directs the Treasury to issue regulations and other guidance relating to implementing the CAMT, and many issues are pending detailed clarification, including issues that are unique to the insurance industry.

Interpretation Issues

2. This interpretation addresses statutory accounting and reporting aspects of the CAMT for year-end 2023 and subsequent reporting periods. 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 which progressively categorizes reporting entities for purposes of statutory accounting for the CAMT so that each step in the interpretation is dependent on the prior steps.
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, 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. 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. Unlike the alternative minimum tax (AMT) that applied under pre-2018 tax law, the new CAMT does not apply to every corporation and is not based on the corporation's regular taxable income with adjustments for minimum tax purposes. Instead, 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 actually due (liability determination) is based on a comparison of consolidated tentative CAMT to consolidated regular tax. 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.

¹ As used herein, an "unaffiliated" corporation is one that is not a member of a tax-controlled group.

4. As described in the rules below, this interpretation is based on the principle that the statutory tax accounting for the CAMT for reporting entities included in a consolidated tax return should be matched to the CAMT charges and credits that actually are expected to be paid by or to the reporting entity. For such reporting entities, this interpretation applies the provisions of the intercompany tax allocation agreement (also referred to as a tax sharing agreement or TSA) that governs allocation of consolidated taxes to individual members of the group.
 - a. Paragraph 16. of *SSAP No. 101* 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*; are pursuant to a written TSA; and income taxes incurred are accounted for in a manner consistent with the principles of FAS 109 (the forerunner of what is now ASC 740), as modified by *SSAP No. 101*.
 - b. This interpretation provides the applicable statutory tax accounting rules for the CAMT for a reporting entity that is included in a consolidated tax return and is subject to a TSA. In such case, the rules are applied consistently with the modifications to ASC 740 pursuant to both *SSAP No. 101* and this interpretation, and CAMT expense or benefit is recognized in accordance with the TSA.
 - c. Consistent with paragraph 4 of *SSAP No. 3 – Accounting Changes and Corrections of Errors*, application of this interpretation shall not be considered a change in accounting principle.

INT 23-XX Discussion

5. A reporting entity is an “applicable corporation” for purposes of this interpretation if, either as an unaffiliated corporation or as a member of a tax-controlled group of corporations, the reporting entity is an “applicable corporation” as defined for CAMT purposes in the tax code or guidance thereunder. With limited exceptions, once a corporation is an applicable corporation under the tax law, it remains an applicable corporation for subsequent taxable years and for purposes of this interpretation. Applicable corporation status means that CAMT must be tentatively determined and compared to regular tax liability. However, no CAMT is actually payable unless tentative CAMT exceeds regular tax liability. CAMT in excess of regular tax liability gives rise to a credit that is carried forward indefinitely for use when regular tax liability exceeds CAMT.

Categories of Reporting Entities

6. In an annual determination, all reporting entities are separated into one of four categories – the first three of which are not required to account for CAMT in determining current or deferred income taxes under *SSAP No. 101*.
 - a. Category a. consists of unaffiliated reporting entities that do not reasonably expect to be an applicable corporation for the taxable year that includes the reporting period. A reporting entity that was an applicable corporation for the preceding taxable year is deemed to 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. Category a. reporting entities are not required to recognize CAMT in any current or deferred tax computations under *SSAP No. 101*. Accordingly, non-applicable corporation status for the current reporting period applies both for purposes of determination of current taxes and determination of the amount “expected to be realized within the applicable period” in the admitted DTA calculation in paragraph 11.b.i. of *SSAP No. 101*.
- b. Category b. includes a reporting entity that is a member of a tax-controlled group of corporations, and the tax-controlled group does not reasonably expect to be an applicable corporation for the taxable year that includes the reporting period. As with category a. reporting entities, a category b. reporting entity that is a member of a tax-controlled group of corporations that was an applicable corporation for the preceding taxable year is deemed to 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. On the other hand, because the tax law does not provide for a separate company scope determination for members of a tax-controlled group, but instead determines applicable corporation status on a tax-controlled group basis, a category b. reporting entity is not required to make a separate company scope determination as if it was an unaffiliated corporation. Like category a. reporting entities, category b. reporting entities are not required to recognize CAMT in any current or deferred tax computations under *SSAP No. 101*, and non-applicable corporation status for the current reporting period applies both for purposes of determination of current taxes and determination of the amount “expected to be realized within the applicable period” in the admitted DTA calculation in paragraph 11.b.i. of *SSAP No. 101*.
 - c. Category c. includes a reporting entity that is a member of a tax-controlled group of corporations, and the tax-controlled group reasonably expects to be an applicable corporation for the taxable year that includes the reporting period. However, the reporting entity is included in a consolidated Federal income tax return with other members of the tax-controlled group and is a party to a TSA that is in effect for the reporting period and pursuant to the terms of which the category c. reporting entity i) is excluded from charges for any portion of the group’s CAMT, and ii) is not allocated any portion of the group’s utilization of CAMT credit carryover. Paragraph 8.3 of *SSAP No. 101 Exhibit A – Implementation Questions and Answers (Q&A)* is not applicable to Category c. reporting entities with respect to the CAMT. Like category a. and b. reporting entities, category c. reporting entities are not required to recognize CAMT in any current or deferred tax computations under *SSAP No. 101*, and this accounting treatment for the current reporting period applies both for purposes of determination of current taxes and determination of the amount “expected to be realized within the applicable period” in the admitted DTA calculation in paragraph 11.b.i. of *SSAP No. 101*. See *Example 1d* in paragraph 10.b. of this interpretation for an illustration.
 - d. Category d. includes all other reporting entities. Accordingly, category d. includes a reporting entity that reasonably expects to be an applicable corporation for the

taxable year that includes the reporting period, either as an unaffiliated corporation or as a member of a tax-controlled group of corporations if, in the latter case, the reporting entity is not included in category c. A category d. reporting entity may be the common parent company of a consolidated return group. It may also be a member of an affiliated group of corporations (as defined for Federal income tax purposes) but excluded from the consolidated tax return and filing its own separate return (if, for example, 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). Category d. reporting entities are required to consider CAMT in *SSAP No. 101* current and deferred tax computations in the manner set forth in the following paragraphs. Because CAMT is not payable by an applicable corporation unless it is in excess of regular tax liability, the calculations under category d. may or may not result in different current and deferred income taxes than if the CAMT was not taken into account.

Operational Rules for Category d. Reporting Entities

7. Category d. reporting entities are required to take CAMT into account under *SSAP No. 101* to the extent it is reasonably expected that the tax actually is (for the current period) or could be (for future years in the *SSAP No. 101* paragraph 11.b. applicable period) incurred a) by the reporting entity (if unaffiliated or affiliated but excluded from a consolidated tax return) or b) by the consolidated tax return group of which the reporting entity is a member and the consolidated CAMT is allocable in some part to the reporting entity pursuant to the group’s intercompany income tax allocation agreement. Such reporting entities recognize CAMT, if any, as a current tax expense for the taxable year that includes the reporting period and recognize CAMT credit utilization as a current tax benefit for such period. If the reporting entity is a party to a TSA, CAMT expense or CAMT credit utilization is based on the amount determined under the TSA. If the reporting entity pays CAMT or utilizes the CAMT credit to offset regular tax liability, its CAMT expense or CAMT credit utilization is based on the amount of such payments or receipts less allocations to other members of the consolidated tax group pursuant to the TSA.
8. 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 regular tax DTAs.² The accounting policy election applies for valuation allowance purposes only - that is, in the determination of adjusted gross DTAs other than CAMT-related DTAs. This accounting policy election cannot be used to avoid a valuation allowance analysis for CAMT credit carryforward DTAs. The accounting policy election must be disclosed in the notes to the financial statements and applied consistently in subsequent reporting periods.

² ASC 740 does not specifically address whether future years’ CAMT should be anticipated in a valuation allowance assessment for regular tax 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 regular tax DTAs.

9. An adjusted gross deferred tax asset (DTA) is recognized for any CAMT credit carryforward that is more likely than not to be recognized (that is, after reduction of the gross DTA by any required valuation allowance) and is admissible under the conditions described in paragraph 10 of this interpretation. The valuation allowance analysis should include, for example, the risk that the reporting entity, or the tax-controlled group of corporations of which the reporting entity is a member, more likely than not may be unable to realize the CAMT credit carryforward. Because the CAMT credit utilization is determined at the consolidated group level for reporting entities that are part of a consolidated group, the reporting entity valuation allowance determination shall be consistent with the consolidated group determination. A valuation allowance analysis for a CAMT credit carryforward is required regardless of the accounting policy election described in paragraph 8.
10. The admissible amount of adjusted gross DTAs for a category d. reporting entity is determined under paragraph 11 of *SSAP No. 101* with the modifications set forth below.
- a. An RBC-reporting entity with an ExDTA Authorized Control Level Risk Based Capital (RBC) percentage – calculated as described in footnote 3 of paragraph 11.b. of *SSAP No. 101* - of greater than [450]% if a life insurance company and [400]% in all other cases is not required 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 paragraph 11.b.i. of *SSAP No. 101* within the 3-year applicable period determined under paragraph 11.b. **[NOTE TO DRAFT:** An RBC ratio is being proposed for this financial strength test in part because *SSAP No. 101* already includes an RBC threshold in paragraph 11.b. An alternative financial strength test might incorporate an approach similar to that of Section 8.B.(3)(c) of the Credit for Reinsurance Model Regulation relating to certified reinsurers, wherein an assuming insurer must maintain financial strength ratings from two or more rating agencies deemed acceptable by the commissioner. For this purpose, acceptable rating agencies include Standard & Poor’s, Moody’s Investor Service, Fitch Ratings, A. M. Best Company, or any other nationally recognized statistical rating organization.] The post-valuation allowance adjusted gross DTA for any CAMT credit carryforward is admitted by such entities without regard to paragraph 11.b.i. The 15% limitation of capital and surplus limitation of paragraph 11.b.ii. of *SSAP No. 101* continues to apply to admitted adjusted gross DTAs, including the adjusted gross DTA for any CAMT credit carryforward. See *Example 1c* below. A category d. reporting entity that accounts for CAMT pursuant to this paragraph 10.a. shall disclose that fact in the notes to the financial statements.
 - b. If this financial strength threshold is not met, the amount expected to be realized under paragraph 11.b.i. of *SSAP No. 101* 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 TSA. CAMT credit utilization during the applicable period is recognized based on the same principles, with the opposite effect – 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. The DTA for any CAMT credit carryforward not admitted under paragraph 11b. of *SSAP No. 101* is available to offset liabilities under paragraph 11c. of *SSAP No. 101* without any other considerations.

c. Paragraph 8.3 of the *SSAP No. 101 Q&A* is not applicable to Category d. reporting entities with respect to the CAMT.

d. Examples

Example 1a: Insurance company IC is a member of a tax-affiliated group of corporations that files consolidated Federal income tax return and that reasonably expects to be an applicable corporation for 20X3. For 20X3, IC falls below the financial strength threshold applicable for category d. but exceeds the RBC threshold in paragraph 11.b. of *SSAP No. 101* for use of a 3-year applicable period. At the end of 20X3, IC has a \$50x CAMT credit carryover DTA (pursuant to the consolidated group's TSA, IC was allocated a portion of the group's expected 20X3 current CAMT expense, which IC included in its 20X3 current tax expense). IC also has \$200x of regular tax adjusted gross DTAs (i.e., as already reduced by any required valuation allowance), of which \$150x reverses over the 3-year applicable period 20X4-20X6 and is expected to be realized in IC's with and without calculation under paragraph 11.b.i. of *SSAP No. 101*. The consolidated group expects to absorb its entire CAMT credit carryover, including the \$50x allocated to IC, in 20X4, and expects to incur CAMT in each of 20X5 and 20X6, of which \$5x each year is expected to be allocated under the TSA to IC. IC's 15% of surplus limitation under paragraph 11.b.ii. of *SSAP No. 101* is \$225x.

