

STATUTORY ACCOUNTING PRINCIPLES (E) WORKING GROUP

**Thursday, November 12, 2020
10:00 a.m. – 12:00 p.m. (Central)**

OVERVIEW AGENDA**HEARING AGENDA**

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• Ref #2020-24: Levelized and Persistency Commissions	See note	See note
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Note: Agenda Item 2019-24: Levelized and Persistency Commissions is planned for discussion during this meeting. Due to the timing of comments received and the posting of these materials, a separate hearing agenda solely referencing 2019-24 will be subsequently posted.

STATUTORY ACCOUNTING PRINCIPLES (E) WORKING GROUP

Thursday, November 12, 2020
10:00 a.m. – 12:00 p.m. (Central)

OVERVIEW AGENDA

Meeting AGENDA

	<u>Meeting Page Number</u>	<u>Attachment</u>
6. SAPWG Meeting – Maintenance Agenda – Pending List—<i>Dale Bruggeman (OH)</i>		
• Ref #2020-32: SSAP No. 26R - Disclosure Update	1	A
• Ref #2020-33: SSAP No. 32R – Publicly Traded Preferred Stock Warrants	1	B
• Ref #2020-34: SSAP No. 43R - GSE CRT Program	2	C
• Ref #2020-35: SSAP No. 97 - Audit Opinions	2	D
• Ref #2020-36: Derivatives Hedging Fixed Indexed Products	3	E
• Ref #2020-37: Separate Account Product Mix	5	F
• Ref #2020-38: Pension Risk Transfer Disclosure	5	G
• Ref #2020-39: Interpretation Policy Statement	6	H
• Ref #2020-40: Prescribed Practices	6	I
• Ref #2020-41: <i>ASU 2020-06, Convertible Instruments</i>	7	J
• Ref #2020-42: <i>ASU 2020-07, Presentation and Disclosures by Not-for-Profit Entities</i>	8	K
7. SAPWG Meeting – Any Other Matters Brought Before the Working Group—<i>Dale Bruggeman (OH)</i>		
• Ref #2020-21: SSAP No. 43R - Update	8	-
• Deferred Agenda Items	8	-
• Ref #2020-49: Retroactive Reinsurance Exception - Update	8	-
• Review of GAAP Exposures	9	L

Comment Deadline for all exposed items (other than the interpretations, if exposed) is Monday, January 11, 2021.

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**Statutory Accounting Principles (E) Working Group
Hearing Agenda
November 12, 2020
10:00 a.m. – 12:00 p.m. CT**

ROLL CALL

Dale Bruggeman, Chair	Ohio	Judy Weaver	Michigan
Carrie Mears / Kevin Clark, Co-Vice Chairs	Iowa	Doug Bartlett	New Hampshire
Richard Ford	Alabama	Bob Kasinow	New York
Kim Hudson	California	Melissa Greiner	Pennsylvania
Kathy Belfi / William Arfanis	Connecticut	Jamie Walker	Texas
Dave Lonchar	Delaware	Doug Stolte / David Smith	Virginia
Eric Moser	Illinois	Amy Malm	Wisconsin
Caroline Fletcher / Stewart Guerin	Louisiana		

NAIC Support Staff: Julie Gann, Robin Marcotte, Jim Pinegar, Fatima Sediqzad, Jake Stultz

Note: This meeting may be recorded for subsequent use.

REVIEW AND ADOPTION OF MINUTES

1. August 17, 2020 E-Vote (**Attachment 1**)
2. October 13, 2020 Minutes (**Attachment 2**)
3. October 15, 2020 Minutes (**Attachment 3**)

The Statutory Accounting Principles (E) Working Group met in regulator-to-regulator sessions on Sept. 21, Sept. 30, Oct 5, and Nov. 9. These regulator sessions were 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 during these meetings, and the overall projects discussed (SSAP No. 43R, SSAP No. 71 and agenda items planned for Nov. 12) were subsequently discussed in public meetings on Oct. 13, Oct. 15 and Nov. 12.

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 #2020-19: Clarifying Edits – Participating in Mortgages
2. Ref #2020-23: Leasehold Improvements
3. Ref #2020-25EP: Editorial Updates

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2020-19 SSAP No. 37 (Jim)	Clarifying Edits – Participation in Mortgages	4 – Agenda Item	In Support	IP - 8

Summary:

On July 30, the Working Group exposed this agenda item to refine the statutory accounting guidance for participation loan agreements in scope of *SSAP No. 37—Mortgage Loans*. The clarifications direct that the financial “rights and obligations” (under normal business circumstances) typically do not extend beyond the attachment to cash flows. Additionally, the clarifications indicate that while various rights may exist, such as 1) the ability to independently take legal action against the borrower, 2) participate with other lenders in determining whether legal action should be taken, or 3) under normal circumstances, communicate directly with the borrower, such rights are not required for participating agreements within scope of *SSAP No. 37*.

Interested Parties’ Comments:

Interested parties support this proposal.

Recommended Action:

NAIC staff recommends that the Working Group adopt the exposed nonsubstantive revisions to *SSAP No. 37—Mortgage Loans*. The revisions clarify that a participant’s financial rights may include the right to take legal action against the borrower (or participate in the determination of legal action), but do not require that the participant have the right to solely initiate legal action, foreclosure, or under normal circumstances, require the ability to communicate directly with the borrower.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2020-23 SSAP No. 22R (Jake)	Leasehold Improvements	5 – Agenda Item	In Support	IP - 12

Summary:

In 2019, the Working Group adopted substantive revisions to *SSAP No. 22R—Leases*, which rejected the financing lease concept that has been adopted in U.S. GAAP, but brought in language from ASC Topic 842 to keep *SSAP No. 22R* as consistent as possible with U.S. GAAP, all while maintaining the operating lease concept for statutory accounting. On July 30, the Working Group exposed edits to update the guidance for the depreciable lives of leasehold improvements in *SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements* and *SSAP No. 73—Health Care Delivery Assets and Leasehold Improvements in Health Care Facilities* to reflect adopted guidance regarding the definition of lease terms in *SSAP No. 22R*.

Interested Parties’ Comments:

Interested parties support this proposal.

Recommended Action:

NAIC staff recommends that the Working Group adopt the exposed nonsubstantive revisions to *SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements* and *SSAP No. 73—Health Care Delivery Assets and Leasehold Improvements in Health Care Facilities* to update the amortization guidance for leasehold improvements. The updated language will allow leasehold improvements to have lives that match the associated lease term, which agrees with U.S. GAAP in ASC Topic 842.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2020-25EP SSAP No. 5R SSAP No. 62R (Robin)	Editorial Updates	6 – Agenda Item	No Comments	IP - 13

Summary:

Maintenance updates provide revisions to the NAIC *Accounting Practices and Procedures Manual*, such as editorial corrections, reference changes and formatting. Current exposed editorial updates are as summarized below:

- *SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets*: Remove redundant paragraph references.
- *SSAP No. 62R—Property and Casualty Reinsurance*: Add a table that lists the questions addressed in Exhibit A - Implementation Questions and Answers.

Interested Parties' Comments:

Interested parties have no comments on this item.

Recommended Action:

NAIC Staff recommends that the Working Group adopt the editorial revisions to SSAP No. 5R and SSAP No. 62R as final.

REVIEW of COMMENTS on EXPOSED ITEMS – EXPECTING MINIMAL DISCUSSION

After review of the proposed edits, the Working Group may individually discuss the following items, or may consider adoption in a single motion:

1. Ref #2020-17: Updating the SCA Review Process
2. Ref #2020-20: Cash Equivalent Disclosures
3. Ref #2020-21: SSAP No. 43R – Designation Categories for RMBS/CMBS Securities

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2020-17 SSAP No. 97 (Fatima)	Updating the SCA Review Process	7 – Agenda Item	In Agreement (minor edits)	IP – 6 & 27

Summary:

On July 30, the Working Group exposed this agenda item proposing administrative updates to the current SCA filing review process, a process as is required by *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*. The proposed edits eliminate many of the manual steps required to communicate the results of each reviewed SCA. With NAIC staff having reviewed over 825 filings in 2019, adoption of the proposed procedure changes will generate a significant savings of manual administrative processing.

As detailed in the proposal, financial statement filers would be responsible for retrieving their finalized SCA review information from VISION, however regulators would now receive the review information in one consolidated monthly email communication (rather than individual emails at the conclusion of each review). This agenda item also proposed various minor updates to improve the readability of various paragraphs.

Interested Parties' Comments:

Interested parties offer the following comments:

- We have no comments on the Form A.
- On the 2 additional files (see attached mark-up versions) which provide filing procedures for filing a Sub-1 form and a Sub-2 form, we suggest changing the following in the 'Note to filer' paragraph on the first page of each document, which is consistent with changes adopted by SAPWG 2017-08 (Extension of SCA Filing Deadlines):
 - ✓ A Sub-1 form is required to be filed within ~~30~~90 days of the acquisition or formation of the investment. A Sub-2 form is required to be filed annually for any existing investment, ~~by June 30th of the next calendar year~~ by August 31st or one month after the audit report date.
- On page 8 of the Sub-2 document, there is reference to 'Sub-1' when it appears that it should be 'Sub-2'. This change has been reflected as a mark-up in the Sub-2 document.

Recommended Action:

NAIC staff recommends that the Working Group adopt the nonsubstantive revisions to SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities, which update 1) various paragraphs with improved descriptive language and 2) the availability/delivery of completed SCA reviews for both domestic regulators and financial statement filers. Additionally, NAIC staff concur with the edits proposed by interested parties for the two informational addendum files (which are nonauthoritative). These addendums have been updated to reflect interested parties' revisions and are included at Attachments 7.1 & 7.2. NAIC staff also propose that the change in the delivery of SCA review documents to occur on January 1, 2021, requesting that state regulators who wish to retain the current delivery process (i.e. one email per SCA review) contact NAIC staff so special arrangements can be made.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2020-20 SSAP No. 2R (Jim)	Cash Equivalent Disclosures	8 – Agenda Item	In Agreement (minor edits)	IP - 8

Summary:

On May 20, the Working Group adopted agenda item 2019-20: *Rolling Short-Term Investments*, incorporating additional principle concepts restricting the classification of certain related party or affiliated investments as cash equivalents or short-term investments. These restrictions applied for items in scope of *SSAP No. 26R—Bonds*, *SSAP No. 43R—Loan-Backed and Structured Securities*, or that would be reported as "Other Invested Assets." With adoption, an additional disclosure element was required stating that short-term investments (or substantially similar investments) which remain on the short-term schedule for more than one consecutive year shall be disclosed in the financial statements.

On July 30, the Working Group exposed this agenda item, expanding the current "rolled" short-term investment disclosure to also include rolled cash equivalent investments. Additionally, at the request of industry, additional clarification was added stating that the disclosure of such investments is satisfied by use of a designated code in the appropriate investment schedules of the statutory financial statements.

Interested Parties' Comments:

Interested parties support the clarification that the disclosure elements as adopted for short term investments shall also apply to relevant cash equivalent investments, and the stipulation that this disclosure is satisfied by use of a designated code in the investment schedules of the statutory financial statements. To avoid inadvertently capturing data which is not relevant to the objectives of this disclosure, we suggest the following qualification be added to the exposed language proposed:

“Identification of cash equivalents (excluding money market mutual funds as detailed in paragraph 7) and short-term investments, (or substantially similar investments), which remain on the same reporting schedule for more than one consecutive reporting period.”

Recommended Action:

NAIC staff recommends that the Working Group adopt the exposed nonsubstantive revisions, incorporating the minor modification as suggested by interested parties to *SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments*. The proposed revisions, as shown below, 1) require the identification/disclosure of cash equivalents and short-term investments, or substantially similar investments, in which remain on the same reporting schedule for more than one consecutive reporting period (an expansion of the current short-term investment disclosure), and 2) clarify that the disclosure is satisfied through the use of the code on the investment schedules. NAIC staff is supportive of the edit proposed by interested parties as money market mutual funds, which are registered under the Investment Act of 1940 and regulated under rule 2a-7 of the Act, are one of the investment products that are anticipated to be continually rolled and were not noted as concerning to regulators.

Proposed Edits to SSAP No. 2R: (The edits highlighted in grey show the changes from the exposure).

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 30.f.
 - e. Identification of cash equivalents (excluding money market mutual funds as detailed in paragraph 7) and short-term investments, (or substantially similar investments), ~~in~~ which remain on the same reporting short-term schedule for more than one consecutive reporting period~~year~~. This disclosure is satisfied by use of a designated code in the investment schedules of the statutory financial statements.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2020-21 SSAP No. 43R (Jim)	SSAP No. 43R –Designation Categories for RMBS/CMBS Investments	9 – Agenda Item	In Agreement (minor edits)	IP - 9

Summary:

On May 14, the Valuation of Securities (E) Task Force adopted revisions to the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual), for financially modeled residential mortgage-backed securities (RMBS) / commercial mortgage-backed securities (CMBS). The current financial modeling process remains unaffected, however the NAIC designations, as produced by the financial model (and as previously used for reporting), will now be mapped to a final NAIC designation category. Reporting entities will then utilize the new NAIC designation category for accounting and reporting purposes.

On July 30, the Working Group exposed this agenda item updating the NAIC financial modeling guidance/mapping instructions in *SSAP No. 43R—Loan-Backed and Structured Securities* for RMBS/CMBS investments. The proposed amendments are to align guidance with the financial modeling process as outlined in Part Four the P&P Manual.

Interested Parties' Comments:

Interested parties support the alignment of final designation guidance for RMBS/CMBS securities in SSAP No. 43R with the instructions recently adopted into Part Four of the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* ("P&P Manual"). To avoid confusion and foster consistent and appropriate application for statutory accounting and reporting purposes in alignment with the instructions in the P&P Manual, we suggest the following editorial clarifications to the proposed updates for SSAP No.43R, paragraph 27.a.iii:

"Step 3: Determine Final Designation – The final NAIC designation, ~~as determined by the modeled price range,~~ 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 six (6) NAIC designations for each CUSIP. **The final NAIC designations is mapped to an NAIC designation category according to the instructions in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office*, along with instructions for tranches that have no expected loss under any of the selected modeling scenarios and instructions for non-modeled securities.** The final NAIC designation ~~and NAIC designation category~~ 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.)."

*The reference to RBC is unnecessary in the statutory accounting and reporting guidance of the AP&P Manual, as this is already appropriately covered with the NAIC's Risk Based Capital Instructions and Forms.

Recommended Action:

NAIC staff recommends that the Working Group adopt the exposed nonsubstantive revisions, incorporating the minor modifications as suggested by interested parties, to *SSAP No. 43R—Loan-Backed and Structured Securities*. This update will be consistent with the guidance recently adopted for the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* for RMBS/CMBS securities. NAIC staff concur with the industry edits proposed as they remove redundant language, which is already reflected in the P&P Manual.

