Statutory Accounting Principles (E) Working Group
Hearing Agenda
May 24, 2022
10:00 a.m. – Noon (Central)

ROLL CALL

Dale Bruggeman, Chair	Ohio	Judy Weaver	Michigan
Kevin Clark/Carrie Mears, Co-Vice Chairs	Iowa	Doug Bartlett	New Hampshire
Sheila Travis	Alabama	Bob Kasinow	New York
Kim Hudson	California	Melissa Greiner/Matt Milford	Pennsylvania
William Arfanis/Michael Estabrook	Connecticut	Jamie Walker	Texas
Rylynn Brown	Delaware	Doug Stolte/David Smith	Virginia
Eric Moser	Illinois	Amy Malm/Elena Vetrina	Wisconsin
Stewart Guerin/Melissa Gibson	Louisiana		

NAIC Support Staff: Julie Gann, Robin Marcotte, Jim Pinegar, Jake Stultz, Jason Farr

Note: This meeting will be recorded for subsequent use.

The Statutory Accounting Principles (E) Working Group met in regulator-to-regulator session on May 17, 2022. This regulator session was pursuant to the NAIC Open Meetings Policy paragraph 3 (discussion of specific companies, entities or individuals) and paragraph 6 (consultations with NAIC staff related to NAIC technical guidance of the *Accounting Practices and Procedures Manual*). No actions were taken as the discussion previewed the May 24th agenda and discussed other items with NAIC staff pursuant to the NAIC open meeting policy.

REVIEW of COMMENTS on EXPOSED ITEMS

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

1. Ref #2022-03: Premium Adjustments Allocated to Jurisdictions
2. Ref #2022-08: INT 22-01T: Freddie Mac When-Issued K-Deal (WI Trust) Certificates
3. Ref #2021-21: Related Party Reporting

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2022-03 Blanks (Robin)	**Premium Adjustments Allocated to Jurisdictions**	**1 – Agenda Item**	**No Comments**	**IP-2**

Summary:
On April 4 the Working Group exposed this agenda to propose revisions, to modify the instructions for Schedule T, the State Page and Accident and Health Policy Experience Exhibit (AHPEE) clarifying the guidance for premium adjustments. The proposed revisions clarify that all premium adjustments, including but not limited to Affordable Care Act (ACA) premium adjustments related to the risk adjustment program, shall be allocated as premium in each respective jurisdiction. This agenda item did not propose statutory revisions, however it expressed support for the sponsored Blanks (E) Working Group proposal 2022-10BWG, which has a 2022 year-end effective date.

Interested Parties' Comments:
Interested parties have no comment on this item.

Recommended Action:
NAIC staff recommends that the Working Group adopt this agenda item, noting that there are no actual statutory revisions. Rather, adoption will express support for the corresponding Blanks (E) Working Group exposure (2022-10BWG), which modifies the instructions for Schedule T, the State Page and Accident and Health Policy Experience Exhibit (AHPEE) clarifying the guidance for premium adjustments.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2022-08 INT 22-01T SSAP No. 43R (Julie)	**INT 22-01T: Freddie Mac When-Issued K-Deal (WI Trust) Certificates**	**2 – Agenda Item 3 – Draft Interpretation**	**In Support**	**IP-2**

Summary:
On April 4, the Working Group exposed a tentative interpretation, *INT 22-01: Freddie Mac When-Issued K-Deal (WI Trust) Certificates,* to clarify that investments in the Freddie Mac "When Issued K-Deal" (WI) Program are in scope of *SSAP No. 43R—Loan-Backed and Structured Securities* from the date of initial acquisition.

As a summary, Freddie Mac "When Issued K-Deal" certificates ("WI") are backed by an asset pool held in trust, but those assets do not initially include any mortgages or mortgage-backed assets. Rather these assets include cash from the sale of the WI certificates and a commitment by Freddie Mac to deliver one or more structured pass-through certificates (SPCs) in exchange for the WI trust's cash within approximately 90 days of settlement. The date on which this delivery occurs is referred to as the "Subsequent Transfer Date."