Ignoring for purposes of this example any DTA admittance under paragraphs 11.a. and 11.c. of *SSAP No. 101*, IC admits the \$50x adjusted gross DTA for the CAMT credit carryover expected to be utilized in 20X4 and reduces its \$150x of regular tax admitted DTAs by the \$10x CAMT expected to be incurred in 20X5 and 20X6, resulting in \$190x of DTA admitted under paragraph 11.b.i., which is less than the \$225x paragraph 11.b.ii. limitation. However, if the 15% of capital and surplus limitation was \$175x instead of \$225x, the \$190x would be limited to \$175x.

	DTAs	Regular DTAs Admitted Standalone	Impact of Consolidated CAMT	Admitted DTAs under 11.b.i	15% Surplus limitation under 11.b.ii	Non Admitted DTAs
Adjusted gross DTAs reversing in 3 years	200	150	(10)	140		60
CAMT Credit DTA	50		50	50		-
	250	150	40	190	225	60

Example 1b. The facts are the same as in *Example 1a* except that the consolidated group of which IC is a member expects to absorb in 20X4 only a portion of its CAMT credit carryover, of which \$30x would be allocated to IC, and expects to incur CAMT in each of 20X5 and 20X6, of which \$5x each year is expected to be allocated under the TSA to IC. The consolidated group also concludes that its remaining consolidated CAMT credit carryforward, of which \$20x would be allocated to IC, is not more likely than not to be realized.

In accordance with paragraph 9 of this interpretation, IC establishes a \$20x valuation allowance against its \$50x AMT credit carryforward DTA, resulting in an adjusted gross DTA of \$30x. Under paragraph 8 of this interpretation, IC makes an accounting policy election to disregard CAMT when evaluating the need for a valuation allowance for its regular tax DTAs. IC admits \$150x of regular tax adjusted gross DTAs and the \$30x adjusted gross DTA for its allocated portion of the CAMT credit carryforward. IC reduces its admitted adjusted gross DTAs by its \$10x share of the consolidated CAMT expected to be incurred in 20X5 and 20X6. The result is an admitted DTA of \$170x, \$20x less than an *Example 1a*, attributable to the \$20x valuation allowance against the CAMT credit carryforward.

Example 1c. The facts are the same as in *Example 1a* except that IC exceeds the financial strength threshold applicable for category d. Accordingly, IC would not reduce its admitted regular tax DTA by any CAMT for years after 20X3. However, IC would still have to perform a valuation allowance analysis on its \$50x CAMT credit carryforward at the end of 20X3 and reduce the adjusted gross DTA for such credit to the amount more likely than not to be realized. Assume the valuation allowance is \$20x and the adjusted gross DTA for the CAMT credit carryover is reduced to \$30x. IC's admitted DTA would be \$180x. Additionally, if IC's 15% of surplus limitation under paragraph 11.b.ii. was \$175x, IC's admitted adjusted gross DTA would be further reduced to \$175x.

Example 1d. If, in *Example 1a*, the TSA to which IC is a party excluded IC from any allocation of CAMT or CAMT credit utilization, IC would be a category c. reporting entity for 20X3, CAMT would be excluded from the calculations, and IC's admitted adjusted gross DTA would be \$150x.

- e. Also recognized are CAMT credit carryovers arising during the applicable period that become utilizable within the applicable period.

Example 2: The facts are the same as *Example 1a* except that the consolidated group (and IC) have no CAMT credit carryovers at the end of 20X3. Furthermore, the consolidated group reasonably expects to incur CAMT liability in each of 20X4 and 20X5 (instead of 20X5 and 20X6) and to utilize in 20X6 a portion of the CAMT credit carryovers generated in 20X4 and 20X5. Of these amounts, IC is expected to be allocated under the TSA \$5x of CAMT in each of 20X4 and 20X5, and \$6x of

CAMT credit utilization in 20X6. In determining admitted adjusted gross DTAs for the 20X3 reporting period, IC reduces its regular tax admitted adjusted gross DTA by its \$10x TSA-allocated portion of the consolidated group's CAMT for 20X4 and 20X5 but increases such admitted amount by its \$6x TSA-allocated portion of the consolidated group's CAMT credit utilization for 20X6.

- f. Projections of CAMT liability, if any, (and CAMT credit utilization) during the applicable period involve forward-looking data, groupings, 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 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 changes. Disclosure of material modifications, and the general reason for such, should be made in the notes to the financial statements.³
- g. *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. A reporting entity may consider tax-planning strategies in making the determinations required under this interpretation. Because the CAMT scope and liability determinations are made at a group level, tax-planning strategies may be considered both at a group level and at the reporting entity level. However, tax-planning strategies at the group level shall not conflict with tax-planning strategies at the reporting entity level and vice versa.
- h. CAMT arising during the *SSAP No. 101* paragraph 11.b. applicable period that reduces the amount expected to be realized under paragraph 11.b. results in DTAs for CAMT credit carryforwards that may be taken into account in the *SSAP No. 101* paragraph 11.c. calculation.

Example 3: The facts are the same as in Example 2. The remaining \$4x of CAMT credit carryforward arising during the 3-year applicable period is taken into account in IC's 20X3 paragraph 11 calculation as part of the amount of adjusted gross DTAs, after application of paragraphs 11.a. and 11.b., that can be offset against existing gross DTLs.

Disclosures

11. The reporting entity shall disclose whether it is a category a., b., c., or d. reporting entity. Additionally, the following disclosures shall be made in the notes to the financial statements of category d. reporting entities:
 - a. The accounting policy election described in paragraph 8. of this interpretation.
 - b. Application of the RBC reporting threshold described in paragraph 10.a. of this interpretation

³ 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.

- c. Any disclosure required by paragraph 10.f. of this interpretation.
- d. In the disclosure required by paragraph 28.b. of *SSAP No. 101*, 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).
- e. Inclusion of CAMT credit carryforwards, if any, in the disclosure required by paragraph 26.a. of *SSAP No. 101*.
- f. The impact of CAMT tax-planning strategies, if any, in the disclosure required by paragraph 22.f. of *SSAP No. 101*.

Transition Guidance

12. 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 22-02.⁴ It is well understood that reporting entities have been awaiting the guidance provided in this interpretation to file requests for approval of TSA amendments or a new TSA relating to the CAMT. This paragraph 11. provides the applicable transition rules for year-end 2023 statutory accounting for requests for a timely-filed TSA amendment or a new TSA for the 2023 taxable year.

- a. Because the CAMT was newly-enacted effective for 2023, TSAs in effect for periods prior to the 2023 taxable year include no explicit provisions relating to the CAMT.⁵ Thus, category c. and category d. reporting entities may need to amend TSAs to deal with the CAMT effective for the entire 2023 taxable year. A reporting entity would file a request for amendment to a TSA or a new TSA on Form D – Prior Notice of a Transaction with its applicable domiciliary regulator(s) and commercial domiciliary regulator(s).
- b. Time is of the essence in both requesting and approving TSA amendments or a new TSA relating to the CAMT for the 2023 taxable year to be applicable to the 2023 reporting period. Accordingly, if, within [45] days after adoption of this interpretation, a reporting entity files the applicable Form D request(s) for TSA amendment or a new TSA to address the CAMT for 2023 and subsequent taxable years,⁶ such TSA amendment or new TSA shall be accounted for as applicable for the entire 2023 reporting period, regardless of whether the approved TSA allocates consolidated CAMT (or utilization of consolidated AMT credit carryforwards) to the reporting entity.
 - i. If the final approved TSA differs in its treatment of the CAMT allocation from the TSA originally requested on the Form D, the difference shall be recorded as follows:
 - 1. If Form D approval occurs subsequent to the balance sheet date, but before the issuance of the statutory financial statements and before

⁴ INT 22-02: Third Quarter 2022 through Second Quarter 2023 Reporting of the Inflation Reduction Act – Corporate Alternative Minimum Tax (last updated April 12, 2023).

⁵ TSAs may include provisions relating to the pre-2018 AMT if not previously amended to remove such provisions.

⁶ That is, with an effective date of January 1, 2023, or, if not a calendar year taxpayer, the first day of the 2023 taxable year.

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*.

2. In the extraordinary circumstance that a 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.
- ii. The transition guidance in this paragraph 12. does not apply to a reporting entity that does not file a Form D request for a CAMT-related TSA amendment or a new TSA within the time period specified in subparagraph b.

Interested Parties Draft

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June 9, 2023

Mr. Dale Bruggeman, Chairman
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National Association of Insurance Commissioners
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RE: Interested Parties Comments on Exposures with Comments due June 9

Dear Mr. Bruggeman:

Interested parties appreciate the opportunity to comment on the items exposed for comment by the Statutory Accounting Working Group (the Working Group) during its March 22, 2023, meeting with comments due June 9.

Ref #2022-19: Negative IMR

The 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.

Please see the comments in the letter submitted by ACLI on May 17th.

Principles-Based Bond Definition

The Working Group exposed changes to several SSAP's that propose statutory accounting changes under the principles-based bond project.

The exposure also proposes changes to Schedule BA to encompass debt securities that do not qualify as bonds and consolidate existing reporting lines.

Interested parties' comments are shown below related to each of the five separate documents exposed for comment.

SSAP No. 26R, SSAP No. 43R, and Other SSAPs

Interested parties have no comments on these exposures and are appreciative of the changes made and the responsiveness to interested parties' previous comments.

Schedule BA

Interested parties will respond to this exposure under separate cover as comments are more involved and not due until June 30, 2023.