Proposed Edits to SSAP No. 43R: *(The edits highlighted in grey below show the changes from the prior exposure. The highlighted changes in paragraphs 27 and 27.a were proposed by NAIC SVO staff subsequent to the previous exposure.)*

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. The *Purposes and Procedures Manual of the NAIC Investment Analysis Office (P&P Manual)* provides detailed guidance. A general description of the processes is as follows:

- a. Financial Modeling: The NAIC identifies securities where financial modeling must be used to determine the NAIC designation. NAIC designation based on financial modeling incorporates the insurers' carrying value for the security. For those 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, Ssecurities where modeling results in zero expected loss in all scenarios and that would be equivalent to an NAIC Designation and NAIC Designation Category of NAIC 1 and NAIC 1.A, respectively, if the filing exemption process in the P&P Manual was applied, are automatically considered to have a final NAIC designation of NAIC 1 and NAIC Designation Category of NAIC 1.A, regardless of the carrying value. The three-step process for modeled 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 the six (6) NAIC designations 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, as determined by the modeled price range, designation that shall be used for investment schedule reporting 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 six (6) NAIC designations for each CUSIP. The final These six (6) NAIC designations is are mapped to an NAIC designation categories according to the instructions as shown in the Purposes and Procedures Manual of the NAIC Investment Analysis Office, along with instructions for tranches that have no expected loss under any of the selected modeling scenarios and instructions for non-modeled securities. This final NAIC designation and NAIC designation category shall be applicable for statutory accounting and reporting purposes and the NAIC designation category will be used for (including 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.).

REVIEW of COMMENTS on EXPOSED ITEMS

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

1. Ref #2020-18: SSAP No. 97 Update
2. Ref #2020-22: Accounting for Perpetual Bonds
3. Ref #2019-34: Related Parties, Disclaimer of Affiliation and Variable Interest Entities
4. Ref #2020-24: Accounting and Reporting of Credit Tenant Loans
5. Ref #2020-30: Premium Refunds and Other Adjustments

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2020-18 SSAP No. 97 (Fatima)	SSAP No. 97 - Update	10 – Agenda Item	Comments Received	IP – 7 New York Life - 58

Summary:

In March 2020, the Working Group adopted agenda item 2018-26: SCA Loss Tracking – Accounting Guidance, for *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*, which clarified guidance stating that reported equity method losses of an investment in a subsidiary controlled or affiliated entity (SCA) would not create a negative value in the SCA investment, thus stopping the reporting of the equity method losses at zero. However, to the extent there was a financial guarantee or commitment, it would require appropriate recognition under *SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets*.

On July 30, the Working Group exposed this agenda item providing a minor revision to the end of paragraph 9, which corroborate the revisions adopted in agenda item 2018-26 and proposed to remove a lingering reference that guarantees or commitments can result in a negative equity value for the SCA.

Interested Parties' Comments:

As stated in the Exposure, earlier this year SAPWG adopted item 2018-26 – SCA Loss Tracking – Accounting Guidance, which updated the accounting guidance provided under SSAP No. 97—*Investments in Subsidiary, Controlled and Affiliated Entities* (SSAP No. 97). Item 2018-26 stated that reported equity method losses of an investment in a subsidiary controlled or affiliated entity (“SCA”) would not create a negative value in the SCA investment, thus stopping the reporting of the equity method losses at zero. However, to the extent there was a financial guarantee or commitment, it would require appropriate recognition under *SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets*. These updates were made to paragraph 14e of SSAP No. 97.

The Exposure intends to further clarify paragraph 9 of SSAP No. 97, which describes all the adjustments that must be recorded by the insurer when recording its equity pick up in 8.b.ii and 8.b.iv entities (8.b.iv entities will be referred to herein as “foreign insurance subsidiaries”). Per the Exposure, the last sentence in paragraph 9 is being modified as shown below to make the sentence consistent with the guidance that was issued under item 2018-26:

Exposed Edit: “Note that the outcome of these adjustments, ~~as well as guarantees or commitments of the parent entity to provide additional funding~~, can result in a negative equity valuation of the investment.”

This change suggests that SSAP No. 97 requires negative equity valuation of foreign insurance subsidiaries. If that was always the intent, we would point out that there are substantive reasons to differentiate foreign insurance subsidiaries from 8.b.ii entities and floor their equity at zero, including the fact that foreign insurance entities have a true business purpose, independent from the parent insurer, and are subject to significant regulations in the foreign jurisdiction in which they operate.

In addition to these reasons, requiring negative equity valuation of foreign insurance subsidiaries would also appear to be a change from our prior understanding, which was based in part upon question 7 of the SSAP No. 97 Q&A. Question 7 of the SSAP No. 97 Q&A only refers to 8.b.ii entities as the type of entities for which negative equity would be required to be recorded. Since question 7 does not mention foreign insurance subsidiaries, we historically interpreted that to mean that negative equity would not be recorded for those entities, regardless of whether the negative equity was due to operating losses or paragraph 9 adjustments.

Interested parties request clarification from the SAPWG on whether the intent of the Exposure's modifications to the paragraph 9 adjustments is intended to cause an insurer's equity investment in a foreign insurance subsidiary to fall below zero. We are also seeking clarification on whether question 7 of the SSAP No. 97 Q&A was only meant to apply to operating losses and not paragraph 9 adjustments. (On a related note, we suggest that question 7 of the SSAP No. 97 Q&A itself be updated to reflect this Exposure since question 7 of the Q&A makes reference to 8.b.ii entities being reported with negative equity. However, we understand that Ref #2018-26 changed that so that negative equity would only be tracked and not reported unless there was a guarantee issued by the insurance reporting entity on the subsidiary.)

In regard to the potential intent of paragraph 9 adjustments requiring an insurance reporting entity to report its equity investment in a foreign insurance subsidiary or an 8.b.ii. subsidiary at an amount below zero, we offer a few comments and observations.

- We agree that with respect to 8.b.ii entities, the statutory accounting guidance would require an insurer to report negative equity since 8.b.ii entities are considered an extension of the insurance company. 8.b.ii entities may own assets that would not be admitted if owned by the insurer, so it is reasonable to require the insurer to report negative equity in those subsidiaries to prevent such assets from becoming admissible simply because they are owned by an 8.b.ii subsidiary and not owned directly by the insurer.
- We, however, do not agree that the application of the paragraph 9 adjustments should ever result in the insurer's investment in a foreign insurance subsidiary being reported at an amount less than zero. Prior to applying the SSAP No. 97 paragraph 9 adjustments, the GAAP equity of a foreign insurance subsidiary is subject to the following recoverability and impairment tests on the net assets inherent in its GAAP equity:
 - ✓ GAAP loss recognition testing of DAC and reserves, for which additional liabilities would be established for expected future losses beyond recovery of any GAAP assets (including recoverability of deferred acquisition costs, or DTAs),
 - ✓ GAAP impairment testing of asset balances (e.g. – goodwill, DTA's, investment other-than-temporary losses)

The application of the paragraph 9 adjustments to a foreign insurance subsidiary's GAAP equity results in a valuation of these entities that is in some cases more conservative than U.S. statutory accounting and that does not reflect the foreign insurance subsidiary's valuation. (For example, deferred acquisition costs that have been deemed recoverable under GAAP are non-admitted, while holding the higher gross GAAP reserve that has no implicit credit for acquisition expenses that is inherent in statutory reserves).

Furthermore, foreign insurance companies are more akin to 8.b.iii entities as they are independent business entities that sell insurance products to customers. In addition, foreign insurance subsidiaries are subject to significant regulations, including capital requirements, by their local insurance regulators. As such, unlike 8.b.ii SCA entities, these foreign insurance companies are stand-alone operations and not an extension of the domestic insurance company. Therefore, we believe these entities should be treated consistently as an 8.b.iii SCA entity, and only recognize a negative equity value (in the form of an SSAP No. 5R liability) to the extent the parent insurance

company has guaranteed obligations of the foreign insurance company or is otherwise committed to provide further financial support for the investee.

Finally, not all foreign insurance companies receive audited GAAP financial statements. In these situations, the investment in the foreign insurance subsidiary (cost basis) is non-admitted, and no results are reflected in surplus until the foreign insurance company distributes earnings to the parent insurance company. If a parent insurance company does decide to obtain an audit of its foreign insurance company, it should not result in an impact to surplus that is worse than non-admitting the investment.

New York Life Comments:

NYL agrees with the comments provided in the September 18, 2020 Interested Party letter. This letter provides additional background on those comments as well as a potential path to resolution by suggesting wording changes that could be incorporated into SSAP No. 97 *Investments in Subsidiaries, Controlled and Affiliated Entities* to address the issues that have been identified.

NYL has been closely watching SAPWG's exposure of revisions to SSAP No. 97, including the most recent exposure that makes some updates to the last sentence of paragraph 9. That exposure caused us to re-examine our understanding of the SSAP and the potential for a foreign insurance subsidiary to record negative equity in the future. As expressed in the Interested Parties comment letter, we believe that it makes sense for SSAP No. 97 to differentiate in its treatment of 8.b.iv foreign insurance subsidiaries and 8.b.ii SCAs.

At a high level, 8.b.ii entities generally operate as an extension of the insurance company and own assets that for the most part would not be admitted if owned by the insurer. In those circumstances, recording negative equity makes sense. In contrast, foreign insurance subsidiaries have a true business purpose, independent from the parent insurer, and are subject to significant regulations in the foreign jurisdiction in which they operate. From our perspective, foreign insurance subsidiaries are closer to 8.b.iii subsidiaries in that they are real operating companies that are independent of the domestic insurer.

While the circumstances that could cause an insurer to record negative equity in a foreign insurance subsidiary are probably not very common, they could come to pass in the future. This could be due to the non-allowance of deferred acquisition costs recorded by the foreign insurer, while still requiring the foreign insurer subsidiary to hold the higher gross GAAP reserve that has no implicit credit for acquisition expenses that is inherent in statutory reserves. Therefore, we believe that changes are needed to prevent this situation from occurring in the future.

At the same time, we want to prevent against any potential abuses that could arise if SSAP No. 97 is updated to remove the negative equity concept for a foreign insurance subsidiary. We have therefore crafted the below underlined language, which we would propose inserting into the last sentence of paragraph 9:

Note that the outcome of these adjustments can result in a negative equity valuation of the investment for all 8.b.ii SCA entities. For an 8.b.iv SCA entity, recording negative equity depends on whether or not the parent insurer has issued a guarantee to fund losses of the 8.b.iv SCA entity or whether the 8.b.iv entity provides services to the parent or affiliated insurer. If the parent insurer has committed to fund losses of the 8.b.iv SCA entity, the accounting described in paragraph 13e should be followed. If the 8.b.iv SCA entity does not provide services to, or holds assets on behalf of, the parent insurer or affiliate, the valuation of the investment in the SCA would be floored at zero if negative equity arises due to the application of these adjustments. For an 8.b.iv SCA entity that provides services to, or holds assets on behalf of, the parent insurer or affiliate, negative equity has to be recorded due to the application of these adjustments for the total amount of the non-admitted assets used to provide services to, or held on behalf of, the parent insurer or affiliate.

Recommended Action:

NAIC staff recommends that the Working Group adopt the exposed nonsubstantive revisions to SSAP No. 97—*Investments in Subsidiary, Controlled and Affiliated Entities*, as well as additional clarifying edits to Exhibit C, question 7, as shown below. These proposed edits do not reflect the interested parties' comments. The proposed edits in agenda item 2020-18 only remove a superseded statement that guarantees or commitments from the insurance reporting entity to the SCA could result in a negative equity valuation of the SCA. As the Working Group previously adopted guidance from agenda item 2018-27, stating that financial guarantees or commitments would be recognized in SSAP No. 5R—*Liabilities, Contingencies and Impairment of Assets*, the edits in this agenda item simply updated a remaining reference regarding guarantees and commitments and did not modify any current guidance regarding the paragraph 9 limited statutory basis adjustments required for 8.b.ii and 8.b.iv entities.

In response to the New York Life comments, the potential negative valuation of 8.b.iv entities (as further discussed below) remains unaffected and was not in scope of this agenda item. NAIC staff is appreciative of the comments received and **requests the Working Group provide direction as to whether a separate agenda item is warranted, reviewing if some of the provisions (i.e. potential negative valuation) of paragraph 9 (requiring limited statutory basis of accounting adjustments) should no longer apply to 8.b.iv entities.**

In response to interested parties' comments regarding negative equity valuation, it is important to note that only equity method (income statement) losses stopping at zero were previously addressed. Asset adjustments as described in SSAP No. 97, paragraph 9, remain in effect (and unmodified) for 8.b.ii and 8.b.iv entities and may result in a *negative equity valuation* of the investment. For discussion purposes, applicable guidance has been included, and bolded below.

SSAP No. 97, paragraph 8.c.

- v. Investments in foreign SCA entities shall follow the guidance in paragraphs 8.b.ii., 8.b.iii. and 8.b.iv. based upon the nature of the SCA as described in the respective paragraphs. To fulfill the requirement for audited U.S. GAAP basis financial statements, the value of foreign SCA investments may be based on the GAAP equity from audited financial statements prepared on a foreign GAAP basis. The audited foreign GAAP basis financial statements must include an audited footnote that reconciles net income and equity on the foreign GAAP basis of accounting to the U.S. GAAP basis. **The statutory carrying value of foreign insurance SCA entities (i.e., paragraph 8.b.iv. entities) and foreign noninsurance paragraph 8.b.ii. SCA entities shall include the additional adjustments as described in paragraph 9.**

9. The limited statutory basis of accounting for investments in noninsurance SCA entities, subject to paragraph 8.b.ii. and foreign insurance SCA entities, subject to paragraph 8.b.iv., shall be adjusted for the following:

- a. Nonadmit assets pursuant to the following statutory accounting principles as promulgated by the NAIC in the *Accounting Practices and Procedures Manual*;
 - i. SSAP No. 6—*Uncollected Premium Balances, Bills Receivable for Premiums, and Amounts Due From Agents and Brokers*
 - ii. SSAP No. 16R—*Electronic Data Processing Equipment and Software*
 - iii. SSAP No. 19—*Furniture, Fixtures, Equipment and Leasehold Improvements*
 - iv. SSAP No. 20—*Nonadmitted Assets*
 - v. SSAP No. 21R—*Other Admitted Assets* (e.g., collateral loans secured by assets that do not qualify as investments are nonadmitted under SAP)

- vi. SSAP No. 29—*Prepaid Expenses*
- vii. SSAP No. 105R—*Working Capital Finance Investments*
- b. Expense costs that are capitalized in accordance with GAAP but are expensed pursuant to statutory accounting as promulgated by the NAIC in the *Accounting Practices and Procedures Manual* (e.g., deferred policy acquisition costs, preoperating, development and research costs, etc.);
- c. Adjust depreciation for certain assets in accordance with the following statutory accounting principles:
 - i. SSAP No. 16R—*Electronic Data Processing Equipment and Software*
 - ii. SSAP No. 19—*Furniture, Fixtures, Equipment and Leasehold Improvements*
 - iii. SSAP No. 68—*Business Combinations and Goodwill*
- d. Nonadmit the amount of goodwill of the SCA in excess of 10% of the audited U.S. GAAP equity of the SCA's last audited financial statements.
- e. Nonadmit amount of the net deferred tax assets (DTAs) of the SCA in excess of 10% of the audited U.S. GAAP equity of the SCA's last audited financial statements.
- f. Nonadmit any surplus notes held by the SCA issued by the reporting entity.
- g. Adjust the U.S. GAAP annuity account value reserves of a foreign insurance SCA, with respect to the business it wrote directly, using the commissioners' annuity reserve valuation method (CARVM) as defined in paragraphs 14 and 15 of Appendix A-820 (including the reserving provisions in the various Actuarial Guidelines which support CARVM). The valuation interest rate and mortality tables to be used in applying CARVM should be that prescribed by the foreign insurance SCA's country of domicile. If the Foreign SCA's country of domicile does not prescribe the necessary tables and/or rates, no reserve adjustment shall be made.