Prior to the Subsequent Transfer Date, the WI trusts pay fixed coupons to certificate holders which are funded from a Freddie Mac guarantee on the WI certificates. After the Subsequent Transfer Date, the WI trust will hold the promised SPCs which are backed by mortgages and guaranteed by Freddie Mac. Additionally, after this date the WI trust becomes a pass-through of the underlying trust. The WI certificates have an optional exchange right where they can be exchanged for the underlying SPCs, but if not exchanged, the WI certificates after the Subsequent Transfer Date will still be backed by the SPCs, however in any case, the investment is guaranteed by Freddie Mac.

Interested Parties' Comments:
Interested parties support the conclusions reached on this interpretation.

Recommended Action:
NAIC staff recommends adoption of the exposed INT to clarify that investments in the Freddie Mac "When Issued K-Deal" (WI) Program are in scope of *SSAP No. 43R—Loan-Backed and Structured Securities* from the date of initial acquisition.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2021-21 SSAP Nos. 25 & 43R (Julie/Jake)	**Related Party Reporting**	**4 – Agenda Item**	**Comments Received**	**IP-2**

Summary:
On April 4, the Working Group exposed SAP clarification revisions to *SSAP No. 25—Affiliates and Other Related Parties* and *SSAP No. 43R—Loan-Backed and Structured Securities* to clarify related party / affiliate guidance as well as new reporting disclosures for investments acquired from a related party, regardless of whether the investment is captured on an "affiliate" reporting line, incorporating proposed revisions after considering comments from interested parties.

The agenda item proposed that the identification of such items would occur through a reporting code in the year-end investment schedules and would apply in a variety of circumstances, which include:

1. Direct loan or direct investment (excluding securitizations) in a related party, for which the related party represents a direct credit exposure.

2. Securitization or similar investment involving a relationship with a related party as sponsor, originator, manager, servicer, or other similar influential role and for which 50% or more of the underlying collateral represents investments in or direct credit exposure to related parties.

3. Securitization or similar investment involving a relationship with a related party as sponsor, originator, manager, servicer, or other similar influential role and for which less than 50% (including 0%) of the underlying collateral represents investments in or direct credit exposure to related parties.

4. Securitization or similar investment in which the structure reflects an in-substance related party transaction but does not involve a relationship with a related party as sponsor, originator, manager, servicer, or other similar influential role.

5. The investment is identified as related party, but the role of the related party represents a different arrangement than the options provided in choices 1-4.

Interested Parties' Comments:
As stated in our original comment letter on this item, we understand that one of the goals of the proposal is to identify investments that are originated, managed, sponsored, or serviced by an affiliate or related party of the insurer (referred to as managed by affiliates for the remainder of this letter). Interested parties agree that this information can be useful for the regulators, but we continue to stress that it is critical to differentiate investments where there is direct credit exposure to an affiliate from those investments that are only managed by affiliates with no underlying credit exposure to the affiliate of the insurer.

In addition to the above, we have the following additional comments on the re-exposure:

1. ***SSAP No. 25*** **-** The Related Party Exposure is proposing to add the paragraph below, which would require a look through of affiliated investment structures to identify entities over which the insurer may have indirect control. To address Interested Parties' comments, the Working Group has added the footnote in italics and red below to clarify that the look-through requirement is not required for SEC-registered mutual funds and ETFs.

"For entities not controlled by voting interests, such as limited partnerships, trusts and other special purpose entities, control may be held by a general partner, servicer, or by other arrangements. The ability of the reporting entity or its affiliates to direct the management and policies of an entity through such arrangements shall constitute control as defined in paragraph 6. Additionally, a reporting entity or its affiliates may have indirect control of other entities through such arrangements. For example, if a limited partnership were to be controlled by an affiliated general partner, and that limited partnership held greater than 10% of the voting interests of another company (FN10), indirect control shall be presumed to exist. If direct or indirect control exists, whether through voting securities, contracts, common management or otherwise, the arrangement is considered affiliated under paragraph 5. Consistent with paragraph 8, a disclaimer of affiliation does not eliminate a "related party" distinction or disclosure requirements for material transactions pursuant to SSAP No. 25."

FN10 Consistent with SSAP No. 97, footnote 1, investments in an exchange traded fund (ETF) or a mutual fund (as defined by the SEC) does not reflect ownership in an underlying entity, regardless of the ownership percentage the reporting entity (or the holding company group) has of the ETF or mutual fund unless ownership of the ETF actually results in "control" with the power to direct or cause the direction of management of an underlying company. ETFs and mutual funds are comprised of portfolios of securities subject to the regulatory requirements of the federal securities laws.