SSAP No. 21R

Paragraphs 22 and 29

Interested parties understand that proposed paragraph 22 of SSAP No. 21 requires that the underlying collateral in an asset-backed security that fails the bond definition must qualify as admitted assets for the security to be admitted. Paragraph 22 also proposes to report these bonds at a value that does not exceed the fair value of the collateral with any amount above the fair value of the collateral being non-admitted. Interested parties have concerns with the proposal as this would be operationally very difficult to do since some asset-backed securities can have a

large number of assets and the fair value of the underlying collateral in the asset-backed security may not be readily available. This is very different from collateral loans in SSAP No. 21 where there are generally fewer assets that compose the underlying collateral. In addition, this would be costly as currently the servicer/trustee reports do not usually include fair value of the collateral so this would be a new service for which we would have to pay. Interested parties believe that accounting for these securities at the lower of cost or market of the security owned by the insurer will consider the performance of the underlying collateral. The unit of account is the security owned by the insurer and not the underlying collateral for the asset-backed security. The fair value of the bond will consider the fair value of the collateral to a great extent, but it will also take into account other key characteristics of the bond itself that impact the bond's fair value and will better reflect the consideration expected to be received upon maturity or sale of the security. If the collateral is an admitted asset, the entire carrying balance of the security should be admitted without having to quantify collateral fair value given the cost and complexity in doing so. Interested parties propose changes to paragraph 22 as a result of the comments above.

Interested parties also have comments regarding the new paragraph 29 that was added to clarify the accounting for residual tranches. We believe that the intent of paragraph 29 is to require non-admission of a residual tranche only if another tranche from the same securitization owned by the insurer fails the bond definition and the collateral is not an admitted investment. Interested parties propose changes to paragraph 29 to further clarify what we believe to be the intent of the paragraph.

We proposed the following changes to paragraphs 22 and 29 to address the aforementioned comments:

22. Debt securities in scope of this standard that do not qualify as bonds under SSAP No. 26R and for which the primary source of repayment is derived through rights to underlying collateral, qualify as admitted assets ~~only to the extent they are secured~~ if the underlying collateral primarily qualify as admitted invested assets. Any residual tranches or first loss positions held from the same securitization that did not qualify as a bond under SSAP No. 26R also only qualify as admitted assets to the extent the underlying collateral primarily qualify as admitted invested assets. Any amounts in excess of the fair value of the underlying admitted invested assets shall be non-admitted.

29. As stated in paragraph 22, Residuals are permitted to be admitted if debt securities from the same securitization qualify as bonds under SSAP No. 26R as an issuer credit obligation or an asset backed security. For example, if a debt security from a securitization does not qualify as a bond, and the source of repayment is derived through rights to the underlying collateral, the debt security is only permitted to be admitted if the underlying assets qualify as admitted assets. If the debt security from a securitization is nonadmitted due to the requirements under paragraph 22, then any residual interests or first loss positions held from the same securitization also do not qualify as admitted assets and would be reported as nonadmitted assets.

Paragraph 25

Interested parties also note that the way paragraph 25 below was written implies that the only securities that can fail the definition are asset-backed securities. Since an issuer credit obligation could also fail the bond definition (i.e., does not reflect a creditor relationship in substance), we believe the changes recommended below are needed to reference the appropriate accounting guidance under either SSAP No. 26 for issuer credit obligations or SSAP No. 43R for asset-backed securities.

25. Debt securities that do not qualify as bonds ~~are captured~~included in the scope of this statement. Debt securities included in the scope of this statement shall follow the guidance in SSAP No. 43R—Asset-Backed Securities or SSAP No. 26R Bonds, depending on whether they would have been classified as asset-backed securities or issuer credit obligations, respectively, should they have qualified as bonds. This includes the guidance, for calculating amortized cost, for determining and recognizing other-than-temporary impairments and for allocating unrealized and realized gains and losses between the asset valuation reserve (AVR) and interest maintenance reserve (IMR).

Paragraphs 30 and 31

In paragraph 31 of the exposure, NAIC asks the following question:

Exposure Question: Industry is requested to provide information on how residual tranches have been amortized and how they have been assessed for OTTI as there are no contractual principal or interest payments.

Regarding the calculation of amortized cost and the assessment of OTTI for residuals, it has generally been industry practice to follow the SSAP No. 43R guidance for beneficial interests (i.e., paragraphs 21-25 of the bond definition proposal titled “Accretable Yield and Changes to Effective Yield for Application of Prospective Method”), which requires estimates of cash flows to be calculated quarterly with prospective yield adjustments. If there is an adverse change in estimated cash flows at the reporting date, an OTTI is recorded. Under those circumstances, the residual is written down to the current estimate of cash flows discounted at a rate equal to the current yield used to accrete the residual with the resulting change being recognized as a realized loss. If the cash flows increase from the prior period, the yield is adjusted upward. To require recognition of a loss for the entire amount of the residual would not be a reasonable accounting result. Also, for insurers who are US GAAP filers, they also apply the prospective method discussed above for their US GAAP financial statements, if they have not elected the fair value option. As a result, interested parties propose the edits below to paragraphs 30 and 31, which also include clarification on AVR treatment of residuals:

30. Residuals shall be initially reported at cost, or allocated cost (using proportional fair values) if acquired along with debt tranches from the securitization. Subsequent to initial acquisition, residuals shall be reported at the lower of amortized cost or fair value, with changes in fair value (or from amortized cost to fair value) reported as unrealized gains or losses. To determine amortized cost, the reporting entity should apply SSAP No. 43R,

paragraphs 21-25 (i.e., prospective method). Unrealized and realized gains and losses on residuals are reported in the AVR.

~~31. Residuals shall be assessed for other-than-temporary impairment (OTTI) on an ongoing basis based on SSAP No. 43R. An OTT shall be considered to have occurred if it is probable that the reporting entity will not receive cash flows distributed to the residual tranche to cover the reported amortized cost basis. Upon identification of a probable OTTI, the reporting entity shall recognize a realized loss equal to the remaining amortized cost basis. Subsequent to the recognition of OTTI, the residual shall be reported with a zero book adjusted carrying value. Any subsequent cash flows received attributed to the residual tranche shall be reported as interest income.~~

Interested parties also note that the recent exposure by the Working Group that intends to expand the scope of what is considered a residual investment may require significant changes to the accounting laid out above. The accounting model for residuals issued in a securitization that we explain above is in line with the accounting for residuals that are more akin to a debt security. If the scope of a residual is expanded to include other types of residuals, this model may not fit those types of investments. Given this linkage, interested parties may have additional recommendations for the accounting discussed above as the residual investment definition is finalized.

Ref #2022-01: Conceptual Framework – Updates

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 GAAP standards with modifications.

The additional exposed revisions to SSAP No. 16X 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 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.

Interested parties believe the proposed changes above are responsive to our previous comments and address the issue of having statutory accounting guidance in other authoritative sources, e.g., the *NAIC Annual Statement Instructions*.

Ref #2022-11: Collateral for Loans

The Working Group exposed revisions to *SSAP No. 21 – Revised—Other Admitted Assets* which clarify that the invested assets pledged as collateral for admitted collateral loans must qualify as admitted invested assets. These revisions clarify that for specific investments, the comparison for admittance is between the net equity audited value of the pledged collateral to the collateral loan

balance. In addition, a consistency revision to *SSAP No. 20—Nonadmitted Assets*, paragraph 4.b. was exposed.

Interested parties support the proposed changes.

Ref #2022-12: Review of INT 03-02: *Modification to an Existing Intercompany Pooling Arrangement*

The Working Group re-exposed the intent to nullify INT 03-02, effective December 31, 2023. The nullification is proposed as INT 03-02 is inconsistent with SSAP No. 25 – *Affiliates and Other Related Parties*, guidance regarding economic and non-economic transactions between related parties. The guidance in INT 03-02 can result with, in essence, unrecognized gains (dividends) or losses through the use of statutory book valuation when using assets (bonds) to make payments to affiliates for modifications to existing intercompany reinsurance pooling agreements. Treatment of transfers of assets between affiliates should be consistent for all intercompany transactions and there is not a compelling need to be different when valuing assets for intercompany reinsurance transactions.

Interested parties note that there are several issues associated with nullifying INT 03-02 and transferring the assets that support the insurance liabilities at fair value versus book value as provided in the current guidance in the INT including the following:

- Inconsistent accounting among affiliates for a modification of the intercompany pooling agreement when some of the transfers generate a realized gain and others do not, depending on the assets transferred;
- The transfer of a bond in an intercompany pooling transaction that generates a realized gain would cause the intercompany pooling modification to be accounted for as retroactive reinsurance, which would violate the accounting guidance currently contained in SSAP No. 63;
- The use of retroactive reinsurance contradicts the basis of presentation in Schedule P for business subject to intercompany pooling agreements;
- Inconsistent presentation of underwriting assets and liabilities among participants in the pooling agreement; and
- Inconsistent accounting for intercompany transactions, as some gains would be deferred while other gains will be realized at the parent level, depending on the insurer's corporate ownership structure.

Depending on market interest rates at the time of a pooling modification, a gain or loss will result from the transfer of bonds at fair value. In times of declining interest rates, the fair value of bonds generally increase. During these times, if a bond with a fair value in excess of book value is transferred as part of a pooling modification and the transfer is accounted for at fair value, the transferor will recognize a gain. This gain will disqualify the transferor and transferee from accounting for the pooling modification as prospective reinsurance based on the accounting guidance in SSAP No. 62R paragraph 36d. However, the same pooling modification can have other participants qualify for prospective reinsurance due to no gain on transfer of the assets.

Prospective reinsurance versus retroactive reinsurance

The transferors, i.e., the ceding pool entities, that qualify for prospective reinsurance will record the premium and loss accounts as prospective reinsurance (i.e., the cedent's participation share of the total intercompany pool written and earned premium, reserves and losses are reported in the cedent's financial statements).

The transferors, i.e., the ceding pool entities, that do not qualify for prospective reinsurance will report written premiums, earned premiums, loss and loss adjustment reserves and losses and loss adjustment expenses without recognition of the retroactive reinsurance. Therefore, insurance accounts subject to pooling will not be reduced for cessions to the lead company of the pool or retrocessions by the lead company to the pool participants. Similarly, any transferees that do not qualify for prospective reinsurance, i.e., the assuming pool entities, will exclude the retroactive reinsurance from loss and loss expense reserves and all schedules and exhibits. SSAP No. 62R requires the following for retroactive reinsurance:

- The ceding entity and the assuming entity shall report by write-in item on the balance sheet, the total amount of all retroactive reinsurance, identified as retroactive reinsurance reserve ceded or assumed, recorded as a contra-liability by the ceding entity and as a liability by the assuming entity;
- The ceding entity shall, by write-in item on the balance sheet, restrict surplus resulting from any retroactive reinsurance as a special surplus fund, designated as special surplus from retroactive reinsurance account;
- The surplus gain from any retroactive reinsurance shall not be classified as unassigned funds (surplus) until the actual retroactive reinsurance recovered exceeds the consideration paid;
- The special surplus from retroactive reinsurance account for each respective retroactive reinsurance agreement shall be reduced at the time the ceding entity begins to recover funds from the assuming entity in amounts exceeding the consideration paid by the ceding entity.