Note that the outcome of these adjustments, ~~as well as guarantees or commitments of the parent entity to provide additional funding~~, can result in a negative equity valuation of the investment.

The intent of such language was to ensure that nonadmitted assets held by an SCA would be reflected in a similar manner had the assets been held directly. As equity method 8.b.ii and 8.b.iv entities could be valued using GAAP, or other non-statutory accounting method, appropriate adjusting entities (noted in paragraph 9) are required. The ending result of these entries could result in a negative equity valuation.

Interested parties also mentioned that SSAP No. 97, Exhibit C, Question 7 could be misinterpreted in that only 8.b.ii entities could be reported as a negative value. While this would be contrary to the guidance found in SSAP No. 97, paragraphs 8.c.v. and 9, NAIC staff propose the following clarification edits to question 7. **(This proposed revision was not previously exposed. However, NAIC staff recommends proceeding with adoption of the exposed edit and this additional revision.)**

7. Q – Is it possible for an SCA investment valued using an equity method to be reported as a negative value?

7.1 A – Yes, the equity method noninsurance SCA could have a negative equity. For example, SSAP No. 97, paragraph 8.b.ii., relating to noninsurance SCA entities, may requires some assets to be reported as a negative value (nonadmitted) in paragraph 9. In this ~~For~~ example, a paragraph 8.b.ii. SCA subsidiary that is only holding furniture, which is nonadmitted, would be reflected with negative equity to the extent the value of the nonadmitted asset(s) exceed(s) reported equity. It should be noted that although SSAP No. 97, paragraph

13.e., discusses some situations in which the equity method should be discontinued, this does not apply to SCA entities, which meet the requirements of paragraph 8.b.ii. In addition, SSAP No. 97, paragraph 13.e., lists some situations where the equity method for 8.b.ii and 8.b.iv entities would result in a valuation that is less than zero; ~~examples are if reporting entity has guaranteed obligations of the investee or is otherwise committed to provide further financial support for the investee, in these cases, the valuation of the investment in subsidiary could be a negative value.~~

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2020-22 SSAP No. 26R (Jim)	Accounting for Perpetual Bonds	11 – Agenda Item	Comments Received	IP - 9

Summary:

On July 30, the Working Group exposed this agenda item to address the accounting treatment for perpetual bonds held as investments within scope of *SSAP No. 26R—Bonds*. A perpetual bond is a fixed income security, representing a creditor relationship, with a fixed schedule of future payments, however it does not contain a maturity date - thus yielding the definitional term “perpetual.” These bonds are typically not redeemable at the option of the holder but likely possess call options for the benefit of the issuer.

Interested Parties’ Comments:

Interested parties appreciate the opportunity to respond to the SAPWG proposed Ref #2020-22, *Accounting for Perpetual Bonds* (“the proposal”). In the proposal, perpetual bonds are defined as those fixed income securities, representing creditor relationships, with fixed schedules of future payments, however the bonds do not contain maturity dates. The proposal compares perpetual bonds to perpetual preferred stock and concludes that they are substantially the same, with the primary cash flow difference being that perpetual bonds have priority in liquidation versus preferred stock. The proposal also states that due to the lack of a maturity date, insurers do not accrete discounts or amortize premiums. As a result, Ref #2020-22 proposes that perpetual bonds be treated the same as perpetual preferred stock by reporting them at fair value for Statutory reporting. Although not specifically stated in the exposure, it is interested parties’ presumption that this implies that periodic changes in fair value would be reported in unrealized capital gains and losses.

Interested parties agree that perpetual bonds do have some characteristics in common with equity securities, which justify their continued reporting as hybrids on Schedule D as established in INT 2008-06’s hybrid discussions. However, we believe that the characteristics of these investments are substantially similar to bonds, are utilized by insurers with similar investment objectives as investing in other bonds and are viewed by the capital markets as bonds. As a result, interested parties believe that perpetual bonds should continue to be accounted for as bonds under SSAP No. 26R (as currently written) and reported on Schedule D as hybrids.

In the discussion below, we provide further clarification of relevant attributes and industry practice associated with perpetual bonds, and outline several key reasons why interested parties do not agree that perpetual bonds should be reported the same as perpetual preferred stock (i.e., at fair value with periodic changes in fair value reported in unrealized gains and losses); rather, we believe accounting for all bonds, including perpetual bonds, as prescribed in SSAP 26R, as currently written, is appropriate.

The following are key reasons why interested parties believe perpetual bonds are substantially the same as other bonds, versus perpetual preferred stock:

- **Amortization of premiums and accretion of discounts:** The proposal notes that due to a lack of a maturity date, insurers do not accrete discounts or amortize premiums on perpetual bonds. However, many insurers in the interested parties group do have methodologies to amortize premiums and accrete discounts.

Most often, companies amortize premiums to the call date for the bonds (i.e., apply yield to worst) and accrete discounts to a date that is far into the future (i.e., consistent with how Bloomberg treats such bonds when quoting market yields for the bonds). Investors believe this approach to estimating a yield is a reasonable depiction of the true yield expected to be earned on the investments.

- **Call date is a pseudo-maturity date:** The capital markets and investors (including insurers) consider the call date in the bonds to be a pseudo-maturity date. That is, it is expected that the perpetual bonds will be called on the call date. Oftentimes insurers price the bonds to the call date. Many times, the bonds have step-up coupon provisions at the call date, which provides an incentive for the issuer to call the bonds, or there are other reasons why there is a market compulsion for the issuer to call such bonds on the call date. The expectation that the bonds will be called is one of the key characteristics that results in many companies reporting such bonds as fixed income for US GAAP reporting purposes. In the rare cases where perpetual bonds do not have callability, all other characteristics are the same as those bonds with callability (e.g., capital markets consider them bonds, the trade like bonds, the investment objective is the same as bonds, etc.) and thus interested parties believe they should be reported the same as all other bonds.
- **How perpetual bonds trade in the market:** The market's view of the call provisions on perpetual bonds, as outlined above, is a key reason (among others) that perpetual bonds trade in the capital markets like bonds. As a result, these instruments are more sensitive to interest rate movements, are generally priced like bonds (inclusive of accrued interest) and are quantified and measured in terms of par value and not in terms of shares of stock.
- **US GAAP reporting:** Those insurers who invest in perpetual bonds generally report them as fixed income for US GAAP reporting purposes. Some companies evaluate the investment characteristics (per the guidance in Topic 815) to determine if the characteristics such as redemption rights, voting rights, conversion rights, dividend rights, and protective covenants are more debt like or equity like when determining the appropriate reporting. Additionally, companies consider how the investments are viewed in the capital markets. The analysis performed generally concludes that perpetual bonds are more bond like than equity like. When classified as bonds, they are evaluated for impairment like any other bond (e.g., insurers assess the ability for the issuer to pay interest and principal).
- **Investment strategy for perpetual bonds:** Insurers invest in perpetual bonds for their fixed cash flows (interest and expected return of principal when called by the issuer) and not for market appreciation. Like other bonds, the expected fixed cash flows are used for cash flow matching to insurance liabilities. Many perpetual bonds have a fixed coupon and if not called the coupon adjusts to a current floating rate plus a spread (e.g., that is stepped-up significantly from original issuance spreads). Also, when insurers manage their investment portfolios (e.g., investment allocations, assessing risks, etc.), perpetual bonds are classified as bonds and not equities.
- **Monetization of perpetual bonds:** A key reason equity securities are reported at fair value for Statutory reporting purposes is because there is no certainty in the cash flows they generate and return to the investor (return of principal and return on investment), which includes dividend payments. Additionally, the return of an investor's original investment can only be monetized by selling the equity security at fair value. As a result, fair value is an important measurement when considering the expected return to the investor. Regarding perpetual bonds, the opposite situation exists. The cash flows have a much higher level of certainty (interest to be paid for the life of the investment is contractual and does not require the issuer's board declaring a dividend like a preferred stock and the return of par at the call date) like any other bond. As a result, similar to other bonds, we do not believe fair value is a relevant measurement principle for such investments for Statutory reporting purposes.

Interested parties agree that perpetual bonds do have some unique characteristics that are similar to equity securities; however, their characteristics are predominantly those consistent with bonds (e.g., investments are generally priced, traded, and utilized by insurers in the same manner as other bonds). We believe accounting for all bonds, including perpetual bonds, as prescribed in SSAP No. 26R, as currently written, is appropriate. We have not identified any justification to report and account for perpetual bonds differently from other bonds. However, given they may contain some equity-like characteristics, we believe they should continue to be reported as hybrid investments in Schedule D, as established in 2008-06BWG's hybrid discussions. This would provide transparency to regulators as to their existence in insurers' investment portfolios.

Recommended Action:

Due to the numerous payment similarities between perpetual bonds and perpetual preferred stock, this agenda item originally proposed the consideration of similar accounting treatment of these instruments (i.e. reported at fair value). However, as perpetual bonds do maintain characteristics of bonds and in most cases contain a schedule of call dates (typically possessing step-up call characteristics, providing an economic enticement to call the bond) which are generally exercised by the issuer. This agenda item has been modified to specify bond treatment for perpetual bonds which have an upcoming, scheduled call date – thus would be subject to amortized cost treatment (utilizing the yield-to-worst concept) in instances where a termination date (i.e. call date) is known.

NAIC staff agrees with interested parties' comments and recognize that perpetual bonds do possess characteristics that are akin to 'traditional' bonds. Nonetheless, NAIC staff also recognize that reporting a perpetual bond indefinitely at historical cost in instances where the bond does not have a remaining call feature, is not an appropriate measurement method. Upon review of perpetual bonds held by insurers, it was noted that a significant percentage of the holdings did not possess (or report) upcoming call dates. They also did not report accretion/amortization of any discount/premium.

SSAP No. 26R impairment guidance only requires an OTTI in the event it is probable that a reporting entity will be unable to collect the amounts due according to the contractual terms of the debt security. Without a maturity or call date, despite a decrease in market value, an argument could be made that an OTTI for principal is not required as there is no contractual timing for repayment.

NAIC staff recommends that the Working Group expose nonsubstantive revisions to SSAP No. 26R—Bonds, which clarify that perpetual bonds are within scope as a “bond”, however shall apply the yield-to-worst concept. Additionally, for perpetual bonds that do not possess or no longer possess a call feature, fair value reporting is required.

NAIC staff notes that fair value measurement was proposed as that mirrors perpetual preferred stock, and perpetual bonds are considered similar to perpetual preferred stock. Per market sources, the coupon on the perpetual bond is considered comparable to the dividends from perpetual preferred stock. The key difference, and what makes perpetual bonds fixed-income instruments, is that the bond coupon payment is mandatory, and preferred stock dividends are discretionary. However, there is no obligation on the issuer to redeem the principal of the bond.

If preferred – and in accordance with IP comments to retain “bond accounting” – the proposed measurement method could be revised to reflect “lower of cost or fair value.” This will prevent a write-up (unrealized gain) on the perpetual bond under a fair value approach while it is held (consistent with other bonds) but require fair value declines to be reflected in the reported value once a call price no longer exists. This will ensure that the amount reported on Schedule D reflects the amount that could be received from the bond, recognizing that the issuer is under no obligation to provide the principle amount, and liquidation in the market may be the only mechanism to receive the reported value. The revisions proposed by NAIC staff would permit continued use of an “amortized cost” method as long as a call date / price exists. From information received from industry, this is common in these structures, with the market value of the perpetual bond reflecting the anticipated call price. If the call date passes without the issuer calling the bond (which is not very common), then the next call date may reflect a “step-up” in call price. However, once a call date/price no longer exists then fair value is appropriate, as the market price reflects

what would be received for the bond, and the issuer has no obligation to redeem the bond from the holder. (Although the issuer has no obligation to redeem the bond from the holder even when a call date/price exists, NAIC staff has proposed to use the next call price as an amortization proxy. From information received from industry, this is existing common practice. However, if preferred by regulators, the lower of cost or fair value approach could be incorporated for all perpetual bonds.)

SSAP No. 26R – Proposed Updates for the November 12th Interim Meeting:

In conjunction with the NAIC staff recommendation to retain bond accounting (i.e. amortized cost) for perpetual bonds in which possess a future call date, however to require fair value accounting for those that do not (or no longer) possess a future call date, the following edits are recommended. All items below are new and have not previously been exposed.

Amortized Cost

10. 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 **FN**. 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.

New Footnote: For perpetual bonds with an effective call option, any applicable premium shall be amortized to the next effective call date. For perpetual bonds purchased at a discount, any applicable discount shall be accreted utilizing the yield-to-worst concept.

Balance Sheet Amount

11. Bonds, as defined in paragraph 3, 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 in which do not possess or no longer possess an effective call option, the bond shall be reported at fair value regardless of NAIC designation.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2019-34 SSAP No. 25 (Jake)	Related Parties, Disclaimer of Affiliation and Variable Interest Entities	12 – Agenda Item	Comments Received	IP - 4

Summary:

During the March 18 conference call, the Working Group deferred discussion on this agenda item. During the 2019 Fall National Meeting, the Working Group exposed this agenda item to clarify identification of related parties and affiliates in *SSAP No. 25—Affiliates and Other Related Parties* and to incorporate new disclosures to ensure regulators have the full picture of complicated business structures. After the 2019 Fall National Meeting, the Working Group sent a referral to the Group Solvency Issues (E) Working Group that outlines agenda item 2019-34 and asked for any further guidance or clarification. The Group Solvency Issues (E) Working Group recommended consideration of a new statutory disclosure that would provide information on minority ownership interests, as well as significant relationships between minority owners and other U.S. domestic insurers/groups. NAIC staff has worked with interested parties to draft proposed revisions to capture this information.