Interested parties' comments on the amendments are as follows:

- We agree that the look-through requirement should not extend to SEC registered mutual funds and ETFs as those investments are subject to many regulatory requirements. However, the exemption should also extend to foreign open-end investment funds governed and authorized in accordance with regulations established by the applicable foreign jurisdiction, which are within the scope of SSAP No. 30 - *Unaffiliated Common Stock* and which are very similar to open-end mutual funds in the United States.

- As stated on our previous comment letter, doing a look-through of the underlying investments of investment funds managed by affiliates to determine if there is indirect control will be a significant operational change as information will need to be requested from affiliated funds regarding their underlying investments along with percentage ownership. Once the information is obtained, insurers will need to go through each investment where the affiliated fund owns more than 10% of the equity of another company to document whether the presumption of control is overcome or not. We kindly request again for a 2023 implementation date to be considered.

- Interested parties would like to confirm our understanding of the look through proposal. We believe an insurer would be required to look through to the underlying investments only in the situation where the entity (managed by an affiliate) in which the insurer owns equity instruments (e.g., private equity funds and CFOs). For example, if the insurer owns debt tranches of a CFO managed by an affiliate, we assume the look through analysis would be applied since the underlying investments of the CFO are equities. However, if the insurer owns an interest (debt or equity) in a CLO investment where the underlying assets are loans, we would not expect the look through to be applied since the CLO loans do not usually give an investor any control. As the look through paragraph is being inserted into SSAP 25 (which applies to all types of instruments), we believe clarification may be needed.

- We also suggest adding the new footnote that was added to the new proposed paragraph 9 of SSAP No. 25 to the new codes being proposed to the investment schedules so that there is consistency regarding the types of assets for which the insurer would have to do a look-through of underlying investments of an affiliated fund.

2. ***Proposed changes to SSAP No. 43R to clarify that investments managed by affiliates are viewed as affiliated even if the underlying assets in the structure do not have any credit exposure to an affiliate –***

As stated above and in our previous comment letter, many insurers own asset management subsidiaries which manage securitization transactions. There is no question that the asset manager itself is a Subsidiary, Controlled and Affiliate (SCA) of the insurer and such asset managers are reported on Schedule Y as affiliates of the insurer and in the related party disclosures. However, when any debt tranches purchased from those securitization vehicles do not have any credit exposure to SCAs of the insurer, the debt tranches are not reported in the affiliated section of Schedule D and not filed as affiliated debt investments with the Securities Valuation Office (SVO) since they do not have affiliated credit risk exposure, even if the securitization vehicle is managed by a related party.

It is very important to interested parties that this distinction is understood for Schedule D bond investments. Schedule D bond investments should not be reported in the affiliated section of Schedule D if they do not have affiliated credit exposure. We believe that the new codes that are being proposed should provide the regulators with information regarding investments that have credit risk exposure to affiliates versus those investments that are only managed by affiliates or other related parties. If the intent is to change how investments are actually reported between affiliated and non-affiliated lines in the schedules, additional changes would need to be made to the current guidance, including the annual statement instructions and the SVO Purposes and Procedures (P&P) Manual, so that this is clear to all insurers. If all unaffiliated investments which are managed by an affiliate were required to be reported as affiliated, updates would have to be made to the SVO P&P manual to clarify that those investments continue to be Filing Exempt since the SVO does not provide designations on asset-backed securities and the manual requires filing for all affiliated debt investments. Furthermore, our understanding of the definition of affiliates and control under the Holding Company act is that they are based on voting rights of an equity holder. Therefore, asset managers that that meet the definition of affiliates under the Holding Company Act are reported as affiliates on Schedule Y and any agreements with those affiliates are reported in the related party disclosure. However, investments that are simply managed by such affiliate with no credit risk exposure to an affiliate and where the underlying borrowers are not affiliates, would not meet the definition of an affiliate under the Holding Company Act.