As a result of the inconsistent accounting between pool entities that are required to account for the intercompany pooling as prospective reinsurance and the pool entities that are required to use retroactive reinsurance, the financial statements of the pool will be extremely confusing and lack useful financial information. The stand-alone financial statements of the legal entities of the pool will not be consistent and the combined audited financial statements of the pool will reflect insurance accounts that are accounted for and reported using different accounting methodologies for the same underlying transactions.

As a practical matter, it would be nearly impossible for an insurer to report intercompany pooling results and balances using both prospective and retroactive reinsurance. Premium, claim, and loss systems are not built to handle such inconsistent accounting for the same underlying transactions.

SSAP No. 62R versus SSAP No. 63

The application of retroactive reinsurance as a result of the nullification of INT 03-02 would also result in a conflict with the guidance in SSAP No. 63, *Underwriting Pools*. The highlighted wording in paragraphs 8 and 9 of SSAP No. 63 instructs the preparer to record the premiums and losses based on the legal entity's participation in the pool. The use of retroactive reinsurance would violate that guidance. Regarding the last sentence of paragraph 7, the use of retroactive reinsurance would also result in timing differences between entities in the pool as a result of certain entities deferring gains in surplus.

7. Intercompany pooling arrangements involve establishment of a conventional quota share reinsurance agreement under which all of the pooled business is ceded to the lead entity and then retroceded back to the pool participants in accordance with their stipulated shares. Arrangements whereby there is one lead company that retains 100% of the pooled business and all or some of the affiliated companies have a 0% net share of the pool may qualify as intercompany pooling. In these arrangements, only the policy issuing entity has direct liability to its policyholders or claimants; other pool participants are liable as reinsurers for their share of the issuing entity's obligations. Although participants may use different assumptions (e.g., discount rates) in recording transactions, the timing of recording transactions shall be consistently applied by all participants.

8. Underwriting results relating to voluntary and involuntary pools shall be accounted for on a gross basis whereby the participant's portion of premiums, losses, expenses, and other operations of the pools are recorded separately in the financial statements rather than netted against each other. Premiums and losses shall be recorded as direct, assumed, and/or ceded as applicable. If the reporting entity is a direct writer of the business, premiums shall be recorded as directly written and accounted for in the same manner as other business which is directly written by the entity. To the extent that premium is ceded to a pool, premiums and losses shall be recorded in the same manner as any other reinsurance arrangement. A reporting entity who is a member of a pool shall record its participation in the pool as assumed business as in any other reinsurance arrangement.

9. Underwriting results relating to intercompany pools shall be accounted for and reported as described in paragraph 8. While it is acceptable that intercompany pooling transactions be settled through intercompany arrangements and accounts, intercompany pooling transactions shall be reported on a gross basis in the appropriate reinsurance accounts consistent with other direct, assumed and ceded business.

Schedule P

Data reported in Schedule P is required to be reported net of intercompany pooling (i.e., only the reporting entity's share of the pool business is reported in Schedule P). This includes data related to premiums, losses and loss adjustment expenses, and claim counts.

Additionally, the *NAIC Annual Statement Instructions* for Schedule P require that when changes to pooling agreements impact prior accident years, historical data values in Schedule P must be

restated based on the new pooling percentages. This instruction effectively recognizes that Schedule F only provides useful information related to changes in intercompany pooling agreements if such changes are treated as prospective reinsurance.

Because intercompany pooling data would not be reflected in the Schedule P of the pool entities that are required to use retroactive reinsurance accounting, distorted data would result because only a portion of the intercompany pool's loss, premium, and claim count data would be reported on Schedule P (i.e., the only pooled data reported in Schedule P would be of the pool participants that qualify for using prospective reinsurance). Note that the use of retroactive reinsurance will apply until all of the claims subject to retroactive reinsurance are settled; therefore, the distortion of Schedule P for the pool entities will likely occur for decades depending on the underlying business. As a result, the Schedule P data for the intercompany pool used by actuaries, analysts, regulators, and the NAIC (including analysis used to update RBC factors) will not be useful or meaningful.

Other intercompany pooling issues

Because intercompany pooling agreements subject certain insurance assets (e.g., agents balances) to pooling, a mismatch would occur in the financial statements of pool participants that are required to use retroactive reinsurance accounting versus the participants that are not. For the ceding entities, insurance assets would reflect the reporting entity's share of the pool business, but premiums and losses will reflect the entity's business excluding the pooling. This would occur because insurance assets such as agents balances are not subject to retroactive reinsurance accounting.

Consistency of accounting

The NAIC has noted concerns that the "guidance in INT 03-02 can result with in essence, unrecognized gains (dividends) or losses through the using the statutory book valuation when using assets (bonds) to make payments to affiliates for modifications to existing intercompany reinsurance pooling agreements." The NAIC also notes that the "treatment of transfers of assets between affiliates should be consistent for all intercompany transactions and there is not a compelling need to be different when valuing assets for intercompany reinsurance transactions." Interested parties note the following:

- As our examples illustrate, the transfer of assets using fair value in an intercompany pooling modification can result in reported realized gains reflected in certain pool participants' financial statements, as well as the combined audited statutory financial statements of the intercompany pool even though the assets remain in the pool.
- The transfer of assets at fair value in an intercompany pooling modification can also result in inconsistent accounting for intercompany transactions, as some gains would be deferred while other gains will be realized at the parent level, depending on the ownership structure of the entities in the intercompany pool.

SSAP No. 63

SSAP No. 63 has limited accounting guidance related to intercompany pooling agreements and instead primarily provides a discussion of what an intercompany pooling agreement is and contains a reference to INT 03-02 in paragraph 5. We believe that a more effective approach to addressing the concerns over moving invested assets at book value in a modification of an intercompany agreement would be to incorporate portions of INT 03-02 into SSAP No. 63, require that insurers settle the movement of assets and liabilities on a net basis (i.e., the net of pool assets less pool liabilities) to minimize the movement of assets, require disclosure if assets with fair values that differ from cost or amortized cost are transferred as part of the modification, and include a cross reference in SSAP No. 25 to the updated guidance in SSAP No. 63 for transfers of assets associated with a modification of an intercompany pooling agreement. This approach would also provide guidance on such modification where none would exist in the absence of INT 03-02. Please see recommended changes to SSAP No. 63 in the attached.

Since the guidance regarding the transfers of assets associated with modifications of intercompany agreements would be located in SSAP No. 63, we recommend that SSAP No. 25 include a new paragraph 4 to direct the reader to the guidance in SSAP No. 63 as follows:

4. If a company transfers assets or liabilities to effectuate a modification to an existing intercompany pooling arrangement, the transaction, including the transfer of assets, shall be accounted for in accordance with the guidance in SSAP No. 63 – *Underwriting Pools*.

Ref #2023-01: Review Annual Statement Instructions for Accounting Guidance

The Working Group moved this agenda item to the active listing, categorized as a SAP clarification, with a request for regulator and industry viewpoints on situations in which guidance in the annual statement instructions should be captured within a SSAP.

Interested parties are aware of Annual Statement guidance on IMR /AVR and Schedule F penalties that should be considered for inclusion in SSAP's as well as the guidance related to intercompany pooling arrangements discussed above. If additional items come to our attention, we will inform the Working Group.

Ref #2023-02: SSAP No. 43R – CLO Financial Modeling

The 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.

Interested parties have no comments on this item.

Ref #2023-05: *ASU 2022-06, Reference Rate Reform (Topic 848), Deferral of the Sunset Date of Topic 848*

The 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.

Interested parties support the extension of the expiration date of *INT 20-01* to December 31, 2024.

Ref #2023-06: Additional Updates on ASU 2021-10, Government Assistance

The 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.

Interested parties agree with the proposed revisions to SSAP No. 24, as exposed in Ref 2023-06, subject to the following comments.

Interested parties noted that the Working Group's discussion of Ref #2023-06 in the Spring 2023 Working Group meeting agenda, indicated that use of a grant or contribution model was not intended to be permitted when accounting for government assistance under statutory accounting principles. The discussion did not indicate what accounting model should be applied. Interested parties are not aware of specific statutory guidance addressing the accounting for government assistance transactions, and believe, in the absence of specific guidance, companies may look to industry practice and other nonauthoritative GAAP guidance, which supports the use of a grant or contribution model, to determine appropriate statutory accounting treatment. Additionally, interested parties believe the disclosure requirements in SSAP No. 24 provide sufficient detail to allow a user of the financial statements to adequately understand the impact of any government assistance received by an insurer on its results regardless of the accounting model used to recognize and measure the assistance. Given these considerations and the relative infrequent occurrence of such items, interested parties suggest that the Working Group clarify that the intent of the exposed revisions in Ref #2023-06 are to require disclosure of unusual or infrequent government assistance transactions regardless of how such transactions are accounted for, and are not intended to prohibit entities from accounting for government assistance transactions through the use of a grant or contribution model.

Ref #2023-07: ASU 2019-08, Codification Improvements to Topic 718 and Topic 606

The 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 in the exposure draft.

Interested parties have no comments on this item.

Ref #2023-08: ASU 2019-07, Codification Updates to SEC Sections

The 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.

Interested parties have no comments on this item.

Ref #2023-09: ASU 2020-09—Amendments to SEC Paragraphs Pursuant to SEC Release No. 33-10762—Debt (Topic 470)

The 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.

Interested parties have no comments on this item.

Ref #2023-10: ASU 2022-05, Long-Durations Contracts

The 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.

Interested parties support the conclusion reached for this guidance

* * * *

Thank you again for your consideration of interested parties' comments regarding the exposures discussed above. Please feel free to contact either one of us with any questions you may have.

Sincerely,

D. Keith Bell

Rose Albrizio

cc: Interested parties
NAIC staff

Statement of Statutory Accounting Principles No. 63

Underwriting Pools

STATUS

Type of Issue	Common Area
Issued	Initial Draft
Effective Date	January 1, 2001
Affects	No other pronouncements
Affected by	No other pronouncements
Interpreted by	INT 03-02
Relevant Appendix A Guidance	None

STATUS	1
SCOPE OF STATEMENT	1
SUMMARY CONCLUSION	1
Disclosures	3
Effective Date and Transition	4
REFERENCES	4
Relevant Issue Papers	4

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for underwriting pools and associations.

SUMMARY CONCLUSION

2. Underwriting pools and associations can be categorized as follows: (a) involuntary, (b) voluntary, and (c) intercompany.

3. Involuntary pools represent a mechanism employed by states to provide insurance coverage to those with higher than average probability of loss who otherwise would be excluded from obtaining coverage. Reporting entities are generally required to participate in the underwriting results, including premiums, losses, expenses, and other operations of involuntary pools, based on their proportionate share of similar business written in the state. Involuntary plans are also referred to as residual market plans, involuntary risk pools, and mandatory pools.