The proposed SSAP revisions intend to address the following key aspects:

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

Interested Parties’ Comments

Based upon a call with NAIC staff and our understanding of the objective of the changes to SSAP No. 25, interested parties marked up SSAP No. 25 with edits that are directed at ownership interests in insurers (the reporting entity) of greater than 10% where the investor (owner) has filed and received a disclaimer of control, but leaves the requirements for investments of the insurer unchanged, except for the proposed additions to certain of the sub-paragraphs of paragraph 4 (see attached).

Also, we reviewed the two approaches for reporting shared by SAPWG staff with interested parties on September 1 regarding the proposed disclosure of ownership interests in insurers of greater than 10%. We believe the Schedule Y approach is the better of the two as it allows for the capture of more information regarding complex ownership arrangements; however, we believe that the development of instructions to go along with the new part of Schedule Y is needed before concluding on that approach.

Additional proposed interested parties’ edits are noted at 17 on attachment 20.

Recommended Action:

NAIC Staff recommends exposing the revised agenda item. The revisions included in the proposed exposure incorporate changes that were made based on discussion with interested parties and also include a proposed new disclosure recommended by the Group Solvency Issues (E) Working Group. The revisions primarily clarify the intent of the guidance.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2020-24 SSAP No. 43R (Julie)	Accounting and Reporting of Credit Tenant Loans	13 – Agenda Item	Comments Received	IP – 43 Lease-Backed Securities Working Group – 50 TIAA - 55

Summary:

This agenda item intends to clarify the reporting of credit tenant loans (CTL) for statutory accounting. Although this is an investment (that if meeting certain criteria) may have been historically captured in *SSAP No. 43R—Loan-Backed and Structured Securities*, due to recent discussions at the Valuation of Securities (E) Task Force, in order to provide timely guidance, it was identified that this issue needs to be considered separately outside of the substantive SSAP No. 43R project. As the SSAP No. 43R project is a substantive assessment, with various aspects being considered, it is noted that the conclusion of that project may extend beyond the timeframe for which clarity on CTLs is needed. This agenda item focuses on credit tenant loans. There are other variations of similar investments that should also be specifically named / addressed in the AP&P Manual. These include ground lease financings as well as other lease-backed (non-ABS) securities. NAIC staff recommends that the Working Group consider first CTLs, with separate subsequent consideration of other structures.

The focus of this agenda item is to inquire whether conforming CTLs should be captured in scope of SSAP No. 43R or whether these investments should be captured in *SSAP No. 21R—Other Admitted Assets*. This agenda item is not proposing that structures that do not conform to current requirements be considered in scope of SSAP No. 43R. This agenda item also inquires whether structures that are not conforming CTLs should be reported as mortgage loans or whether these structures should be captured in SSAP No. 21R. This agenda item is not proposing to reconsider the existing SVO guidelines in determining whether a CTL is “conforming” and in determining what is considered to be a suitable amount of “residual risk.” If there is a desire to reassess these provisions, NAIC staff would recommend a separate project with the Task Force, after concluding on desired reporting location and governing SSAP, to review these parameters.

Although it is understood that historical practice has permitted certain SVO verified CTLs that meet legal and structural analyses to be reported on Schedule D, there is a question whether these investments reflect bonds or securitized assets that should be included on the bond schedule. If preferred by the Working Group, revisions can be considered to remove these items from potential Schedule D reporting and instead capture these investments in scope of SSAP No. 21R. Some elements to consider in determining whether SSAP No. 21R would be more appropriate:

- If captured in scope of SSAP No. 21R, all CTLs will be reported in the same schedule, regardless of whether they are considered “conforming” or “non-conforming” CTLs. (In other words, the same reporting schedule would occur regardless of the NAIC SVO assessment.) This reporting process would likely result with improved identification and assessment of CTL investments in the financial statements. Under the current process, since CTLs are bifurcated across reporting schedules, it is not possible to identify the full extent an insurer is invested in CTLs (regardless if confirming or non-conforming).

- If captured in scope of SSAP No. 21R, CTLs could still be filed with the NAIC SVO for the legal and structural analysis and, if qualifying, to obtain an NAIC designation. For these “conforming” CTLs, revisions could be incorporated to permit the NAIC designation to be reported on Schedule BA. This NAIC designation could be used by life insurers to obtain an improved RBC designation. (Although the improved RBC is not an option under the current RBC formula for non-life entities, from information gathered, most CTL holders are life insurers.)
- Reporting CTLs in scope of SSAP No. 21R would be consistent with previous decisions of the SAPWG to not report non-bond items as bonds simply for RBC purposes. It would also be consistent with the policy statement that obtaining an NAIC designation does not direct statutory accounting or reporting. Pursuant to this policy statement, obtaining an NAIC designation does not change an investment’s applicable SSAP, annual or quarterly reporting schedule or override other SSAP guidance required for the investment to be an admitted asset. This policy statement does identify that there are limited situations in which an SVO-listing could be used for classification purposes that focuses on the underlying structure of the investment. If conforming CTL investments are retained in SSAP No. 43R (and not moved to SSAP No. 21R), it would be recommended that CTLs that meet the SVO structural analysis be captured on a listing that could be referred to in the scope section of SSAP No. 43R. It is noted that the recent issues involving non-conforming CTLs seem to originate from an interpretation that obtaining a CRP rating would allow entities to report these structures as bonds on Schedule D through the filing exemption process. This assessment is incorrect under existing statutory accounting guidance and the existing policy statement.
- Reporting CTLs in scope of SSAP No. 21R would seemingly be consistent with the decision made for structured settlements in 2018. Although structured settlements and CTLs are vastly different investments, they both represent an investment, that is not a bond, but reflects an investment in a cash flow stream that is subject to the underlying credit quality of the payer.

On May 29, 2020, the Valuation of Securities (E) Task Force submitted a referral to the Working Group to permit non-conforming CTLs that receive an NAIC designation from the SVO to be considered in scope of SSAP No. 43R. Excerpts of this referral have been provided below:

The Task Force is referring this memo and proposed amendment to the Statutory Accounting Principles (E) Working Group and **requesting the Working Group affirm that they would consider these Non-conforming CTLs to have the characteristics of a bond if assigned an NAIC Designation by the SVO staff.** Like the referral from earlier this year on GLFs, these Non-conforming Credit Tenant Loan (CTL) Transactions have historically been reported under the Accounting Practices & Procedures Manual’s SSAP No. 43R – Loan-Backed and Structured Securities under Paragraph 27, b as a type of CTL. The SVO staff recommends affirming that treatment only if the SVO staff can assign an NAIC Designation.

The edits noted in the Task Force referral are revisions to the *Purposes and Procedures Manual* (P&P) to affirm the Task Force’s role in making all decisions on the use of CRP ratings and provides guidance to insurance company filers on what to do if they are uncertain about the filing procedure for a particular security or class of securities.

NAIC staff highlights that it would be inconsistent with the *Policy Statement on Coordination of the AP&P Manual and the P&P Manual of the NAIC IAO* to permit CTLs to be classified as a bond simply in accordance with an NAIC designation / CRP rating. However, the provisions in the Policy Statement does identify that such classifications can occur based on an SVO structural assessment of an investment. NAIC SAPWG staff has confirmed with the SVO staff that the review and assignment of an NAIC designation for CTLs requires a structural assessment, and they only receive an NAIC designation if the CTL possess bond characteristics.

Interested Parties' Comments:

Background

Interested parties note that the impetus behind the Exposure is the referral from the Valuation of Securities Task Force where the VOSTF pointed to non-conforming CTLs that had not been submitted to the SVO and/or did not qualify under the SVO's structural and legal analysis. These non-conforming CTLs were being reported on Schedule D with filing exempt designations. This has led to questions about both conforming CTLs and non-conforming CTLs.

It has been long-standing practice for conforming CTLs to be filed with the NAIC SVO for review and assessment. Once filed, the SVO goes through a legal and structural analysis of the CTL designed to identify bond characteristics and verify that minimal residual real-estate risk is present, along with other necessary criteria such as a minimum DSCR requirement. If the SVO determines that the CTL passes the test, the CTL has been granted bond treatment and reported on Schedule D.

This has been standard practice for approximately 25 years. It was in the mid-1990s that the NAIC's Invested Asset Working Group (IAWG), SAPWG and VOSTF held a long running project which culminated in conforming CTLs being reported as Schedule D bonds. This resulted in the specific reference of CTLs in SSAPs and the SVO's P&P Manual. Initially, CTLs were in the scope of SSAP No. 26R. For reasons that interested parties never fully understood, even though CTLs do not have prepayment/extension risk that would merit the modified amortized cost accounting within SSAP No. 43R, CTLs were subsequently moved to SSAP No. 43R. We have discussed this point separately in our letter on SSAP No. 43R. The key consideration relating to this Exposure is that conforming CTLs have for 25 years been reported as Schedule D bonds.

As noted in the Exposure, there is not clear guidance in the AP&P Manual related to CTLs other than a generic reference. Lacking specific guidance on non-conforming CTLs, a number of reporting entities focused on the definition of a bond in SSAP No. 26R and noted that most non-conforming CTLs meet this definition and concluded, inappropriately as it turned out, that certain non-conforming CTLs were filing exempt. The VOSTF, upon clarifying the P&P Manual for filing exempt bonds, recognized the ambiguity of the prior combined SSAP 43R and P&P guidance and recommended a "grandfathering" of non-conforming CTLs if purchased by an insurance company prior to January 1, 2020. Interested parties believe the VOSTF referral was only looking to affirm this treatment of non-conforming CTLs. There was no suggestion that the longstanding bond treatment of conforming CTLs should be questioned.

Conforming CTLs

Given this background, interested parties were surprised and alarmed to find that the Exposure questions whether conforming CTLs are, or should be treated as, bonds. No substantive rationale is given for this.

Conforming CTLs meet the definition of a "bond" under SSAP No. 26R, "Bonds shall be defined as any securities⁽¹⁾ representing a creditor relationship, whereby there is a fixed scheduled for one or more future payments" and therefore also meet the definition of a bond under US GAAP.

As a result, any treatment of conforming CTLs, as other than bonds, would require a specific carve-out from this definition. Any alteration of a key definition like this must be supported by a substantive rationale. As mentioned above, no such rationale has been offered.

The definition of a CTL in the Exposure, per the P&P Manual, is as follows:

"A CTL is a mortgage loan made primarily in reliance on the credit standing of a major tenant, structured with the assignment of the rental payments to the lender with real property pledged as collateral in the form of a first lien."

Put differently, a CTL has, as its primary source of repayment of both principal and interest, the legally and contractually bound payments of a lessee or major tenant. In addition, a CTL has the secondary benefit of a first lien on real estate.

Compared to a direct unsecured loan to a corporate credit, a CTL backed by the assignment of rents payable by the same corporate credit, as tenant, provides additional security in the form of mortgaged property. Of the two, the CTL has less chance of default for the lender or investor, as the lease can be affirmed even in the event of the bankruptcy of the corporate credit, and the CTL can remain current at a time when payment to unsecured creditors is suspended. In a bankruptcy, the tenant must either affirm or reject the lease, as is. By contrast, there is a very wide variety of possible outcomes for unsecured bond claims in a bankruptcy.

In the event that the lease is rejected in bankruptcy, the CTL lenders can sell or release the collateral to reduce losses, while also filing a partial unsecured claim for lease rejection damages. Bankruptcies are uncommon but experience does indicate that CTL lenders fare better than general unsecured claimants. Conforming CTLs are self-amortizing and cannot have a balloon payment or residual asset risk of greater than 5%. There is nothing exotic or alternative about conforming CTLs.

It is no surprise, given this key differentiation, that conforming CTLs were affirmed bond status by the IAWG, SAPWG and VOSTF in mid 1990s after significant analysis and public deliberation. Nor does it make sense to report such conforming CTLs as mortgage loans given that SSAP No. 37 clearly excludes securities from its scope. Further, the corporate credit nature of conforming CTLs, with the additional benefit of the real estate collateral, result in a higher LTV than for most typical mortgage loans, which current mortgage RBC formulas do not contemplate. As such, current mortgage loan RBC requirements would be materially punitive.

The Exposure suggests that it may be appropriate to have all CTLs reported in one location. If so, it seems entirely random to select Schedule BA as that location. Putting CTLs on Schedule BA would potentially cause companies to run afoul of state investment limits. For many insurers, Schedule BA includes a number of equity type investments, such as investments in limited partnerships and private equity funds. As a result, external parties (whether rating agencies or other) often associate Schedule BA with elevated risk. This widespread association would immediately create an unfavorable headwind for the CTL market. If regulators would like to understand insurance company exposure (whether by insurer or industry) to conforming CTLs, a separate category within Schedule D can easily be created.

Because of this, and in light of the outstanding track record of such CTLs, it is troubling to interested parties, and should be troubling to regulators as well, that the NAIC staff's recommendation is to alter the longstanding practice of reporting conforming CTLs as bonds on Schedule D. It is clearly in the best interest of insurance companies, and ultimately policyholders, to report such bonds on Schedule D.

This is particularly true given the excellent long-term track record of CTLs. An April 2019 study, "Society of Actuaries; 2003-2015 Credit Loss Experience Study: Private Placement Bonds" demonstrated the superior track record of private placement bonds compared to public bonds and then showed that of all the private placement asset classes, CTLs had both the lowest rate of default ("Credit Risk Event") and lowest loss rates. The average annual economic loss rate of 0.02% (2 basis points) outperformed by many multiples any other asset class.

Further, "The NAIC December 2018 Capital Markets Report: "U.S. Insurance Industry Exposure to Credit Tenant Loans and Equipment Trust Certificates" states that while both asset classes "are a relatively small portion of insurer investments, they are noteworthy because of their unique structures and strong performance (in terms of low historical default rates). In addition, they may be considered attractive investments in the current low interest rate environment where investors are seeking alternatives to achieve higher yields."

At a time when insurance companies are challenged by an extended low interest rate environment, we question why regulators would want to disadvantage such bonds, given their track record of success.