All the language included in the exposure with the exception of the last sentence in the new paragraph 6b being proposed in SSAP No.43R support the view that unaffiliated investments managed by an affiliate shall be reported as unaffiliated. The last sentence in 6b indicates that "any arrangement that results in direct or indirect control, including control through a servicer" should be considered affiliated. While this statement is meant to make it clear, it is confusing as it relates to unaffiliated investments (where the insurer has no credit risk exposure to the underlying borrower), that are managed by an affiliate (either a subsidiary of the insurer or an entity under common control with the insurer). Interested parties request that the final sentence be removed as this sentence will only add confusion and will create inconsistency in reporting depending on how each insurer interprets these rules. As stated throughout the letter, the presence of certain arrangements such as an affiliated servicer do not usually mean that the investments managed are affiliated. A determination of direct or indirect control over the ultimate obligor pursuant to SSAP No. 25 is still required.

> b. A loan-backed or structured 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 loan-backed or structured 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.~~

As stated above, we are more than happy to provide the transparency that the regulators are looking for, which we believe will be accomplished through the new codes that will flag these investments as being managed by related parties.

3. ***Proposed annual statement changes to add a new electronic-only column to the investment schedules to identify investments involving related parties*** –The new codes being proposed in the related party exposure are as follows:

   1. Direct loan or direct investment (excluding securitizations) in a related party, for which the related party represents a direct credit exposure.

   2. Securitization or similar investment vehicles such as mutual funds, limited partnerships and limited liability companies involving a relationship with a related party as sponsor, originator, manager, servicer, or other similar influential role and for which 50% or more of the underlying collateral represents investments in or direct credit exposure to related parties.

   3. Securitization or similar investment vehicles such as mutual funds, limited partnerships and limited liability companies involving a relationship with a related party as sponsor, originator, manager, servicer, or other similar influential role and for which less than 50% (including 0%) of the underlying collateral represents investments in or direct credit exposure to related parties.

   4. Securitization or similar investment vehicles such as mutual funds, limited partnerships, and limited liability companies in which the structure reflects an in-substance related party transaction but does not involve a relationship with a related party as sponsor, originator, manager, servicer, or other similar influential role.

   5. The investment is identified as related party, but the role of the related party represents a different arrangement than the options provided in choices 1-4.

   Interested parties offer the following additional comments on the proposed codes:

   - We understand that the codes will be required on all investment schedules. However, most of the codes appear to be more applicable to Schedule D and Schedule BA investments where investments can be made through an investment vehicle. For example, when we think of the relevancy of the codes to the mortgage loan schedule, it would appear that the only code that may potentially apply is code No. 1 if the insurer has issued a mortgage loan to a related party. Codes 2-5 do not seem applicable since mortgage loans reported on Schedule B can only be reported on Schedule B if the insurer has issued the mortgage loan directly to a borrower. The same would likely be true for Schedule DB.

   - It is unclear to interested parties what “in-substance” related party transactions are referred to in code 4. Perhaps some examples can be provided as to the types of structures this is referring to so that insurers know what to report under this category.

   - When reviewing the Blanks exposure on this item, we noted that the Blanks exposure added an additional code 6 for investments that have no related party relationship. We question the need for such code as a significant majority of insurers’ investments will probably be coded as such. There are other columns that are populated only if the code applies to that investment (e.g., Column 3 – Code; Column 5 – Bond Characteristics). Perhaps leaving the code blank will accomplish the same objective.

Recommended Action:

NAIC staff recommends that the Working Group 1) adopt the exposed agenda item with minor edits as shown below, 2) confirm key aspects detailed in the below bullets, and 3) provide direction to NAIC staff to consider footnote revisions, as proposed by interested parties to SSAP Nos. 25 & 97 in a separate agenda item.

Proposed revisions to the prior exposure, SSAP No. 43R, paragraph 6.b. are shown in grey below:

b. A loan-backed or structured 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 loan-backed or structured security or any type of underlying servicing arrangement. For the avoidance of doubt, investments from any arrangement that results in direct or indirect control, which include but are not limited to, ~~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*.

Confirmation of Key Aspects:

- The related party electronic code column is effective Dec. 31, 2022.
- The related party new electronic code column is effective for all noted investment schedules: B – Mortgage Loans, D – Bonds, DB – Derivatives, BA – Other Invested Assets, DA – Short-Term, E2 – Cash Equivalents and DL – Securities Lending. (This is consistent with the exposure.)
- The related party new electronic code column shall be completed for all investments on any reporting line.
- The Working Group supports the inclusion of Code 6 (no related party relationship) as exposed by the Blanks (E) Working Group (2021-22 BWG) to eliminate potential confusion on whether a blank represents incomplete reporting or a non-related party relationship.