4. Voluntary pools are similar to involuntary pools except they are not state mandated and a reporting entity participates in the pool voluntarily. In addition, voluntary pools are not limited to the provision of insurance coverage to those with higher than average probability of loss, but often are used to provide greater capacity for risks with exceptionally high levels of insurable values (e.g., aircraft, nuclear power plants, refineries, and offshore drilling platforms).

5. Intercompany pooling relates to business which is pooled among affiliated entities who are party to a pooling arrangement.^(INT 03-02)

6. Participation in a pool may be on a joint and several basis, i.e., in addition to a proportional share of losses and expenses incurred by the pool, participants will be responsible for their share of any otherwise unrecoverable obligations of other pool participants. In certain instances, one or more entities may be designated as servicing carriers for purposes of policy issuance, claims handling, and general administration of the pooled business, while in other cases a pool manager or administrator performs all of these functions and simply bills pool participants for their respective shares of all losses and expenses incurred by the pool. In either case, liabilities arising from pooled business are generally incurred on a basis similar to those associated with non-pooled business, and should therefore be treated in a manner consistent with the guidelines set forth in *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets*.

7. Intercompany pooling arrangements involve establishment of a conventional quota share reinsurance agreement under which all of the pooled business is ceded to the lead entity and then retroceded back to the pool participants in accordance with their stipulated shares. Arrangements whereby there is one lead company that retains 100% of the pooled business and all or some of the affiliated companies have a 0% net share of the pool may qualify as intercompany pooling. In these arrangements, only the policy issuing entity has direct liability to its policyholders or claimants; other pool participants are liable as reinsurers for their share of the issuing entity's obligations. Although participants may use different assumptions (e.g., discount rates) in recording transactions, the timing of recording transactions shall be consistently applied by all participants.

8. Insurance groups that utilize intercompany pooling arrangements often modify these arrangements from time to time for various business reasons. These business reasons commonly include mergers, acquisitions, dispositions, or a restructuring of the group's legal entity structure. In order to effectuate a relatively simple modification, such as changing pooling participation percentages without changing the pool participants, companies often simply amend the existing pooling agreement. Alternatively, in order to effectuate a more complex modification, such as changing (by adding or removing) the number of pool participants, a company may commute the existing pooling agreement and execute a new pooling agreement(s). In conjunction with executing the appropriate intercompany pooling agreements, a transfer of assets and liabilities amongst the impacted affiliates may also be required in order implement the new pooling agreement(s). The following subparagraphs provide guidance specific to modifications of intercompany pooling arrangements and shall not be applied to an analogous transaction or event.

- a) The appropriate valuation basis to be used for assets and liabilities that are transferred among affiliates in conjunction with the execution of a new intercompany pooling agreement(s) that serves to substantively modify an existing intercompany pooling arrangement is statutory book value for assets and statutory value for liabilities.
- b) The net amount of the assets and liabilities being moved among entities as a result of a modification to an intercompany pooling shall be used to settle the intercompany payable/receivable (i.e., the assets that are transferred in conjunction with the modification) to minimize the amount of assets transferred in the modification.

9. Underwriting results relating to voluntary and involuntary pools shall be accounted for on a gross basis whereby the participant's portion of premiums, losses, expenses, and other operations of the pools are recorded separately in the financial statements rather than netted against each other. Premiums and losses

shall be recorded as direct, assumed, and/or ceded as applicable. If the reporting entity is a direct writer of the business, premiums shall be recorded as directly written and accounted for in the same manner as other business which is directly written by the entity. To the extent that premium is ceded to a pool, premiums and losses shall be recorded in the same manner as any other reinsurance arrangement. A reporting entity who is a member of a pool shall record its participation in the pool as assumed business as in any other reinsurance arrangement.

10. Underwriting results relating to intercompany pools shall be accounted for and reported as described in paragraph 8. While it is acceptable that intercompany pooling transactions be settled through intercompany arrangements and accounts, intercompany pooling transactions shall be reported on a gross basis in the appropriate reinsurance accounts consistent with other direct, assumed and ceded business.

11. Equity interests in, or deposits receivable from, a pool represent cash advances to provide funding for operations of the pool. These are admitted assets and shall be recorded separately from receivables and payables related to a pool's underwriting results. Receivables and payables related to underwriting results shall be accounted for in accordance with the guidance in paragraphs 6-8. If it is probable that these receivables are uncollectible, any uncollectible amounts shall be written off against operations in the period such determination is made. If it is reasonably possible a portion of the balance is uncollectible but is not written off, disclosure requirements outlined in SSAP No. 5R shall be followed.

Disclosures

12. If a reporting entity is part of a group of affiliated entities which utilizes a pooling arrangement under which the pool participants cede substantially all of their direct and assumed business to the pool, the financial statements shall include:

- a. A description of the basic terms of the arrangement and the related accounting;
- b. Identification of the lead entity and of all affiliated entities participating in the intercompany pool (include NAIC Company Codes) and indication of their respective percentage shares of the pooled business;
- c. Description of the lines and types of business subject to the pooling agreement;
- d. Description of cessions to non-affiliated reinsurers of business subject to the pooling agreement, and indication of whether such cessions were prior to or subsequent to the cession of pooled business from the affiliated pool members to the lead entity;
- e. Identification of all pool members which are parties to reinsurance agreements with non-affiliated reinsurers covering business subject to the pooling agreement and which have a contractual right of direct recovery from the non-affiliated reinsurer per the terms of such reinsurance agreements;
- f. Explanation of any discrepancies between entries regarding pooled business on the assumed and ceded reinsurance schedules of the lead entity and corresponding entries on the assumed and ceded reinsurance schedules of other pool participants;
- g. Description of intercompany sharing, if other than in accordance with the pool participation percentage, of the Aging of Ceded Reinsurance (Schedule F, Part 3) and the write-off of uncollectible reinsurance;
- h. Amounts due to/from the lead entity and all affiliated entities participating in the intercompany pool as of the balance sheet date.

- i. For modifications to an existing intercompany pooling arrangement that involve the transfer of assets with fair values that differ from cost or amortized cost, the statement value and fair value of assets received or transferred by the reporting entity.
13. Refer to the Preamble for further discussion regarding disclosure requirements.

Effective Date and Transition

14. This statement is effective for years beginning January 1, 2001. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*.

REFERENCES

Relevant Issue Papers

- *Issue Paper No. 97—Underwriting Pools and Associations Including Intercompany Pools*

June 9, 2023

Mr. Dale Bruggeman, Chairman
Statutory Accounting Principles Working Group
National Association of Insurance Commissioners
1100 Walnut Street, Suite 1500
Kansas City, MO 64106-2197

Dear Mr. Bruggeman:

Re: Exposure Reference No. 2022-11 – Collateral for Loans

Security Benefit Life Insurance Company would like to thank the Statutory Accounting Principles Working Group (“SAPWG”) for the opportunity to provide comments for consideration on Reference No. 2022-11—Collateral for Loans (the “Exposure”)¹, which proposes revisions to Statements of Statutory Accounting principles (“SSAP”) No. 21R, *Other Admitted Assets* (“SSAP No. 21R”) as follows:

1. A joint venture, partnership, or limited liability company (“JV/LP/LLC”) or a subsidiary controlled or affiliated entity (“SCA”) that is pledged as collateral to support an outstanding collateral loan balance must each be audited annually to qualify as an admitted investment.
2. The audited net equity of a pledged JV/LP/LLC and/or SCA is the basis of measurement for comparison to an outstanding collateral loan balance. Any portion of the outstanding balance of a collateral loan that is greater than the audited net equity of a pledged JV/LP/LLC and/or SCA must be non-admitted.

Firstly, consistent with the separate and broader Interested Party comment letter dated February 10, 2023, we do not believe an audit is necessary. In addition, we believe considering book value as a measure of the adequacy of collateralization, or ability for a borrower to repay a collateral loan is not supportable. Book value of equity is not acknowledged to reflect the value of what an asset would be bought or sold for (*i.e.*, the ultimate source of repayment for the collateral loan). The concept of fair value (*vs.* book value) exists precisely to represent the price that would be received for the sale of an asset in an orderly transaction between market participants at the measurement date. This variance between book value and fair value is observed in markets every day, where trading and transaction prices vary significantly from the proportionate book value of equity (hence the concept of “price-to-book multiples”). Book value can be lower than or higher than fair value. Notably, for example, insurers often trade on public markets for less than one times price-to-book value ratio (*i.e.*, book value is greater than fair value).

Using the book value of equity in lieu of fair value when assessing collateralization for the admissibility of collateral loans will all but guarantee the carrying value of the collateral will differ from what it could ultimately be sold for to repay the collateral loan. This will create volatility for insurance companies and may lead borrowers to begin to manage to a metric in the short term that does not ultimately provide the highest proceeds to repay the collateral loan.

Please consider the following example: a borrower borrows \$100 on a collateral loan to make a \$100 equity investment in an equipment leasing business. The \$100 investment equates to 20% of the company upon investment, which implies that the total business is worth \$500. The total book value of the business is \$250 (equipment leasing businesses, for example, typically trade around 2x price/ book value). This means that, immediately upon making the \$100 investment, the borrower’s stake would be considered to have a collateral value of only \$50 (*i.e.*, 20% of the \$250 book value), resulting in an immediate loss of \$50 of collateral value. Further, this differs from the statutory accounting that would apply if the insurer had made the investment directly on its balance sheet (equity-method accounting). In accordance with SSAP No. 48, the insurer would record the initial investment in an investee at cost plus subsequent capital contributions to the investee. The carrying amount of the investment would then subsequently be adjusted for the amortization difference (difference between the cost and underlying GAAP equity) over a period of time as well as for the insurer’s pro-rata share of GAAP-basis earnings or losses and distributions of the investee. Therefore, under SSAP No. 48, the investment is worth its investment at cost (*i.e.*, \$100) on day one and subsequently amortized to the GAAP equity value of the investee over the period that the investing entity benefits economically rather than at a point in time as would occur under the proposed revisions in SSAP No. 21R.

We request consideration for the likely adverse effects to decision-making this exposed revision may cause, in addition to the operational disruptiveness of immediate adoption, as discussed further in this document.