To recap, conforming CTLs are bonds, and while having a mortgage loan component, should continue to be treated as bonds, given their positive differentiating characteristics. Any other treatment, whether reported as mortgage loans on schedule B, or as other schedule BA assets, would not reflect the substance of such bonds, and it also would harm insurance companies, and ultimately policyowners, by severely disadvantaging such investments at the precise time insurance companies are in need of such safe and high quality investments.

Non-Conforming CTLs

Interested parties support SAPWG affirming the VOSTF recommendation that non-conforming CTLs treated by investors prior to December 31, 2019, inadvertently as filing exempt, should continue to be reported as Schedule D bonds. Interested parties believe the previously mentioned ambiguity of the prior combined SSAP 43R and P&P guidance makes this the right thing to do.

More importantly, while the term “non-conforming” is a workable label for differentiating CTL securities that do not meet the structural analysis as laid out in the P&P Manual, the term can be misleading, as it can obscure the fact the non-conforming CTLs are also bonds. Non-conforming CTLs have all the bond attributes discussed above for conforming CTLs, with the exception that residual asset risk is greater than 5%. Similarly, CMBS securities are bonds, even though residual asset risk is often far above levels seen for non-conforming CTLs.

At least definitionally, such non-conforming CTLs were also affirmed as bonds by SAPWG when amending SSAP No. 26R in 2017 as they meet the definition of a bond as laid out therein. Consistent with the interested parties letter on the SSAP No. 43R exposure, Interested parties believe any security meeting the definition of a bond in SSAP No. 26R, should be reported as a bond on Schedule D, unless a compelling case can be made otherwise or such transactions have been deemed abusive such as with principal protected notes. Interested parties have no information, nor has any information been provided in the Exposure, that such additional residual asset risk was associated with deterioration in credit performance as compared with conforming CTLs or has led to any significant problems for insurers. Nor do interested parties believe such securities are abusive.

Just because a bond has a significant residual payment which is backed by an asset (e.g., residual asset risk), does not mean it is not a “bond” or eligible to be reported on Schedule D. To make this conclusion would ignore or question the status of an estimated nearly \$1 trillion in bonds with large balloons that are secured by real estate or other assets. These include CMBS (e.g., non-agency CMBS outstanding alone, as of 2Q 2020, was \$592 billion per data from SIFMA), including several billion in “single-asset/single-borrower (“SASB”) bonds, many with little-to-no amortization, as well as ABS, CRE CLOs and infrastructure bonds, all of which are reported on Schedule D.

The investment markets have evolved substantially since the mid-1990s to recognize a wide variety of bonds with residual asset risk. For example, even the CFR definition proposed by NAIC staff in the SSAP No. 43R Exposure recognizes up to 65% residual asset risk for asset backed securities meeting that definition. As noted in our letter on the SSAP No. 43R Exposure, interested parties believe SAPWG needs to distinguish between (i) securities backed by non-admitted assets that, by their nature, are not cash generating (e.g., collector’s items or artwork) and (ii) securities backed by non-admitted assets (or admitted assets) that are capital assets, used and useful in commerce, such as ships, aircraft, railcars and power plants.

We expand upon this concept in great length, and quite thoughtfully, in our SSAP No. 43R letter and ask regulators to carefully think about the precedent setting ramification of deeming any security with residual asset risk not a bond. Is this best for insurance companies, regulators and ultimate policyholders? We understand the regulatory concern with debt securities backed by physical assets that are very unlikely ever to generate cash flows (e.g., corporate art). However, to deem any security with residual asset risk not a bond is hasty, inappropriate, and harmful to the capital markets and ultimately insurance companies and policyowners.

In summary, interested parties note that “non-conforming” CTLs are bonds and meet the definition of a bond in SSAP No. 26R. Absent a compelling case that such bonds are harmful or abusive, or violate some fundamental principle of SAPWG, such bonds should be reported on Schedule D.

If there is a desire to more easily assess insurance company exposure (whether by insurer or industry) to CTLs, a separate category within Schedule D can easily be created with any distinguishing characteristic regulators deem appropriate (e.g., amount of residual asset risk). Such a step is far simpler as well as far less problematic than abrupt and drastic measures such as moving CTLs to Schedule BA.

While interested parties do not believe either of the NAIC staff's proposed solutions are optimal, or in the best interest of insurance companies, regulators or policyholders, we stand ready to work with NAIC staff and regulators to achieve a solution that works for all parties.

Industry Lease-Backed Securities Working Group Comments:

Per subsequent information received, this group includes representatives from the following firms: TIAA/Nuveen, Catholic Order of Foresters, CGA Capital, CTL Capital, Mesirow Financial, and Waterway Capital.

Our group agrees with and wholeheartedly supports the comment letter submitted by the "Interested Parties" of even date with this letter, which concludes that all these transactions, both "conforming" and "non-conforming" CTLs, should continue to be reported as Schedule D bonds. However, as our group is most intimately involved with this sector of the securities market – not only as insurance company investors, but also as originators and legal counsel to investors – we want to supplement the comments offered by the other Interested Parties.

The Exposure proposes possible changes to the Accounting and Reporting of "Credit Tenant Loans" ("CTLs") as specifically defined in the P&P Manual for the past 24 years and reported on Schedule D throughout the same period, as well as another class of securities which do not meet the requirements for a CTL as defined in the Manual (referred to in the Exposure as "non-conforming CTLs").

Two options are put forward in the Exposure for the consideration of the SAP Working Group, which for brevity, we summarize below:

Option 1: Essentially continue with the historical practice of Schedule D treatment within the scope of SSAP No. 43R for "Credit Tenant Loans" as currently defined in the P&P Manual. At the same time, consider whether other lease-backed transactions – referred to in the Exposure as "non-conforming CTLs" – should be reported on Schedule B as mortgages, or on schedule BA under SSAP 21: "Other Admitted Assets".

Option 2: Report "all CTLs" (i.e.: CTLs as current defined in the P&P Manual, and the other lease-backed transactions that do not meet the requirements to be reported as "CTLs") on Schedule BA within the Scope of SSAP 21: "Other Admitted Assets".

Our group believes that the use of the terms "conforming" and "non-conforming" CTL which are used in the Exposure, create the impression that any transactions which do not meet the P&P Manual guidelines for a "CTL" in the P&P Manual are somehow not bonds because they are "non-conforming".

The P&P Manual has a number of very specific requirements for a transaction to be classified as a "CTL." As noted above, these requirements have been in place for 24 years, and "CTLs" as defined in the Manual are filed directly with the SVO and are not rated by a CRP.

There are a variety of other lease-backed securities that do not meet the definition of a "CTL" as defined in the P&P Manual. These transactions have historically been filed as Schedule D Bonds with a ratings letter from a CRP using the old modified Filing-Exempt guidelines ("Modified FE") – but as pointed out in the Exposure, a few transactions were mis-categorized by some filers as "CTLs". For the rest of this letter, we will refer instead to "other rated lease-backed securities" to distinguish them from "CTLs."

All these transactions: both CTLs and other rated lease-backed securities (or per the Exposure: "non-conforming CTLs"), have the following characteristics in common:

- 1.) The primary source of repayment is a legal assignment from the borrower to the lender of fixed rental payment stream from the rated credit-tenant which supports the debt. The payment stream is a contractual obligation of the tenant under the lease.
- 2.) These are single rated-credit payor/single obligor transactions with fixed payment schedules which are more akin to straight corporate bonds than to structured securities such as ABS, Project Finance, CMBS, and EETCs – which are also bonds. In addition, CTLs as defined in the P&P Manual, unlike most public corporate debt, are fully or nearly-fully*-amortizing structures, with little-to-no balloon risk. (*The current provisions in the P&P Manual permit a maximum uninsured residual payment of 5% of the original principal balance.)
- 3.) While there is a mortgage on the property as additional security for the loan, this is a credit enhancement and is secondary to the credit analysis.

As the Exposure points out, the primary difference between a CTL and these other rated lease-backed securities is the size of the balloon or residual payment. (Although the P&P Manual specifies that a “CTL” must have a residual payment no greater than 5% of the original principal balance, larger residual payments are permitted if insured by a third-party residual value insurance provider.) Lease-backed structures with larger uninsured residual payments were historically rated by CRP and submitted as Filing Exempt.

We agree that the accounting treatment of these “other rated lease-backed securities” needs to be clarified. Indeed, it has been the lack of a clear guidelines for these securities that led to confusion among investors and the mis-categorization of some investments as “CTLs”, and we, as a group, are committed to working with SAPWG, VOSTF and the SVO to clarify the proper regulatory and accounting treatment for these securities.

However, both “CTLs” as defined in the P&P Manual and other rated lease-backed securities, clearly meet the definition of a “bond” set forth in SSAP 26: “Bonds shall be defined as any securities representing a creditor relationship whereby there is a fixed schedule for one or more future payments.” They also have all the characteristics of a “security” as defined under US GAAP and adopted for SSAP 26.

The Exposure offers no explanation of why CTLs or other rated lease-backed securities should be relegated to Schedule BA under SSAP 21 as “Other Admitted Assets” and not reported as Schedule D bonds, since they clearly meet all definitions of both a “bond” and a “security” under SSAP 26.

The Exposure creates the impression that the inclusion of a large balloon payment as well as the presence of a mortgage on an asset as additional security for that payment means that these investments are not “bond-like” and should more properly be reported as Mortgages on Schedule B, or as “Other Admitted Assets” on Schedule BA.

However, just because a bond has a significant residual payment which is backed by an asset, does not mean it is not a “bond” or eligible to be reported on Schedule D. To argue otherwise ignores the estimated nearly \$1 trillion [Note: Non-agency CMBS outstanding balances alone as of 2Q 2020 equals \$592B based on SFIMA data.] in bonds with large balloons that are secured by real estate or other assets. These include CMBS – including billions of dollars of “single-asset/single-borrower (“SASB”) bonds, many with little-to-no amortization – as well as ABS, CRE CLOs and infrastructure bonds. All of these securities rely on ratings from CRPs.

To be consistent, this would require moving all securities with significant residual payments to Schedule BA – which would shut down large segments of the market and be disastrous for insurance company investors.

To single out “non-conforming” CTLs only as falling within the scope of SSAP 21: “Other Admitted Assets” appears to be inconsistent with the treatment of other bonds, and there is no clear explanation in the Exposure of the basis for making such a distinction for this asset class alone.

Moreover, Option 2 in the Exposure: moving even “conforming” CTLs to Schedule BA, is especially surprising considering that **CTLs consistently have THE best credit performance of any private-placement investment**, as documented by long-term studies conducted by the Society of Actuaries – (see attached **Addendum –2019 Study by the Society of Actuaries: Credit Loss Study of Private Placement Bonds – 2003-2015**):

- CTLs show both the lowest incidence of default (“Credit Risk Events”) and the lowest losses of any asset class.
- With annualized loss rates of 0.02% (2 basis points per annum), CTLs outperformed, *by far*, all other asset classes. Compared to project finance and equipment trusts, the out-performances are between 9 and 11x better. In other words: CTLs are not just “slightly better” performers, but as an asset class they have been clearly the safest schedule D private placement that the study examined.
- CTLs make up only 5.3% of the portfolios examined. This is critical to acknowledge because when considering that one of the smallest asset classes on the books has one of the best severities adjusted track records of any bond, the notion of fundamental change of accounting practice seems unnecessary.

We have no information on how many rated lease-backed securities were mistakenly filed as “CTLs,” but given that CTLs make up less than 6% of insurance company private placements, we surmise that the mis-filed transactions constitute a very small number. Moreover, there is no evidence that the mis-categorization of these securities was associated with any deterioration in credit as compared with “conforming CTLs” or led to any significant problems for insurers.

Finally and importantly, both CTLs as defined in the P&P Manual and these other rated lease-backed securities are used not just by commercial tenants, but are also a major financial resource used by municipal governments and the United States Federal Government and its agencies to fund major infrastructure improvements and large national security build-to-suit mission-critical facilities. (Examples include major projects for the Veteran’s Administration, the IRS, the CIA, the Office of the Director of National Intelligence, the National Nuclear Security Administration, and others too numerous to mention.)

Moving these securities to Schedule BA, as suggested in the Exposure, would freeze the market for these securities and severely limit not just the ability of insurers to access this valuable investment option, but the ability of many borrowers and space users— including the Federal Government and many local & State Governments – to access financing for major long-term infrastructure improvements. In fact, merely considering such a change will have a chilling effect on markets as investors wonder whether an investment will be classified as Schedule D or BA.

Schedule BA is widely considered by insurance company investors as “the Penalty Box”: the place to put investments that cannot find a home on any other schedule: affiliated transactions, private equity, hedge funds, etc. It is also the first place inspectors look for risky or “problem” assets. There is a definite stigma attached to BA assets, and many investment shops have strict requirements to invest in only “Schedule D” securities. Furthermore, Property and Casualty Insurers are prohibited from investing in Schedule BA assets.

If a separate category for these other lease-backed bonds needs be established, it could easily be accomplished within the scope of either SSAP 43R or 26R. These transactions, both CTLs as defined in the P&P Manual, and other rated lease-backed securities (referred to in the Exposure as “non-conforming CTLs”) are clearly bonds as defined under the SSAPs and should be reported on Schedule D.

Once again, we agree wholeheartedly with other Interested Parties that all these securities should be reported on Schedule D as bonds – whether within the scope of SSAP 26 or 43R – and not on any other Schedule.

Teachers Insurance and Annuity Association of America (TIAA) Comments:

Teachers Insurance and Annuity Association of America (“TIAA”) appreciates the opportunity to submit the enclosed comments pertaining to the July 30, 2020, staff exposure draft 2020-24 (“exposure draft”) to the Statutory Accounting Principles (E) Working Group (“Working Group”) seeking public comment on accounting of credit-tenant loans (“CTLs”) under SSAP No. 43R. Below, we provide our thoughts on the bond-like nature of CTLs and why we believe they belong on Schedule D. We hope that our comments will assist the NAIC as it considers accounting treatment of CTLs.

Credit Tenant Loans should be treated as bonds.

CTLs are currently recognized as bonds under SSAP 43R and the P&P Manual, and that recognition should continue. In the past, CTLs fell under SSAP 26, which states that “[b]onds shall be defined as any securities representing a creditor relationship whereby there is a fixed schedule for one or more future payments.” CTLs are single obligor debt securities with a fixed payment schedule enhanced by the creditworthiness of the tenant leasing the property. The primary distinguishing point is that there is a mortgage on the property as additional security for the loan. The inclusion of a mortgage within this structure does not diminish a CTL’s bond-like payment structure or its status as a security. The mortgage is a credit enhancement, providing additional security for the underlying debt and should not be the basis for treating CTLs as a mortgage or other asset type. There has been much discussion contrasting conforming and non-conforming CTLs. TIAA believes this is a false distinction distracting from the underlying point that CTLs function as bonds and should be classified as a form of bond. If other lease-backed securities are being mis-categorized, the appropriate remedy is to clarify the definition of CTLs as bonds and assign other non-CTL assets appropriately.