Direction of Footnote Revisions:

Interested Parties suggested revisions to reference open-end foreign regulated investments (captured in SSAP No. 30, paragraph 4.e) along with mutual funds and ETFs in the new footnote, **NAIC staff recommends that the Working Group direct staff to draft possible edits for consideration to SSAP No. 25 and corresponding edits to footnote 1 of SSAP No. 97 in a separate agenda item.** The proposed new footnote in SSAP No. 25 references the SSAP No. 97 footnote, so it would be important to be consistent.

Discussion:

The Working Group confirms that there are no proposed revisions within this agenda item that revises the current definition of an affiliate or reporting on the affiliate reporting line. Interested parties' comments suggest that the additions to SSAP No. 25 require a "look through" exercise that does not exist under current SSAP No. 25 and the holding company act, thus presenting a new reporting burden for year-end 2022. SSAP No. 25 and the holding company act already state that control includes "possession, directly or **indirectly**, of the power to direct or cause the direction of the management and policies of the investee" and that "control shall be presumed to exist if a reporting entity **and its affiliates** directly or **indirectly**, own, control, hold the power to vote, or hold proxies **representing 10% or more** of the voting interest of the entity". The added guidance is not changing this, and therefore should not introduce any new burden on reporting entities.

Although interested parties' comments have provided comments on this topic with both exposures, this discussion is unrelated to the current agenda item that proposes new reporting codes to identify the type of involvement of related parties, regardless of whether affiliated or unaffiliated. **The new electronic columns to capture related party relationships is applicable to all reporting lines regardless of affiliate determination. If consideration or clarity is needed on items captured within the affiliated reporting line, then NAIC staff requests that the Working Group direct consideration of that topic in a separate agenda item.**

It is particularly noted that the information contained in the interested parties' comments regarding the determination of affiliation under the holding company act, and that it is based solely on voting rights of an equity holder, is incorrect. The definition of an affiliate and control per the Holding Company Act (Model 440) and SSAP No. 25 are consistent and detailed below. As noted within this guidance, an affiliate is determined through control, and control can occur through other means besides ownership of voting securities. **Although ownership of 10% of voting securities results in a presumption of control, voting securities are clearly not the sole basis for determining control.** For many types of entities, control is not typically held through voting securities which has long been recognized under both GAAP and statutory accounting principles (see SSAP No. 25, Paragraph 7a as it pertains to limited partnerships). As has always been the case, determination of the affiliation of an investment is based on an evaluation of control of the investee, whether through voting interests or other means. This agenda item does not propose to change this in any way.

Although interested parties have requested deletion of the sentence copied below, the deletion of this sentence has no impact on the determination of whether an investment shall be reported as an affiliated investment. Pursuant to the existing guidance in Model #440 and existing guidance in SSAP No. 25, affiliation is determined through direct or indirect control, and that control can be based on voting rights, management and policies, contract or "otherwise."

NAIC staff recommend that the Working Group expand the sentence that was recommended to be deleted to instead reference all of the situations that could result with direct or indirect control pursuant to SSAP No. 25, paragraph 6. The proposed revisions are highlighted in grey below.

Sentence proposed to be deleted by industry:

For the avoidance of doubt, investments from any arrangement that results in direct or indirect control, which include but are not limited to, ~~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*.

Excerpts from the Holding Company Act as well as SSAP No. 25 are provided to further detail the existing guidance regarding determination of control.

Excerpt from Holding Company Act:

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

C. "Control." The term "control" (including the terms "controlling," "controlled by" and "under common control with") **means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract other than a commercial contract for goods or nonmanagement services, or otherwise**, unless the power is the result of an official position with or corporate office held by the person. Control shall be presumed to exist if any person, directly or indirectly, owns, controls, holds with the power to vote, or holds proxies representing, ten percent (10%) or more of the voting securities of any other person. This presumption may be rebutted by a showing made in the manner provided by Section 4K that control does not exist in fact. The commissioner may determine, after furnishing all persons in interest notice and opportunity to be heard and making specific findings of fact to support the determination, that control exists in fact, notwithstanding the absence of a presumption to that effect.

SSAP No. 25—Affiliates and Other Related Parties

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

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

The comment letter is included as Attachment 5 (7 pages).