Secondly, we believe the Exposure proposes substantive changes, not clarifications, and as a result, the process for a substantive change is not being followed. The Exposure will impose undue costs and efforts if adopted, as it substantively causes a change

¹ Dated March 22, 2023.

to the application of SSAP No. 48, *Joint Ventures, Partnerships and Limited Liability Companies* (“SSAP No. 48”) and SSAP No. 97, *Investments in Subsidiary, Controlled and Affiliated Entities* (“SSAP No. 97”). The Accounting Practices and Procedures Manual provides that “[n]onsubstantive revisions are characterized as language clarifications which do not modify the original intent of a SSAP . . .” Utilization of fair value equity of pledged JV/LP/LLC and/or SCA investments has long been utilized as required by SSAP No. 21R and subject to both independent audits and state insurance department examinations, without this practice being raised as an issue nor requiring adjustments to financial statements. Accordingly, the Exposure modifies the original intent of SSAP Nos. 21R, 48 and 97.²

The accelerated approach here is not supported by the analytical rigor that the SAPWG typically applies and denies affected parties the due process otherwise required when substantive changes are made. Should the Exposure be adopted with the proposed revisions to SSAP No. 21R to require audited net equity of pledged JV/LP/LLC and/or SCA investments, it would similarly be a material modification to an acceptable and supportable industry practice. It would also require insurers to disclose a change in accounting policy, which is further evidence that this is a substantive change. Furthermore, we would have to incur considerable cost and effort along with our borrowers (assuming that borrowers are willing to cooperate and, given that loan documentation was drafted prior to the changes being proposed here, there can be no assurance of such cooperation) to accurately determine the collateral value by applying the guidance prescribed in SSAP No. 48 with no assurance that we would be successful given the ability of borrowers to obtain the required information from their investees. Without the additional time typically afforded for a substantive modification, we find ourselves unable to consider effective alternative solutions in a timely manner and unable perform a full risk assessment of adoption impacts for both intended and potentially unintended consequences.

As a standard setting body (not a regulatory body), the NAIC has an obligation to adhere to proper processes and to base decisions on empirical data rather than hypotheses. Providing more process, rather than less, is critically important because decisions that the NAIC make can adversely affect competition in the industry; failing to do so can result in its decisions impermissibly choosing winners and losers in the marketplace. The Company believes that there have been other occasions where a proposed revision has been classified as “non-substantive” or a “SAP clarification,” despite the fact that the revisions have modified the intent of applicable SSAPs and thereby caused material changes in acceptable accounting practices.³

* * * * *

We appreciate your attention to the issues raised in this letter and would be pleased to discuss our questions and comments with the SAPWG or its staff at your convenience.

Kind Regards,



Tai D. Giang
Director, Accounting Policy
Security Benefit Life Insurance Company

² The same can be said of the Exposure’s requirement to perform audits of JV/LP/LLC and/or SCAs pledged in support of collateral loans. For years insurers have secured collateral loans with these types of interests and have been subject to both independent audit and state insurance department examinations without this practice being raised as an issue nor requiring adjustments to financial statements. We therefore believe requiring audits is a substantive change to SSAP No. 21R.

³ See, e.g., Exposure Ref No. 2019-24—Levelized and Persistency Commissions and Exposure Ref Nos. 2021-21—Related Party Reporting and 2022-15—Affiliate Reporting Clarification.

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June 30, 2023

Mr. Dale Bruggeman, Chairman
 Statutory Accounting Principles Working Group
 National Association of Insurance Commissioners
 1100 Walnut Street, Suite 1500
 Kansas City, MO 64106-2197

RE: Interested Parties Comments on Exposures with Public Comment Period ending June 30

Dear Mr. Bruggeman:

Interested parties appreciate the opportunity to comment on the items exposed for comment by the Statutory Accounting Working Group (the Working Group) on May 16th with the public comment period ending June 30th.

Ref #2022-14: New Market Tax Credits

Interested Parties appreciate the opportunity to comment on the substantive revisions exposed by the Working Group to SSAP No. 93 - *Low Income Housing Tax Credit Property Investments* and SSAP No. 94 *Transferable and Non-Transferable State Tax Credits*. As stated in our prior comment letter on this topic, interested parties agree with having uniformity in accounting and reporting for equity and debt investments for which the return is earned primarily through tax credits. Interested parties also agree that the proportional amortization method is an appropriate method to use for any type of investment (debt or equity) where the return is primarily earned through tax credits. We have a few comments on the exposure to make sure the guidance is clear and insurers know how to apply it.

SSAP No. 93

- 1) Paragraph 2 and 3– Paragraph 2 includes the criteria for investments in tax credit structures to apply the proportional amortization method. If an investment does not meet the criteria, then paragraph 3 states that the investment should follow the applicable statutory accounting statement. For equity investments, that means that SSAP No. 48 should be followed, which would require the use of equity method of accounting. For bonds in tax credit structures that

do not meet the definition, interested parties believe that the bond needs to be analyzed under the new proposed principles-based bond definition to determine if bond reporting or other-invested asset reporting is required. Interested parties recommend clarifying this in the standard if that is the case.

- 2) Paragraph 14 (a) –This paragraph states that tax credits under the SSAP No. 93 accounting guidance are to be recorded and assessed for admittance in accordance with SSAP No. 94. Interested parties found this confusing and subject to many different interpretations. There is a key difference between SSAP No. 93 and SSAP No. 94 tax credits in that SSAP No. 93 tax credits are only earned as part of the return on the investment so the only asset recorded on the insurer’s books is related to the investment itself. The tax credits are only recorded upon becoming available for use on a reporting entity’s tax return. Therefore, there is no tax credit to non-admit per se. In the rare case that the tax credit cannot be utilized in the year that it is allowed to be utilized due to the insurer not having enough income from operations in the case of federal tax credits or premium income in the case of state programs, the insurer would record a Deferred Tax Asset (DTA). Any DTA set up would be subject to the admissibility requirements under SSAP No. 101 - *Income Taxes*. For these reasons, interested parties recommend that paragraph 14 (a) be removed.
- 3) Paragraph 18 (a) and (b) and (c) - These paragraphs are intended to address admissibility considerations. Paragraph (c) states that if the tax credits cannot be utilized in the next three years, they will be non-admitted, while paragraphs (a) and (b) are intended to address instances when the credits cannot be utilized by the insurer, but the insurer has the ability to sell them to third parties or get a refund for the credits. We understand from discussions with the Working Group that the intent of this guidance is for an insurer to first start with the assessment in (c) to determine if it will be able to utilize the tax credits in the next three years. If not, then the insurer can consider whether the tax credits can be sold or whether the insurer can be reimbursed for the credits if unable to utilize them. Under the former, the insurer can admit the credits up to their fair value as the insurer would recover the fair value in a sale. Under the latter, the insurer can admit up to the amount of the expected refund.

Similar to our comments under #1 above, it is not clear to us what exactly we are non-admitting. As explained above, the only item that gets recorded on the balance sheet as an actual asset is the investment itself. The cost of the investment is amortized in proportion to the tax credits earned every year regardless of whether the credits are utilized or not. Admissibility requirements are already addressed for the investment itself in the proposal (i.e., the tax opinion and audited financial statements). As the tax credits are allocated to the insurer, they either reduce federal income taxes, or state/premium taxes. If the tax credits cannot be utilized in a given year, a DTA would be established. Any admissibility rules on the DTA itself are already addressed in SSAP No. 101 - *Income Taxes*.

If the DTA admissibility is what is being addressed in paragraph 18, interested parties recommend that be clarified. We understand that this may have been one of the reasons why the SSAP No. 93 proposal references SSAP No. 94. As stated above, to avoid any confusion regarding the accounting for the tax credits earned in a SSAP No. 93 investment, we suggest including all guidance in SSAP 93 (i.e., no reference to SSAP 94) regarding the credits

earned in a SSAP No. 93 investment. Interested parties also have the following suggested edits to make the admissibility rules on the tax credits themselves clear.

~~Paragraph 18 – If tax credits allocated to the reporting entity cannot be utilized in the year they have been allocated to the entity, a deferred tax asset (DTA) would be established. Under those circumstances, the reporting entity would follow the requirements under SSAP No. 101 *Income Taxes* regarding admissibility rules on DTAs. A reporting entity is required to assess the realization of tax credits against tax liability for both the tax year in which the credit can be initially utilized as well as in accordance with carry-forward and/or carryback periods to determine the extent the investments can be admitted:~~

- ~~a. Tax credit investments which allocate tax credits which are transferable in accordance with permitted IRS or state tax provisions are admitted up to the lesser of the proportional amortized cost, or fair value of the tax credits.~~
- ~~b. Tax credit investments which allocate tax credits eligible for direct payment are admitted up to the lesser of the proportional amortized cost, or the estimated proceeds.~~
- ~~e. For all other tax credits, if a reporting entity does not expect to fully utilize investment tax credits in the upcoming tax year or for a carryback year, the reporting entity shall perform an assessment to determine the extent it will be able to utilize the tax credits over the life of the investment. If assessment projections identify that the tax credits from investments in tax credit programs will exceed what can be utilized under IRS or state tax provisions (current and other applicable tax periods), the reporting entity shall nonadmit investments as necessary so that investments in scope of this statement (in aggregate) are only admitted to the extent tax credits are expected to be utilized. Additionally]. In making this assessment, the reporting entity is not permitted to assume increased operations (e.g., expanded product sales) beyond actual experience to conclude that additional federal or state tax liability will exist that would allow additional utilization of tax credits. A reporting entity can subsequently admit a previously nonadmitted tax credit investment, based on subsequent assessments in which the reporting entity determines that they will be able to utilize the tax credits.~~

- 4) Paragraph 34 - The SSAP No. 93 exposure states that reporting entities shall prospectively modify the recognition, accounting and reporting of tax credit investment structures to follow the guidance under SSAP No. 3. We believe this means that on day of adoption, the SSAP No. 93 investment's book value is the starting value of the investment and the prospective method will be applied using that book value and amortizing the book value at the date of adoption based on the future tax credits to be earned. If that is the case, some clarification on the application of the prospective method would be helpful. Those companies that are US GAAP reporters are to apply the FASB ASU on a retrospective basis and thus there will continue to be differences between US GAAP and Statutory proportional method results for already existing tax credit investments. We believe further clarification of how the prospective method is to be applied for Statutory reporting should be clarified to avoid inconsistent interpretation of the intent.

SSAP No. 94

- 1) Paragraph 1 – This paragraph explains the scope of the types of tax credits that fall within the SSAP No. 94 guidance. Interested parties believe that the key difference between SSAP No. 93 and SSAP No. 94 is that SSAP No. 93 relates to tax credits that are earned as a result of being an investor (i.e., an equity investor) in the entity earning the credits and SSAP No. 94 relates to tax credit certificates that are purchased outright without being an investor in the entity. To make sure that is clear, interested parties propose the following changes to paragraph 1

Paragraph 1 – This statement establishes statutory accounting principles for state and federal tax credits certificates that are purchased by the reporting entity without being an investor in the entity from which the tax credit certificates were purchased. ~~that are consistent with the Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy (Statement of Concepts)~~

- 2) Paragraph 2 - The last sentence in this paragraph states that the tax credits received from SSAP No. 93 tax credit investments are within the scope of SSAP No. 94. For the reasons stated above in the SSAP No. 93 section of this comment letter, we do not think that SSAP No. 94 and SSAP No. 93 should be linked. As stated above, there are two very different assets that are recorded upon purchasing an investment under SSAP No. 93 versus SSAP No. 94. The only similarity in accounting for the tax credits relates to instances when the credits earned under a SSAP No. 93 investment cannot be utilized in the current year. Under that scenario, a DTA would be recorded, which would be subject to the admissibility rules under SSAP No. 101. For that reason, interested parties recommend removing the last sentence in paragraph 2 as suggested below.