Credit Tenant Loans belong on Schedule D.

CTLs should continue to be reported on Schedule D. The exposure draft offers two proposals for revising the reporting treatment of CTLs:

- Option 1 would continue to report conforming CTLs on Schedule D while non-conforming CTLs would be reported on Schedule B as mortgages or Schedule BA as “Other Admitted Assets;” and
- Option 2 would relegate all CTLs to Schedule BA.

TIAA respectfully disagrees with both options. As explained above, TIAA believes that CTLs function exactly like bonds and thus are appropriately reported on Schedule D with bonds as has historically been the case. The exposure draft reports that some lease-backed securities have been misreported on Schedule D on the basis that they are CTLs. the appropriate remedy for the problem of misreported lease-backed securities is greater clarity regarding which securities are CTLs and which securities must be reported under some other category rather than relegating CTLs to either Schedule B or Schedule BA.

Transferring the reporting of CTLs from Schedule D to Schedule BA would result in market participants disfavoring CTLs as an asset class. Schedule BA is perceived within the marketplace as the catch-all schedule for novel, risky, or disfavored asset classes, such as hedge funds or private equity. In fact, many investors have strict policies prohibiting investments in Schedule BA assets; for example, property and casualty insurers are banned from investing in Schedule BA assets. This type of disfavored status is not appropriate for CTLs, which over decades have shined as an asset with both the lowest incidence of default and lowest losses of any asset class. CTLs consistently have the best credit performance among private placement investments. TIAA urges the Working Group against transferring CTLs off Schedule D as an inappropriate treatment of CTLs as an asset class.

Recommended Action:

In overall summary, NAIC staff recommends that the Working Group direct NAIC staff as follows:

- 1) **Direct NAIC staff to clarify the inclusion of “conforming” CTLs in scope of SSAP No. 43R (e.g., those on an SVO listing) with guidance that specifies the reporting of non-conforming CTLs on Schedule BA (unless the Working Group directs for mortgage loans). With this direction, the Working Group is recommended to expose proposed revisions that reflect the direction. (*Example language for both options are included in the attachment to assist with the discussion.*) The proposal for BA intends to allow for the ability to have improved RBC based on a credit-analysis even if the structural analysis for bond reporting is not met. If this direction is provided, NAIC staff recommends a referral response to the Valuation of Securities (E) Task Force to clarify that non-conforming CTLs that were reported on Schedule D-1 shall not be grandfathered for continued reporting on Schedule D-1. CTLs are permitted for Schedule D-1 if they comply with the requirements to be considered “conforming” per the P&P Manual requirements. (For example, if a residual value insurance policy is obtained to**

address residual risk, a prior non-conforming CTL could meet the conforming requirements. If this occurs, Schedule D-1 reporting would be permitted.)

- 2) Send a referral to the SVO and Capital Markets Group requesting comments on an appropriate residual risk percentage to assess whether it is appropriate to increase the 5% residual risk threshold as a restriction in determining whether a CTL is conforming. Furthermore, inquire whether other mechanisms, beyond a residual insurance policy, could be incorporated as a mitigating factor for CTLs that exceed the residual risk threshold. (With this referral, NAIC staff recommends that the SVO provide information on how many CTLs exceed the residual risk requirements but are considered as “conforming” due to mitigating factors such as a residual insurance policy.)

Staff Note: Additional discussion of CTLs can occur as part of SSAP No. 43R project.

With this recommendation, CTLs that meet specified criteria (structural analysis) will be captured on an SVO listing and in scope of SSAP No. 43R. It is proposed that the CTLs that do not meet the specified criteria be captured in Schedule BA. If this approach is used, then the CTLs that do not meet the structural analysis for inclusion on the SVO listing and Schedule D-1 could still be submitted to the SVO for a credit assessment and an NAIC designation. This would permit those non-conforming investments to obtain improved RBC than if reported as a mortgage loan on Schedule B. (NAIC staff notes that reporting on BA has been communicated as a concern from investment managers as investment contracts require “Schedule D” investments and if reported on Schedule BA, the investment managers would not be able to acquire those investments on behalf of insurers.)

NAIC staff provides the following additional discussion points in response to the comment letters received:

- Although the comment letters indicate that in the Form A NAIC staff has advocated moving conforming CTLs to Schedule BA, this is not an accurate representation. The Form A only presented two options to consider in reporting CTLs. **The first option in the agenda item proposed to retain historical treatment, with conforming CTLs reported on Schedule D, in scope of SSAP No. 43R with clarity for the reporting of non-conforming CTLs.** The second option (to move all CTLs to BA), was proposed as it was industry reps noted to NAIC staff that the incorrect reporting of non-conforming CTLs was driven by the structural requirements to determine conforming CTLs as well as punitive RBC, if reporting as a mortgage loan on B. As such, the BA option would have eliminated the “structural analysis requirement” and permitted improved RBC (similar to bonds) for any life insurer with CTLs that were filed to the SVO and received a credit assessment NAIC designation.
- The comment letters indicate that **conforming** CTLs is a well-performing asset class with a low-level of default. **NAIC staff does not disagree with these statements and believes this is likely attributable to the structural components, including a low (5%) residual risk permitted to be considered a conforming CTL.** It is noted that even if a CTL has a greater than 5% residual risk, the structure only needs to have a “residual insurance contract” and the CTL can still qualify as a conforming CTL.
- The comment letters indicate that non-conforming CTLs should be considered “other lease-backed securities” (and not CTLs). These comments indicate that under the broad bond definition (securities representing a creditor relationship whereby there is a fixed schedule for one or more future payments), these instruments shall be reported in scope of SSAP No. 26R and reported on Schedule D-1 regardless of the structural analysis / residual risk component. NAIC staff does not agree with this statement. **Fundamentally, CTLs are defined as mortgage loans.** This is explicit in both the NAIC Investments of Insurers Model Law (#280) as the P&P Manual. **NAIC staff highlights that if all non-conforming CTLs are reported on Schedule D-1 (either in SSAP No. 26R or SSAP No. 43R), then NAIC staff speculates that it would be unnecessary to file any CTL for a structural analysis to determine if it is a conforming CTL, as it would not matter for ultimate accounting, reporting or RBC.** If non-conforming CTLs are going to be considered “bonds,” NAIC staff notes that changes to the NAIC Model Law may be required:

- S. “Credit tenant loan” means a mortgage loan which is made primarily in reliance on the credit standing of a major tenant, structured with an assignment of the rental payments to the lender with real estate pledged as collateral in the form of a first lien.
- NAIC staff notes that the “residual risk” percentage of 5% is a regulatory decision that dates back to 1994 from the Invested Asset Working Group. However, NAIC staff also notes that the CTLs that are being misreported are not slightly over this 5% threshold. **Instead, these CTLs are significantly over the threshold, with some possessing 100% and greater than 100% residual asset risk.** (For 100% residual risk, this means that none of the principal balance is being paid over the course of the lease. For those situations that are greater than 100%, it seems that both principal and some of the contractual interest are not satisfied over the course of the lease.) **Although NAIC staff agrees that it may be time to revisit the 5% residual risk requirement, NAIC staff believes that assessment is separate from the accounting and reporting clarification of CTLs that “conform” and those that “do not conform” to requirements.**
 - NAIC staff has also noted that the comments supporting inclusion for non-conforming on Schedule D-1 provides a linkage of CTLs with balloon payments to CMBS with balloon payments. To address this comment, NAIC staff received the following information from the Capital Markets Bureau:

There is a significant difference in credit approach:

- CMBS is underwritten based on the property and its ability to generate revenue during the mortgage period AND its ability to refinance during the balloon. The latter is done by modeling in-place revenues and property values at balloon. If there is expected turnover in tenants, then this too is modeled with appropriate haircuts.
- CTL is based solely on the credit of the credit tenant. This is a “shortcut” to the traditional CRE analysis and assumes that the credit tenant covers all uncertainties of the above.
- Lastly, NAIC staff has reviewed a listing of known non-conforming CTLs received from the SVO. Although this may not be a complete listing, there are only a few insurance companies that hold more than a couple of these investments, and/or reflect a more than insignificant portion of surplus. For the non-conforming CTLs that were rejected based on the balloon payment, NAIC staff highlights that the balloon was significantly higher than the existing 5% threshold.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2020-30 SSAP Nos 53, 54R, & 66 (Robin)	Premium Refunds and Other Adjustments	14 – Agenda Item	Comments Received	IP – 14 APCIA - 49

Summary:

On July 30, the Working Group exposed this agenda item, seeking industry feedback on the proposal to provide more explicit guidance on return of premium and other premium adjustments. The discussion during the exposures of *INT 20-08: COVID-19 Premium Refunds, Rate Reductions and Policyholder Dividends*, highlighted the need for more explicit guidance regarding policyholder refunds and other premium adjustments for accident and health and property and casualty lines of business. The premium adjustments addressed will also address newer policy form types such as data telematics policies

SSAP No. 53—*Property and Casualty Contracts – Premiums* provides guidance for premium adjustments due to changes to the level of exposure based on insurance risk. SSAP No. 66—*Retrospectively Rated Contracts* provides guidance for loss sensitive products. Some property and casualty products, which are commonly referred to as data telematics policies, provide premium adjustments for other reasons than what is articulated in the current guidance. One example of a data telematics policy would be the use of an automobile plug-in to determine driving habits of the insured for purposes of policy pricing. As such there is a need to provide principles-based guidance for these types of policies.

Interested Parties' Comments:

Interested parties offer the following comments:

We agree that the proposed guidance should treat discretionary returns of premium as a reduction of premium, consistent with the conclusion reached in Issue 1 of INT 20-08: COVID-19 Premium Refunds, Limited-Time Exception, Rate Reductions and Policyholder Dividends (paragraphs 8 through 11). There is a difference, however, between contracts that contain loss-sensitive terms and guaranteed cost contracts that become subject to a discretionary return of premium by the insurer. For loss-sensitive contracts, the adjustment to premium is based on loss experience in a prior period and is estimated each period with a true-up recorded in the current period. For guaranteed-cost contracts where the insurer gives policyholders a discretionary refund of premium or credit for future premium periods, the adjustment should be recognized in the period in which the refund or credit is applicable. For example, a premium refund or credit for previous months should be recognized as a true-up in the current period (similar to a loss sensitive contract); however, a premium refund or credit applicable to future periods should be recognized in earned premium in those future periods.

Specifically, with regard to health insurance, the SSAPs could be made clearer through some examples as illustrated below as an addition to paragraph 4 of SSAP No. 54R. While many examples can be cited, these are just a few to illustrate how examples in the SSAPs can enhance more uniform understanding of the principles involved. Interested parties would be glad to work with SAPWG and NAIC staff in developing a set of examples that is brief, appropriate, and illustrative in achieving that objective.

Suggested revisions to Paragraph 4 of SSAP No. 54R are highlighted in grey below.

4. _____ Premium income shall be reduced for premiums returned and for allowances to industrial policyholders for the direct payment of premiums. For example:

a. For refunds or reductions in premiums under the terms of the policyholder or group contract refer to:

1. Contracts Subject to Redetermination – Paragraphs 27-32 below
2. Retrospectively Rated Contracts - SSAP No. 66

b. For voluntary refunds or reductions in premiums that are not specified by the terms of the policyholder or group contract, the timing of the recognition of the payment (or credit to gross billed premiums) is based on when the corresponding gross premium is or has been earned. To illustrate (not intended to be an exhaustive list):

1. For premium reductions pertaining to previous or expired periods of coverage, the full amount of the reduction is recognized immediately.
2. For premium reductions that relate to the current month's coverage, the reduction is recognized in the current month.
3. For reductions that relate to subsequent months' coverage, the reduction will be recognized in the month to which it pertains so as to match the recognition of the reduction with that of the gross premium and coverage period to which it pertains.

2. Interested parties are not aware of products that have premium adjustments for reason that are not covered by existing guidance in the SSAPs.

With regard to health insurance, to the extent such situations exist (e.g., regarding some wellness programs), they are adequately covered by the text in SSAP Nos. 54R and 66 pertaining to adjustments to premiums under the terms of the policyholder or group contract, and/or are clearly immaterial.

3. Consistent with the conclusion reached in Issue 4 of INT 20-08, a dividend that is issued on participating policies or issued by non-stock companies such as mutual entities or other corporate entity types in which profits are shared with policyholders should be accounted for as a dividend rather than a return of premium. We are not aware of other situations where such payments or credits are being applied other than as premium adjustments.

American Property Casualty Insurance Association (APCIA) Comments:

APCIA supports the recommended changes to statutory accounting exposed in Ref. #2020-30, which provides that payments to policyholders (regardless of whether the payments are voluntary or contractually required) must be reported as adjustments to premiums. We agree with the observation in the proposal that the discussion during the exposures of *INT 20-08: COVID-19 Premium Refunds, Rate Reductions and Policyholder Dividends* highlighted the need for more explicit guidance regarding policyholder refunds and other premium adjustments. Although APCIA supported the basic position taken in the INT, we also requested a limited exception for companies that, prior to adoption of the INT, already filed and disclosed to regulators their intention to report voluntary payments to policyholders as a result of COVID-19 as “other underwriting expenses”. The intent of this limited, one-time exception was to preserve the basic position taken by the Working Group, while recognizing that insurers taking the expense approach acted in good faith to take the steps they felt were necessary to expedite payments to policyholders under unprecedented circumstances. These concerns were addressed through INT 20-08, but permanent statutory accounting guidance is needed to address future situations where policyholder relief may be a suitable reaction to a future event. Therefore, APCIA is pleased that the Working Group has taken up this project, and we support the changes to statutory accounting recommended in Ref. #2020-30. Furthermore, APCIA also supports the clarifying comments with respect to this exposure provided in the industry interested parties’ letter.

Recommended Action:

NAIC staff recommends the Working Group direct NAIC staff to draft revisions for future Working Group review. NAIC staff should consult with interested parties as needed.

The recommendations from industry are consistent with the overall guidance in *INT 20-08: COVID-19 Premium Refunds, Limited-Time Exception, Rate Reductions and Policyholder Dividends* (without the limited exception). The interested parties have noted that providing examples regarding timing of the recognition for adjustments would be helpful. APCIA has noted support for the letter submitted by interested parties and a willingness to assist with drafting. Interested parties have recommended that cross references and illustrations be added to *SSAP No. 54R—Individual and Group Accident and Health Contracts*. NAIC staff appreciates the health revisions submitted by industry but would like to further review, prior to exposure.