Paragraph 2 - Investments in tax credits as discussed in SSAP No. 93R - *Investments in Tax Credit Structures*, which involve investments in projects or programs that generate general business federal tax credits or state tax credits, are not within the scope of this statement. ~~However, the tax credits received from tax credit investments are within the scope of this statement.~~

- 3) Paragraph 9 - This paragraph states that federal and state tax credits that can be utilized in the year allocated or purchased shall be reported in the income statement as an offset to federal taxes in accordance with SSAP No. 101 or state premium tax, respectively. Interested parties note that most tax certificates reduce a reporting entity's tax liability and do not directly impact the income statement at the time they are used. In addition, interested parties believe that upon purchase, the tax credits should be reported as an other-than-invested asset since the asset represents a right to receive future benefits. As the tax credits become available for use, a reduction to the insurer's income tax payable or premium/state taxes payable should take place. Based on that, we propose the following changes:

Paragraph 9 – Tax credits shall be recognized in the period that they are purchased or allocated to the reporting entity for tax purposes:

- a. ~~Federal and state tax credits are recorded as other-than-invested assets upon purchase. As the tax credits are redeemed, the carrying value of the tax credits is reduced dollar for dollar by the amount of tax credits applied toward the reporting entity's federal or state/premium tax liability, as applicable. that can be utilized in the year allocated or purchased shall be reported in the income statement as an offset to federal taxes in accordance with SSAP No. 101 *Income Taxes*. Federal tax credits that cannot be utilized in the year allocated or purchased and are carried forward to a future tax year shall be reported net of deferred tax asset (DTA) in accordance with SSAP No. 101.~~
- b. ~~Federal and State tax credits that can be utilized in the year allocated or purchased shall be reported in the income statement as an offset to state premium tax or state income tax, whichever is applicable, in the tax reporting year in which the credit is utilized. State tax credits that cannot be utilized in the year they are available for use allocated or purchased and are carried forward to a future tax year shall be reported as a deferred tax asset (DTA). gross of any related state tax liabilities and reported in the category of other than invested assets (not reported net).~~

We have updated the illustration that was included in Exhibit B below to reflect this as well.

- 7) Paragraph 7 - The accounting for purchased tax credits under the SSAP No. 94 exposure is different from the current guidance in that the credits will be recorded at face value instead of at cost. Interested parties do not have an issue with this accounting treatment per se, but we would like to point out that this is not consistent with the accounting treatment for other types of assets that are purchased at a premium or discount such as bonds and mortgage loans.
- 8) Exhibit B – Accounting for Non-Transferable Tax Credits

Interested parties recommend some edits to the illustration under Exhibit B to reflect the changes described in item 2) above. In addition, the edits below include other edits that we believe are necessary to show the appropriate flow of transactions and to add clarity to the accounting for federal tax credit certificates. These are our suggestions:

On 7/1/X1 LJW Insurance Company purchased non-transferable federal tax credits for a cost of \$100,000. The federal tax credits are redeemable for \$110,000 and expire on, April 1, 20x2. LJW expects to utilize the tax credits before expiration in the amount of \$110,000. The credits are earned pro-rata every quarter from acquisition date to expiration date. Therefore, the credits earned quarterly are about \$36,666. The illustration below assumes that LJW Insurance Company's quarterly income tax liability equals the amount of credits that were purchased.

7/1/x1	Federal tax credits	110,000	
	Deferred gains on acquired tax credits		10,000
	Cash		100,000
	<i>To record the purchase of the tax credits</i>		

9/30/x1	Income Premium tax expense	36,666	
	Income Premium taxes payable to		36,666
	<i>To record quarterly income tax liability.</i>		
10/1/x1	Income taxes payable	36,666	
	Federal tax credits		36,666
	<i>To record the use of tax credits in the quarter</i>		
12/31/x1	Income tax expense	36,666	
	Income taxes payable		36,666
	<i>To record quarterly income tax liability</i>		
1/1/x2	Income taxes payable	36,666	
	Federal tax credits		36,666
	<i>To record the use of tax credits in the quarter</i>		
3/31/x2	Income tax expense	36,666	
	Income taxes payable		36,666
	<i>To record quarterly income tax liability</i>		
4/1/x2	Income taxes payable	36,666	
	Deferred gains on acquired tax credits	10,000	
	Other Income		10,000
	Federal tax credits		36,666
	<i>To record the use of income tax credits in excess of cost and recognize a gain on premium tax credits in other income.</i>		

4/1/x2

Ref #2019-21e - Principles-Based Bond Definition: Schedule BA

Interested parties have the following observations and suggestions to the proposed changes to the categories within Schedule BA (*Other Invested Assets*):

- Ensure that all reporting categories reflect the related SSAP within the instructions.
- Recommend exposing changes to the columns.

- For investments tagged as ‘Debt Securities That Do Not Quality as Bonds’ that are transferred from Schedule D, interested parties recommend that the investment will retain its’ NAIC Designation and its’ FE/ PLR status at the time of transfer.
- We believe the instructions for Tax Credit Investments (e.g., Guaranteed Low Income Housing Tax Credit Investments) are stale as the sentence ‘*There must be an all-inclusive guarantee from a CRP-rated entity that guarantees the yield on the investment*’ is no longer valid.
- The various types of Tax Credit Investments (e.g., Low Income Housing; New Market; Renewable Energy) have different risks and should be evaluated accordingly and be reported according to their risks. Recommend a referral to the RBC Investment Risk & Evaluation Working Group to evaluate the various risk categories such that changes could be implemented for Annual 2025 reporting.
- Based on Ref #2022-14 (*Tax Credits*), interested parties will provide additional comments when this item is adopted by the Statutory Accounting Principles Working Group (SAPWG).
- Based on Ref #2023-12 (*SSAP No. 48 - Residuals*), interested parties will provide comments when this item is adopted by SAPWG.
- Please refer to the attached markup version of the exposure as there are several editorial revisions that we are suggesting that clarify the descriptions within the categories and language within the instructions.

Interested parties have attached a markup version of the exposure with our detailed suggested changes.

Ref #2023-13: PIK Interest Disclosure Clarification

The 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.

Interested parties have no comment on this item.

Ref #2023-12: Residuals in SSAP No. 48 Investments

The Working Group moved this agenda item to the active listing, categorized as an 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.

Interested parties have received comments from NAIC staff that we are currently reviewing and will submit a separate comment letter at a later date.

* * * *

Please feel free to contact either one of us with any questions you may have.

Sincerely,

D. Keith Bell

Rose Albrizio

cc: Interested parties
NAIC staff

**Bond Definition
Proposed Reporting Lines – Schedule BA
2023 Spring NM Exposure**

This document proposes annual statement reporting line and descriptions for suggested reporting lines for investments reported as other invested assets on Schedule BA. The main focus is to categorize debt securities that do not qualify as bonds under SSAP No. 26—Bonds or SSAP No. 43R—Asset-Backed Securities and are captured in scope of SSAP No. 21R—Other Admitted Assets. As detailed within, other revisions have also been proposed to update the schedule.

Comments are requested on all aspects of this document – including whether reporting lines should be added or deleted as well as the suggested instructions to clarify what should be captured in each location.

SCHEDULE BA – PARTS 1, 2 AND 3

OTHER LONG-TERM INVESTED ASSETS – GENERAL INSTRUCTIONS

Include only those classes of invested assets not clearly or normally includable in any other invested asset schedule, or that have been specifically identified for reporting on Schedule BA: Other Invested Assets.
For accounting guidance related to foreign currency transactions and translations, refer to SSAP No. 23—Foreign Currency Transactions and Translations.

If a reporting entity has any detail lines reported for any of the following required groups, categories, or subcategories, it shall report the subtotal amount of the corresponding group, category, or subcategory, with the specified subtotal line number appearing in the same manner and location as the pre-printed total or grand total line and number:

<u>Group or Category</u>	<u>Line Number</u>
Debt Securities That Do Not Qualify as Bonds	
Debt Securities That Do Not Reflect a Creditor Relationship in Substance	
NAIC Designation Assigned by the Securities Valuation Office (SVO)	
Unaffiliated	
Affiliated	
NAIC Designation Not Assigned by the Securities Valuation Office (SVO)	
Unaffiliated	
Affiliated	
Debt Securities That Lack Substantive Credit Enhancement	
NAIC Designation Assigned by the Securities Valuation Office (SVO)	
Unaffiliated	
Affiliated	
NAIC Designation Not Assigned by the Securities Valuation Office (SVO)	
Unaffiliated	
Affiliated	
Debt Securities That Do Not Qualify as Bonds Solely to a Lack Of Meaningful Cash Flows	
NAIC Designation Assigned by the Securities Valuation Office (SVO)	
Unaffiliated	
Affiliated	
NAIC Designation Not Assigned by the Securities Valuation Office (SVO)	
Unaffiliated	
Affiliated	

Equity Interests in Joint Ventures, Partnerships, Limited Liability Companies or Non-Registered Private Funds with Underlying Assets Having the Characteristics of:

Fixed Income Instruments

NAIC Designation Assigned by the Securities Valuation Office (SVO)

Unaffiliated
Affiliated.....

NAIC Designation Not Assigned by the Securities Valuation Office (SVO)

Unaffiliated
Affiliated.....

Common Stocks

Unaffiliated
Affiliated

Real Estate

Unaffiliated
Affiliated

Mortgage Loans

Unaffiliated
Affiliated

Other

Unaffiliated
Affiliated

Surplus Notes

Unaffiliated.....
Affiliated

Capital Notes

Unaffiliated.....
Affiliated

Collateral Loans

Unaffiliated.....
Affiliated

Non-collateral Loans

Unaffiliated.....
Affiliated

Guaranteed Federal Tax Credit

Unaffiliated.....
Affiliated

Non-Guaranteed Federal Tax Credit

Unaffiliated.....
Affiliated

Guaranteed State Tax Credit

Unaffiliated.....
Affiliated

Non-Guaranteed State Tax Credit

Unaffiliated.....
Affiliated

All Other Tax Credit

Unaffiliated.....
Affiliated

NAIC Staff Note: The reporting lines for Low Income Housing Tax Credits are anticipated to be updated as part of the current tax credit investment statutory accounting review.

Working Capital Finance Investment	
Unaffiliated.....	.....
Residual Tranches or Interests with Underlying Assets Having Characteristics of:	
Fixed Income Instruments	
Unaffiliated .....	.....
Affiliated.....	.....
Common Stock	
Unaffiliated .....	.....
Affiliated.....	.....
Preferred Stock	
Unaffiliated .....	.....
Affiliated.....	.....
Real Estate	
Unaffiliated .....	.....
Affiliated.....	.....
Mortgage Loans	
Unaffiliated .....	.....
Affiliated.....	.....
Other	
Unaffiliated .....	.....
Affiliated.....	.....
Any Other Class of Assets	
Unaffiliated.....	.....
Affiliated .....	.....
Subtotals	
Unaffiliated.....	.....
Affiliated .....	.....
TOTALS.....	.....

The following listing is intended to give examples of investments to be included in each category; however, the list should not be considered all-inclusive:

Debt Securities That Do Not Qualify as Bonds

Include: Debt securities captured in *SSAP No. 21R—Other Admitted Assets*. This is specific to securities, as that term is defined in *SSAP No. 26—Bonds*, whereby there is a fixed schedule for one or more future payments (referred to as debt securities), but for which the security does not qualify for bond reporting under *SSAP No. 26R* as an issuer credit obligation or an asset-backed security.

Investments that have been assigned an NAIC designation by the Securities Valuation Office (SVO) pursuant to the policies in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* shall be reported on Lines **TBD and TBD**.

Investments that have not been assigned an NAIC designation by the Securities Valuation Office (SVO) pursuant to the policies in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* for this category. Designations received from an SEC NRSRO are permitted to be reported but are not required. **Report these investments on Lines TBD, TBD, TBD, TBD, TBD and TBD.**

Exclude: Any investment that does not qualify as a security. This term is defined in *SSAP No. 26R – Bonds*.

Any investment that is not captured as a debt security that does not qualify as a bond pursuant to *SSAP No. 21R—Other Admitted Assets*.

Equity interests in Joint Ventures, Partnerships or Limited Liability Companies or Non-Registered Private Funds with Underlying Assets Having the Characteristics:

Fixed Income Instruments

Include: Equity interests in joint ventures, partnerships, limited liability companies or non-registered private funds that are engaged in bond or preferred stock fixed income strategies..

Investments on the NAIC List of Schedule BA Non-Registered Private Funds with Underlying Assets Having Characteristics of Bonds or Preferred Stock that has been assigned an NAIC designation by the Securities Valuation Office (SVO) pursuant to the policies in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office*. Report these investments on Lines TBD and TBD.

Investments that have not been assigned an NAIC designation by the Securities Valuation Office (SVO) pursuant to the policies in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office*. Designations received from an SEC NRSRO are permitted to be reported but are not required. Report these investments on Lines TBD and TBD.

Common Stocks

Include: Venture Capital Funds or other underlying equity investments.

Real Estate

Include: Real estate development interest. Reporting should be consistent with the detailed property analysis appropriate for the corresponding risk-based capital factor for this investment category. If the requisite details are not available for reporting, report under “Other” subcategory.

Mortgage Loans

Include: Mortgage obligations. Reporting should be consistent with the detailed property analysis appropriate for the corresponding risk-based capital factor for this investment category. If the requisite details are not available for reporting, report under “Other” subcategory.

Other

Include: Limited partnership interests in oil and gas production.

Forest product partnerships.

Investments within the Joint Venture and Partnership Interests category that do not qualify for inclusion in the “Fixed Income Instruments,” “Common Stocks,” “Real Estate” or “Mortgage Loans” subcategories.

Surplus Notes

Include: That portion of any subordinated indebtedness, surplus debenture, surplus note, debenture note, premium income note, bond, or other contingent evidence of indebtedness that is reported in the surplus of the issuer.

Capital Notes

Include: The portion of any capital note that is reported on the line for capital notes of the issuing insurance reporting entity.

Collateral Loans

Include: Loans meeting the *SSAP No. 21R—Other Admitted Assets* definition of collateral loans, regardless if the collateral is sufficient to fully cover the loan, shall be captured in this category. Guidance in *SSAP No. 21R* shall be followed to determine nonadmittance.

Refer to *SSAP No. 21R* for a definition of collateral loans.

In the description column, the name of the actual borrower and state if the borrower is a parent, subsidiary, affiliate, officer or director. Also include the type of collateral held.

Non-collateral Loans

Include: Non-collateral loans are considered the unpaid portion of loans previously made to another organization or individual in which the reporting entity has a right to receive money for the loan, but for which the reporting entity has not obtained collateral to secure the loan.

Non-collateral loans shall not include those instruments that meet the definition of a bond, per *SSAP No. 26R—Bonds*, a mortgage loan per *SSAP No. 37—Mortgage Loans*, asset-backed securities per *SSAP No. 43R—Loan-Backed and Structured Securities*, or a policy or contract loan per *SSAP No. 49—Policy Loans*, or a collateral loan in *SSAP No. 21, Other Admitted Assets*.

Non-collateral loans are nonadmitted unless they are to related parties and meet the criteria in *SSAP No. 25—Affiliates and Other Related Parties*. *SSAP No. 20 Nonadmitted Assets* and *SSAP No. 25* should be referred to for accounting guidance for Non-collateral loans

In the description column, provide the name of the actual borrower. For affiliated entities, state if the borrower is a parent, subsidiary, affiliate, officer or director.

Low Income Housing Tax Credit

Note: These instructions will be updated in accordance with the SAPWG tax credit agenda item.

- Include: All Low Income Housing Tax Credit Investments (LIHTC or affordable housing) that are in the form of a Limited Partnership or a Limited Liability Company including those investments that have the following risk mitigation factors:
- A. Guaranteed Low Income Housing Tax Credit Investments. There must be an all-inclusive guarantee from a CRP-rated entity that guarantees the yield on the investment.
 - B. Non-guaranteed Low Income Housing Tax Credit Investments.
 - I. A level of leverage below 50%. For a LIHTC Fund, the level of leverage is measured at the fund level.
 - II. There is a Tax Credit Guarantee Agreement from General Partner or managing member. This agreement requires the General Partner or managing member to reimburse investors for any shortfalls in tax credits due to errors of compliance, for the life of the partnership. For a LIHTC Fund, a Tax Credit Guarantee is required from the developers of the lower tier LIHTC properties to the upper tier partnership and all other LIHTC investments.
 - III. There are sufficient operating reserves, capital replacement reserves and/or operating deficit guarantees present to mitigate foreseeable foreclosure risk at the time of the investment.

Non-qualifying LIHTCs should be reported in the “All Other” category

[placeholder for changes resulting from SAPWG 2022-14 (*New Market Tax Credits*)]

Working Capital Finance Investment

- Include: Investments in an interest in a Confirmed Supplier Receivables (CSR) under a Working Capital Finance Program (WCFP) that is designated by the SVO as meeting the criteria specified in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* for an NAIC “1” or “2.”

Working Capital Finance Program (WCFP)

Open account program under which an Investor may purchase interests, or evidence thereof, in commercial non-insurance receivables. A WCFP is created for the benefit of a commercial investment grade obligor and its suppliers of goods or services and facilitated by a financial intermediary.

Confirmed Supplier Receivables (CSR)

A first priority perfected security interest claim or right to payment of a monetary obligation from the Obligor arising from the sale of goods or services from the Supplier to the Obligor the payment of which the Obligor has confirmed by representing and warranting that it will not protest, delay, or deny, nor offer nor assert any defenses against, payment to the supplier or any party taking claim or right to payment from the supplier.

See *SSAP No. 105R—Working Capital Finance Investments* for accounting guidance.

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 – Asset-Backed 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.

[placeholder for changes resulting from SAPWG 2023-12 (*SSAP No. 48 – Residuals*)]

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.

Any Other Class of Assets

Include: Investments that do not fit into one of the other categories. An example of items that may be included are reverse mortgages.

All structured settlement income streams acquired as investments where the reporting entity acquires the legal right to receive payments. (Valuation and admittance provisions are detailed in *SSAP No. 21R—Other Admitted Assets*.)

This category shall also include oil and gas leases, aircraft owned under leveraged lease arrangements, investments in extractive materials and timber deeds that are not owned within a partnership, LLC or joint venture structure.

<https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/NationalMeetings/A.NationalMeetingMaterials/2023/3-22-23-Spring/Exposures/19-21e-ScheduleBA-ReportingLines02-16.23.doc>

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July 14, 2023

Mr. Dale Bruggeman, Chairman
Statutory Accounting Principles Working Group
National Association of Insurance Commissioners
1100 Walnut Street, Suite 1500
Kansas City, MO 64106-2197

RE: Interested Parties Comments on Ref #2023-12, Residuals in SSAP No. 48 Investments

Dear Mr. Bruggeman:

Interested parties appreciate the opportunity to comment on the following item that was exposed for comment by the Statutory Accounting Working Group (the Working Group).

Ref # 2023-12: Residuals in SSAP No. 48 Investments

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 regardless of the legal form of the residual (e.g., debt, stock, LP/LLC equity ownership, etc.) It proposes guidance to clarify the reporting of in-substance residuals regardless of the structure of the investment vehicle.

Interested parties has been working with NAIC staff to clarify the definition in order to facilitate consistent interpretation by the industry and auditors, to avoid unintended consequences of certain equity investments being scoped into the definition of a residual when they were not intended to be in scope. We appreciate NAIC staff working with us on these clarifications and look forward to reviewing the next exposure. In addition to the redrafted exposure draft, we offer the following comments.

In reviewing the exposure, we understand that the residual definition is related to investment structures that issue debt securities created for the primary purpose of raising debt capital backed by collateral assets (ABS issuers as defined in paragraph 8 of the current bond exposure in SSAP Nos. 26R). As a result, interested parties do not believe the intent was to include the following types of investment structures:

- Private Funds (e.g., equity, debt, hedge)- that issued debt for liquidity / operating purposes rather than to raise capital backed by a discrete pool of collateral assets.
- Real Estate Funds (including REITs and JVs) (i.e., considered Issuer Credit Obligations, or “ICOs”, in the proposed bond standard)
- Non-US registered Funds (i.e., considered ICOs in the proposed bond standard)
- Other ICOs in the proposed bond definition, such as 40 Act Funds, Business Development Company, Operating Entities, and Holding Companies supported by operating companies.

The exposure currently addresses changes to SSAP No. 48 - Joint Ventures, Partnerships and Limited liability Companies, but we also believe the definition is relevant to SSAP Nos. 26R, 43R, and 21R and should be included in those other SSAPs. Also, consideration should be given to whether the definition should also be added to SSAPs where residuals may currently be in scope, such as SSAP No. 30R (e.g., from securitizations in legal form of a corporation).

Upon adoption of the Form A, interested parties believe the guidance would be effective immediately. Interested parties will need time to consider the guidance, develop accounting policies, and identify the residuals under the new definition. As a result, we recommend an effective date of six months after the adoption by Executive (Ex) Committee.

* * * *

Please feel free to contact either one of us with any questions you may have.

Sincerely,

D. Keith Bell

Rose Albrizio

cc: Interested parties
NAIC staff