REVIEW of PREVIOUSLY ADOPTED INTERPRETATIONS for POSSIBLE EXTENSION

The Working Group indicated that during the Summer National Meeting, that interpretations adopted in response to COVID-19 would be evaluated for possible extension. The INTS have been grouped for discussion based on current effective date.

The following INTs were effective through 3rd quarter, 2020:

1. INT 20-02: Extension of the Ninety-Day Rule for the Impact of COVID-19
2. INT 20-04: Mortgage Loan Impairment Assessment Due to COVID-19
3. INT 20-05: Investment Income Due and Accrued

The following INTs are effective for the 60-days following the termination of the National Emergency, or Dec. 31, 2020, whichever occurs first:

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

Ref #	Title	Attachment #	Current Effective Date
INT 20-02 INT 20-04 INT 20-05 (Julie)	Interpretations in Response to COVID-19 Expiring 3rd Quarter 2020	15-17	Effective through 3 rd Quarter Expires September 29, 2020

Summary:

In April and May 2020, the Working Group adopted a number of interpretations in response to COVID-19 effective through 2nd quarter 2020. These were extended to the 3rd quarter during the Summer National Meeting:

1. *INT 20-02: Extension of the Ninety-Day Rule for the Impact of COVID-19:* This interpretation provides a one-time optional extension of the ninety-day rule of uncollected balances for: 1) premiums receivables from policyholders or agents per *SSAP No. 6—Uncollected Premium Balances, Bills Receivable for Premiums, and Amounts Due From Agents and Brokers*, 2) uncollected uninsured plan receivables (excluding Medicare and similar government plans) per *SSAP No. 47—Uninsured Plans*, 3) life premium due and uncollected per *SSAP No. 51—Life Contracts*, and 4) high deductible policies per *SSAP No. 65—Property and Casualty Contracts*. The exception to the ninety-day rule only apply for policies which were in effect and current prior to the date as of the declaration of a state of emergency by the U.S. federal government (March 13, 2020) and policies written or renewed on or after March 13.
2. *INT 20-04: Mortgage Loan Impairment Assessment Due to COVID-19:* This interpretation provides a temporary, limited-time statutory exception for the assessment of impairment for bank loans, mortgage loans and investment products with underlying mortgage loans. This exception only defers the assessment of impairment due to situations caused by the forbearance or modification of mortgage loan payments and does not delay the recognition of other than temporary impairments if the entity made a decision to sell the investment and/or if provisions other than the limited-time forbearance or modifications of mortgage loans payments caused the entity to identify that they would not recover the reported carrying value of the investment.
3. *INT 20-05: Investment Income Due and Accrued:* This interpretation provides a limited-time collectability assessments and admittance exceptions for *SSAP No. 34—Investment Income Due and Accrued*. Under the interpretation: 1) The INT would continue with existing guidance for the recognition of investment income. 2) The INT would continue with requirements to assess collectability of investment income, with a presumption that mortgage loans, bank loans and investment products with underlying mortgage loans impacted by forbearance or modifications that were current as of Dec. 31, 2019 were not experiencing

financial difficulties at the time of the modification. For these items, further evaluation of collectability would not be required for the 1st and 2nd quarter financial statements unless other indicators that interest would not be collected are known (e.g., entity has filed bankruptcy). 3) The INT provides an exception for the nonadmittance of recorded investment income due and accrued deemed collectible and over 90-days past due. With the exception, reported investment income that becomes over 90-days past due in the 1st or 2nd quarter may continue to be admitted in the 2nd quarter financial statements.

Recommended Action:

Pursuant to informal regulator comments previously received, NAIC staff is uncertain whether there is regulator support for further extensions on these interpretations. Particularly, NAIC staff thinks there is hesitation in a potential continued deferral of impairment recognition. NAIC staff recommends that the Working Group provide comments on whether a further extension should be considered. If there is support for a potential extension for any of the INTs, then NAIC staff recommends an exposure for a shortened comment period ending Dec. 4, 2020.

If supported and exposed by the Working Group, similar to what occurred for the previous extensions of the interpretations it is suggested that unless comments noting concern with the extensions are raised during the exposure period, that the Working Group proceed with adopting the revised INTs, with extensions to 4th quarter, via an email vote.

If this extension is adopted by the Working Group, the INTs will be updated to reflect that they are applicable to the December 31, 2020 financial statements. Furthermore, the interpretations will be updated to note that they will expire automatically on March 30, 2021 (and not effective for Q1 2021 reporting). If directed by the Working Group, continued reference of subsequent review for possible extension (during the 2021 Spring NM) will be reflected in the interpretations.

Ref #	Title	Attachment #	Current Effective Date
INT 20-03 INT 20-07 (Julie)	Interpretations in Response to COVID-19 Expiring 60 Days after Termination of the National Emergency of Dec. 31, 2020	18-19	Effective for 60-Days After the National Emergency Terminates or Dec. 31, 2020 – Whichever Occurs First

Summary:

In April and May 2020, the Working Group adopted a number of interpretations in response to COVID-19 with effective dates consistent with the CARES Act. Pursuant to the CARES Act, the interpretations will only be applicable for the period beginning on March 1, 2020 and ending on the earlier of December 31, 2020, or the date that is 60 days after the date on which the national emergency concerning the novel coronavirus disease (COVID–19) outbreak declared by the President on March 13, 2020 under the National Emergencies Act (50 U.S.C. 1601 et seq.) terminates.

1. *INT 20-03: Troubled Debt Restructuring Due to COVID-19:* The Working Group reached a consensus to clarify that a modification of mortgage loan or bank loan terms in response to COVID-19 shall follow the provisions detailed in the April 7, 2020 “Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus” (detailed in paragraph 8) and the provisions of the CARES Act (detailed in paragraph 7) in determining whether the modification shall be reported as a troubled debt restructuring within SSAP No. 36.
2. *INT 20-07: Troubled Debt Restructuring of Certain Investments Due to COVID-19:* This interpretation provides limited-time practical expedients in determining whether a modification under *SSAP No. 36—Troubled Debt Restructuring* are insignificant, and therefore is not a concession. If a modification is not a concession, recognition of the modification as a troubled debt restructuring is not required. For a practical

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expedients, it was determined that if a restructuring 1) results with a change that reflects a 10% or less shortfall amount in the contractual amount due, and 2) results in an extension of the maturity of the debt by no more than three years, the modification shall be considered insignificant and thus not requiring troubled debt accounting. Additionally, the interpretation clarified that restructurings that solely modify debt covenants are not considered troubled debt restructurings.

Recommended Action:

As the National Emergency has not yet been terminated, these INTs are still in effect and will be effective through the 4th quarter. As such, NAIC staff does not believe extension consideration is needed at this time.

The comment letters are included in Attachment 20 (59 pages).

Note: Agenda Item 2019-24: Levelized and Persistency Commissions is planned for discussion during this meeting. Due to the timing of comments received and the posting of these materials, a separate hearing agenda solely referencing 2019-24 will be subsequently posted.

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**Statutory Accounting Principles (E) Working Group
Meeting Agenda
November 12, 2020**

A. Consideration of Maintenance Agenda – Pending List

1. Ref #2020-32: SSAP No. 26R - Disclosure Update
2. Ref #2020-33: SSAP No. 32R – Publicly Traded Preferred Stock Warrants
3. Ref #2020-34: SSAP No. 43R - GSE CRT Program
4. Ref #2020-35: SSAP No. 97 - Audit Opinions
5. Ref #2020-36: Derivatives Hedging Fixed Indexed Products
6. Ref #2020-37: Separate Account Product Mix
7. Ref #2020-38: Pension Risk Transfer Disclosure
8. Ref #2020-39: Interpretation Policy Statement
9. Ref #2020-40: Prescribed Practices
10. Ref #2020-41: *ASU 2020-06, Convertible Instruments*
11. Ref #2020-42: *ASU 2020-07, Presentation and Disclosures by Not-for-Profit Entities*

Ref #	Title	Attachment #
2020-32 SSAP No. 26R (Jim)	SSAP No. 26R – Disclosure Update	A

Summary:

During the Summer National Meeting, through agenda item #2020-02: Accounting for Bond Tender Offers, the Working Group clarified that the accounting and reporting of bond investment income and capital gains/losses, due to early liquidation either through a call or a tender offer shall be similarly applied. Accordingly, this agenda item proposes to expand the existing called bond disclosures to include bonds which were early terminated through a tender offer.

Recommendation:

NAIC staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to the disclosures in SSAP No. 26R—Bonds. The revisions expand the called bond disclosures to also include bonds which are terminated early through a tender offer.

Ref #	Title	Attachment #
2020-33 SSAP No. 32R (Jim)	SSAP No. 32R – Publicly Traded Preferred Stock Warrants	B

Summary:

Stock warrants generally fall into scope of SSAP No. 86—*Derivatives*, although publicly traded common stock warrants are scoped into SSAP No. 30R—*Unaffiliated Common Stock*. Due to the only difference between publicly traded common and preferred stock warrants is the type of stock an entity would receive (i.e. common or preferred stock), this agenda item proposes a similar carveout and accounting/reporting treatment for publicly traded preferred stock warrants. This agenda item proposes 1) to expand the scope of SSAP No. 32R—*Preferred Stock* to include publicly traded preferred stock warrants and 2) require publicly traded preferred stock warrants to be reported at fair value. Revisions are also proposed to SSAP No. 86—*Derivatives* to identify this treatment.

Recommendation:

NAIC staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to SSAP No. 32R—*Preferred Stock* and SSAP No. 86—*Derivatives*, to scope publicly traded preferred stock warrants into SSAP No. 32R. The proposed revisions would require the publicly traded preferred stock warrants to be reported at fair value.

Ref #	Title	Attachment #
Ref #2020-34 SSAP No. 43R (Jim)	SSAP No. 43R – GSE CRT Program	C

Summary:

During the 2019 Spring National Meeting, the Working Group adopted agenda item 2018-18: Structured Notes, which expanded the scope of SSAP No. 43R—*Loan-Backed and Structures Securities* to include certain Government-Sponsored Enterprises (GSE) – Credit Risk Transfer (CRT) Transactions.

This agenda item has been drafted to reflect recent changes to the Freddie Mac Structured Agency Credit Risk (STACR) and Fannie Mae Connecticut Avenue Securities (CAS) programs as it is anticipated that future Freddie Mac STACR and Fannie Mae CAS issuances will be solely conducted through a Real Estate Mortgage Investment Conduit (REMIC) trust. The REMIC trust remains functionally equivalent and retains the same material risk structure as the original STACR and CAS programs. Additionally, investment in securities issued by a GSE REMIC trust remains within the review scope of the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual). Per part 4 of the P&P Manual, Mortgage Referenced Securities are not eligible for filing exemption and are subject to assessment by the Structures Securities Group.

This agenda item proposes to 1) include STACR and CAS REMIC's into the scope of SSAP No. 43R and, 2) align SSAP No. 43R guidance regarding the financial modeling of mortgage referenced securities to the requirements as directed in the P&P Manual.

Recommendation:

NAIC staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to SSAP No. 43R—*Loan-Backed and Structures Securities*, incorporating minor scope modifications to reflect recent changes to the STACR and CAS programs. The proposed edits would allow credit risk transfer securities from Freddie Mac and Fannie Mae to remain in scope when a REMIC structure is used in the STACR program or CAS program.

Ref #	Title	Attachment #
Ref #2020-35 SSAP No. 97 (Jim)	SSAP No. 97 – Audit Opinions	D

Summary:

SSAP No. 97—*Investments in Subsidiary, Controlled and Affiliated Entities* provides guidance for admissibility in certain circumstances where an SCA investment does not receive an unqualified audit opinion. In short, if the U.S. GAAP audit opinion is qualified or adverse the investment can only be admitted if the departure is quantified (then the departure is nonadmitted), or if the departure is as the result of utilizing a statutory accounting principle in lieu of following U.S. GAAP (in such cases, a quantification of the departure is not required).

The allowance of qualified or adverse audit opinions for admission of SCA investments without quantification are only permitted for U.S. insurance entities (commonly referred to as an 8.b.i entity). This agenda item proposes to expand the quantification exception guidance to 8.b.iii entities (referred to as U.S. GAAP SCA entities) in limited situations. Particularly, the proposed exception would allow U.S. GAAP SCA entities that depart from a U.S. GAAP provision that has been rejected for statutory accounting to be admitted SCAs without quantification if the departure from U.S. GAAP results in a more conservative position (i.e. fewer assets or greater liabilities), as a result of the departure.

Although specific quantification is not needed, this would require auditor certification that the departure from U.S. GAAP results in a more conservative position. From a situation shared in which an 8.b.iii SCA (U.S. GAAP entity) was following provisions similar to the insurer with regards to revenue recognition, the auditor noted that the U.S. GAAP revenue recognition provisions (which requires consideration of future, expected activity) warranted a qualified opinion. Under the existing guidance, this qualified opinion results in nonadmittance of the SCA because it could not be quantified, which was material to the reporting entity. This nonadmittance treatment was noted to be punitive as the SCA was following processes that were consistent with SAP accounting that resulted in a more conservative financial statement representation of the SCA.

Recommendation:

NAIC staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and request comments on the extent to which situations exist that hinder admittance of 8.b.iii entities due to the departure of U.S. GAAP as a result of the inability to quantify the departure.

Ref #	Title	Attachment #
Ref #2020-36 SSAP No. 86 SSAP No. 108 (Julie)	Derivatives for Hedging Fixed Indexed Products	E

Summary:

This agenda item proposes the development of new guidance for the accounting and reporting of derivatives that effectively hedge the growth in interest credited for fixed indexed products - for example, fixed indexed annuity (FIA) and indexed universal life (IUL), reported in the general account. (NAIC staff is also investigating the classification of structured / registered indexed linked annuities (RILA) in the separate account, and the use of derivatives in the separate account to hedge risk related to these products. This assessment will be completed within a separate agenda item.) This agenda item is proposed to be substantive, with potential development of a new SSAP.

Accounting / Reporting Issue

It has been identified that there is a mismatch of accounting provisions when derivatives are used to hedge the growth in interest credited to reserves (liability). Although the derivative may be an effective hedge to the interest credited for the performance of a referenced index, under the provisions of SSAP No. 86, the derivative does not qualify for hedge accounting. As such, the derivative is reported at fair value, with fair value changes recognized as unrealized gains or losses through surplus. With this reporting, the results of the effective hedge do not directly offset the change in reserve recognized in the summary of operations during the hedging period. The ultimate impact is the effective hedge is not illustrated in the company's performance results within the financial statements, and the current reporting creates a presentation of additional surplus volatility from the use of derivatives, although they are effectively hedging the growth in interest that will be credited to the policy as a direct result of related indices.

Although specialized guidance was developed in SSAP No. 108 to address derivatives hedging variable annuity guarantees, the guidance in SSAP No. 108 cannot be easily adapted to incorporate derivatives hedging the growth in interest credited to FIA/IUL reserves. This is primarily because the fundamental hedging provisions in SSAP

No. 108 utilize a fair value hedging approach. Under that approach, the fair value change of the hedging instruments is compared to the fair value change of the variable annuity reserves to determine effectiveness. However, for derivatives hedging the growth in interest credited for FIA/IUL reserves, determination of effectiveness is driven by a cash flow hedge assessment. Meaning, that the hedging derivative will produce cash flows that will offset the indexed-based interest crediting rate in the hedged reserves.

Although the programs may vary significantly by company, it is anticipated that the following elements may be present in these derivative arrangements:

- Designation of many hedged items that reflect bundles of FIA/IUL contracts with similar terms/crediting dates hedged with a single derivative (or portfolio of derivatives) to exactly mirror the terms of the crediting rate, resulting with the intent of a perfect hedge. (It is anticipated that a reporting entity would have many outstanding derivative structures to cover various bundles of contracts.)
- Continuous assessment of hedge, noting deviations between the intended perfect match due to changes in the portfolio of hedged items (e.g., policy lapses) or slight issues with execution (e.g., timing delay in derivative acquisition) or maturity dates (e.g., 360 instead of 365 days).
- Incorporation of additional derivatives (macro/dynamic) as needed to overlay the entire structure to address deviations in the intended match and ensure effective coverage of risk of the index crediting rate.

Proposed Concepts to Address Reporting Mismatch:

(Additional detail and concepts to consider for each approach are in the agenda item.)

This agenda item proposes to incorporate new statutory accounting guidance to establish accounting and reporting concepts that properly represent the use of effective hedges for indexed products in the general account. From an initial assessment, it appears that there are two potential approaches to consider:

1. Approach 1: Establish guidance that permits effective hedge treatment that is in line with SSAP No. 86. With this approach, the derivative would be reported at amortized cost, with direction that the fair value changes in the hedging derivative (at settlement) would be recognized to net investment income (or realized gains and losses) to offset the recognized change in FIA/IUL reserve. With this approach, the derivatives would change the SAP measurement method (from fair value to amortized cost) and result with a disconnect from U.S. GAAP in the derivative reported value as all derivatives are required to be reported at fair value under U.S. GAAP. This approach would not reflect changes in the derivative position (e.g., if in a loss or gain position) in the financials, so the actual assets / liabilities from derivative activity would not be shown on the balance sheet. However, this approach would eliminate artificial volatility in derivative fair value changes through surplus while the derivative is open.
2. Approach 2: Establish guidance that permits effective hedge treatment that is in line with SSAP No. 108. With this approach, the derivative would be reported at fair value, with direction that the change in fair value is bifurcated for reporting based on whether the change is an effective hedge to the interest crediting rate change in the hedged FIA/IUL reserve. This approach would be more in line with U.S. GAAP with the use of fair value for the reported value of derivatives and would be designed to recognize the derivative and reserve change at the same time through the income statement. This approach would require assessment as to any fair value fluctuation that does not offset the crediting rate and require separate reporting guidance for those changes.

Recommendation:

NAIC Staff recommends that the Working Group move this item to the active listing, initially categorized as substantive and expose the agenda item to solicit comment from state insurance regulators and industry on establishing accounting and reporting guidance for derivatives hedging the growth in interest for fixed indexed annuity products. In addition to the two general options presented in the agenda item, NAIC staff is open for additional commentary and suggestions, and requests to work with industry throughout the

process similar to the collaborative efforts that occurred when developing the guidance in SSAP No. 108. With this exposure, NAIC staff recommends notification to the Life Actuarial (E) Task Force.

Pursuant to preliminary information received, NAIC staff has an initial impression that pursuing an approach similar to SSAP No. 108 (use of fair value with deferred assets/liabilities as a mechanism to timely match effective hedge changes through the summary of operations) may be more beneficial to both industry and regulators with improved reporting in the financial statements. This is because the focus of the SAP changes will be on derivative measurement and recognition and will not encompass changing reserve calculations (or the timing of reserve impacts). NAIC staff plans to proceed with starting an issue paper during the exposure period (as time allows). As such, initial informal comments and aspects to consider are requested throughout the exposure period.

Ref #	Title	Attachment #
Ref #2020-37 SSAP No. 56 (Jim)	Separate Account Product Mix	F

Summary:

This agenda item proposes increased product identifier reporting granularity in question 1.01 (product mix) of the separate account general interrogatories (GI 1.01). At the request of regulators, primarily in response to the recent growth of pension risk transfer (PRT) transactions and registered indexed linked annuity (RILA) products that are generally held in insulated separate accounts, improved reporting was requested so regulators can more readily identify and review the products captured in the separate account. Additionally, it was found that most entities grouped their separate account products in 3-4 broad categories. Due to this aggregate grouping, regulators have expressed difficulty in assessing risk with each associated product. This agenda item does not anticipate modifications to *SSAP No. 56—Separate Accounts*, however if supported by the Working Group, would likely result in a proposal to the Blanks (E) Working Group for annual statement instruction modifications.

Recommendation:

NAIC staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose the agenda item to solicit comments from state insurance regulators and industry regarding the degree of product identifying details needed to adequately assess the product features and reserve liabilities. Additionally, feedback is requested regarding if a threshold should be established for when aggregate reporting would be permitted.

Ref #	Title	Attachment #
Ref #2020-38 SSAP No. 56 (Jim)	Pension Risk Transfer Disclosure	G

Summary:

This agenda item proposes increased product identification and disclosure of pension risk transfer (PRT) transactions in the separate account financial statements. At the request of regulators, in response to the recent growth of PRT, improved reporting is sought so regulators can more readily identify and analyze such transactions. Regulators requested several enhancements, including separated PRT reporting and improved PRT disclosure regarding reserves, associated assets, and general account exposure.

Currently, the most specific details concerning PRT transactions are generally captured/disclosed in question 1.01 (product mix) of the separate account general interrogatories (GI 1.01). While other details of the broadly categorized products are captured in various other general interrogatories this agenda item, at the request of

regulators, proposes enhanced detailed reporting requirements for pension risk transfer products and transactions in the scope of *SSAP No. 56—Separate Accounts*.

Recommendation:

NAIC staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive to solicit comments from state insurance regulators and industry regarding possible modifications to *SSAP No. 56—Separate Accounts*. Depending upon the feedback received, the Working Group would have several options available including, but not limited to, requiring the separate identification of pension risk transfer products (including transactions, guarantees, reserve assumptions, etc.) within existing disclosure requirements or the addition of a new general interrogatory (and perhaps new separate accounting reporting schedules / exhibits) to separate specific product detail that was previously reported in an aggregated format. NAIC staff is open for additional commentary and suggestions, and requests to work with industry and regulators throughout this and any subsequent exposure.

Ref #	Title	Attachment #
Ref #2020-39 Appendix F (Jim)	Interpretation Policy Statement	H

Summary:

To date, the Working Group has issued a total of nine accounting interpretations for 2020. Throughout this process, it was identified that the *NAIC Policy Statement on Maintenance of Statutory Accounting Principles* in Appendix F regarding the issuance and adoption of accounting interpretations would benefit from clarification edits. This agenda item proposes revisions regarding the voting requirements for when an interpretation issued by the Working Group can be overturned, amended, or deferred by the Accounting Practice and Procedures (E) Task Force. Additionally, explanatory language has been added to clarify that in certain circumstances, the Working Group may elect to postpone the effective date until the item has been discussed by the Task Force and the Financial Condition (E) Committee and both have had an opportunity to review the interpretation

Recommendation:

NAIC staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose clarifying revisions to *NAIC Policy Statement on Maintenance of Statutory Accounting Principles* in Appendix F regarding the issuance and adoption of accounting interpretations. These revisions document the adoption and review process of interpretations of statutory accounting principles.

Ref #	Title	Attachment #
Ref #2020-40 Preamble (Julie)	Prescribed Practices	I

Summary:

This agenda item intends to clarify the definition and application of prescribed practices. This issue has been presented in response to questions received on existing references in the *NAIC Accounting Practices & Procedures Manual* (AP&P).

In summary, each state insurance department has the authority to regulate any insurance company that is licensed in their state. Accordingly, the financial statements filed with the NAIC and subject to independent audit, pursuant

to *Model Law 205: Annual Financial Reporting Model Regulation* shall be in accordance with practices prescribed or permitted by the domiciliary state.

However, a non-domiciliary state in which the company is licensed may require or allow different accounting practices in the financial statements filed in that state. Ideally, to prevent reporting entities from having to file different financial statements or reports with differing states, the practices permitted or prescribed by a domiciliary state will be accepted in all states in which a company is licensed (however, each state in which a company is licensed could allow or require differing financial reports). If a non-domiciliary state in which the company is licensed requires or allows a practice by state statute / bulletin (or other state-wide provision) that is different from NAIC SAP, this provision would also be considered a prescribed practice. If the company files financial statements that reflect this practice, even if the financial statements are filed only in the non-domiciliary state, then the prescribed practice disclosure of Note 1 shall apply.

Recommendation:

NAIC staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive, and expose proposed revisions to the Preamble Implementation Questions and Answers to clarify prescribed practices. These revisions clarify that while any state in which a company is licensed can issue prescribed practices, the prescribed practices directed by the domiciliary state shall be reflected in the financial statements filed with the NAIC and are the financial statements subject to the independent auditor requirements.

Ref #	Title	Attachment #
Ref #2020-41 SSAP No. 43R (Jake)	<i>ASU 2020-06: Convertible Instruments</i>	J

Summary:

ASU 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 intends to address issues identified as a result of the complexity associated with applying U.S. generally accepted accounting principles (U.S. GAAP) for certain financial instruments with characteristics of liabilities and equity.

Under U.S. GAAP, there are five accounting models for convertible debt instruments. Except for the traditional convertible debt model that recognizes a convertible debt instrument as a single debt instrument, the other four models, with their different measurement guidance, require that a convertible debt instrument be separated (using different separation approaches) into a debt component and an equity or a derivative component. The use of such models is not a practice recognized by statutory accounting.

Additional amendments relate to the derivatives scope exception for contracts in an entity’s own equity change the population of contracts that are recognized as assets or liabilities. For a freestanding instrument, if the instrument qualifies for the derivatives scope exception under the amendment, an entity should record the instrument as equity. For an embedded feature, if the feature qualifies for the derivatives scope exception under the amendment, an entity should no longer bifurcate the feature and account for it separately. The Working Group has previously addressed liability vs. equity issues and the bifurcating of derivatives is not permitted under *SSAP No. 86—Derivatives*.

Recommendation:

NAIC staff recommends the Working Group move this item to the active listing, categorized as nonsubstantive, and expose revisions to SSAP No. 5R, SSAP No. 72 and SSAP No. 86 to reject *ASU 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 for statutory accounting as this update primarily addresses various convertible debt valuation models (a concept not employed by statutory accounting) as well as require bifurcating embedded derivative components (a concept not permitted under statutory accounting).

Ref #	Title	Attachment #
Ref #2020-42 Appendix D (Jake)	ASU 2020-07: <i>Presentation and Disclosures by Not-for-Profit Entities</i>	K

Summary:

ASU 2020-07, *Not-for-Profit Entities (Topic 958), Presentation and Disclosures by Not-for-Profit Entities for Contributed Nonfinancial Assets* intends to improve U.S. generally accepted accounting principles (U.S. GAAP) by increasing the transparency of contributed nonfinancial assets for not-for-profit (NFP) entities through enhancements to financial statement presentation and disclosure. The amendments address stakeholder input concerning the lack of transparency about the measurement of contributed nonfinancial assets recognized by NFPs, as well as the amount of those contributions used in an NFP's programs and other activities. These updates provide minor changes to U.S. GAAP disclosures for not-for-profit entities and require that contributed nonfinancial assets be reported on a separate line item in the statement of activities, apart from contributions of cash and other financial assets.

Recommendation:

NAIC staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive, and expose revisions to *Appendix D—Nonapplicable GAAP Pronouncements to reject ASU 2020-07, Not-for-Profit Entities (Topic 958), Presentation and Disclosures by Not-for-Profit Entities for Contributed Nonfinancial Assets* as not applicable to statutory accounting. This item is proposed to be rejected as not applicable as ASU 2020-07 is specific to not-for-profit entities, which for statutory accounting purposes are not subject to different disclosure treatment than other entity types.

ANY OTHER MATTERS

a. Ref #2019-21: SSAP No. 43R – (Julie)

During the Oct. 12 Working Group call, the Working Group exposed the Iowa Insurance Proposal to define what should be captured in scope of Schedule D-1: Long-Term Bonds for a public comment period ending Dec. 4. Although the comment period has not ended, NAIC staff, industry and key regulators have been working to discuss the definition throughout the exposure period. It is anticipated that a series of focused calls will occur beginning in 2021.

b. Deferred Agenda Items – (Dale)

For the purposes of this meeting, the SAPWG has currently deferred the following topics. The Working Group will continue discussions on a subsequent conference call or national meeting:

- Ref #2019-12: *ASU 2014-17, Business Combinations, Pushdown Accounting*
- Ref #2019-14: *Allocation of Goodwill*

Note: While these items remain deferred, NAIC staff has proposed a project to holistically review the business combination (and goodwill) guidance in *SSAP No. 68—Business Combinations and Goodwill*. If approved, the outstanding items in these agenda items will likely be addressed in the project.

c. Update on Ref #2019-49: Retroactive Reinsurance Exception – (Robin)

This issue is to address a referral from the Committee on Property and Liability Financial Reporting

(COPLFR) of the American Academy of Actuaries which noted diversity in reporting regarding companies applying the retroactive reinsurance exception which allows certain contracts to be reported prospectively.

NAIC staff has held some preliminary discussion with members of Casualty Actuarial and Statistical (C) Task Force on this topic. NAIC staff's preliminary recommendation is that the premium and losses transferred under such transactions should be allocated to the prior Schedule P calendar year premiums and the losses allocated to the prior accident year incurred losses. NAIC staff anticipates having a few more discussions with industry and having proposed revisions for Working Group review for exposure either in the interim or at the Spring National Meeting

d. Review of GAAP Exposures – Attachment L - (Fatima)

The attachment details the items currently exposed by FASB. NAIC staff recommends reviewing the issued ASUs under the standard SAP Maintenance process.

Industry is invited to provide additional comments on FASB projects and developments.

The comment deadline for all exposed items is Monday, January 11, 2021*. (60 days)

***Note – this comment deadline does not include the interpretations, should the Working Group elect to expose for public comment.**

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