Statutory Accounting Principles (E) Working Group
Hearing Agenda
March 15, 2021
2:00 p.m. – 4:00 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	Kimberly Rankin/Melissa Greiner	Pennsylvania
Kathy Belfi/William Arfanis	Connecticut	Jamie Walker	Texas
Rylynn Brown	Delaware	Doug Stolte/David Smith	Virginia
Eric Moser	Illinois	Amy Malm	Wisconsin
Stewart Guerin/Melissa Gibson	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. November 12, 2020 Minutes **(Attachment 1)**
2. December 8, 2020 E-Vote **(Attachment 2)**
3. December 18, 2020 Minutes **(Attachment 3)**
4. December 28, 2020 E-Vote **(Attachment 4)**
5. January 6, 2021 E-Vote **(Attachment 5)**
6. January 25, 2021 E-Vote **(Attachment 6)**

The Statutory Accounting Principles (E) Working Group met in regulator-to-regulator session on March 9. This regulator session was pursuant to the NAIC Open Meetings Policy paragraph 3 (discussion of specific companies, entities or individuals) and paragraph 6 (consultations with NAIC staff related to NAIC technical guidance of the *Accounting Practices and Procedures Manual*). No actions were taken during this meeting and the discussion was limited to the Spring National Meeting agenda.

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 #2020-32: 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 #2020-41: *ASU 2020-06, Convertible Instruments*
6. Ref #2020-42: *ASU 2020-07, Presentation and Disclosures by Not-for-Profit Entities*

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2020-32 SSAP No. 26R (Jim)	**SSAP No. 26R – Disclosure Update**	**7 – Agenda Item**	**No Comment**	**IP - 9**

Summary:
On Nov. 12, the Working Group exposed this agenda item, expanding existing disclosures for called bond to also include bonds terminated through a tender offer. This agenda item was in response to the Working Group's previous adoption of 2020-02, which 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.

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

Recommended Action:
NAIC staff recommends that the Working Group adopt the exposed nonsubstantive revisions to *SSAP No. 26R—Bonds.* The revisions expand the current called bond disclosures to include bonds terminated through a tender offer.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2020-33 SSAP No. 32R (Jim)	**SSAP No. 32R – Publicly Traded Preferred Stock Warrants**	**8 – Agenda Item**	**No Comment**	**IP - 9**

Summary:
On Nov. 12, the Working Group exposed this agenda item proposing to 1) 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. Stock warrants currently generally fall into scope of *SSAP No. 86—Derivatives*, however 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 proposed a similar carveout and accounting/reporting treatment for publicly traded preferred stock warrants.

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

Recommended Action:
NAIC staff recommends that the Working Group adopt the exposed nonsubstantive revisions to *SSAP No. 32R—Preferred Stock* and *SSAP No. 86—Derivatives*, which will place publicly traded preferred stock warrants in scope of SSAP No. 32R. In addition, the revisions clarify that publicly traded preferred stock warrants shall be reported at fair value.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2020-34 SSAP No. 43R (Jim)	**SSAP No. 43R – GSE CRT Program**	**9 – Agenda Item**	**No Comment**	**IP - 9**

Summary:
On Nov. 12, the Working Group exposed revisions to *SSAP No. 43R—Loan-Backed and Structures Securities* to reflect recent changes to the Freddie Mac Structured Agency Credit Risk (STACR) and Fannie Mae Connecticut Avenue Securities (CAS) program. 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. As the REMIC trust remains functionally equivalent and retains that same material risk structure of the original STACR and CAS program, the proposed revisions would 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.

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

Recommended Action:
NAIC staff recommends that the Working Group adopt the exposed nonsubstantive revisions to *SSAP No. 43R—Loan-Backed and Structures Securities*, which will incorporate 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 of SSAP No. 43R when a REMIC structure is used in the STACR program or CAS program.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2020-35 SSAP No. 97 (Jim)	**SSAP No. 97 – Audit Opinions**	**10 – Agenda Item**	**Minor Comments Received**	**IP - 10**

Summary:
SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities provides guidance for admissibility in 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 SCA investment can only be admitted if the departure is quantified (then the departure is nonadmitted), or if the departure is the result of utilizing statutory accounting principles for U.S. insurance entities in lieu of following U.S. GAAP (in such cases, a quantification of the departure is not required).

On Nov. 12, the Working Group exposed this agenda item, seeking comments regarding the extent situations exist that have hindered admittance of any 8.b.iii entity (non-insurance SCA) due to the inability to quantify a departure from U.S. GAAP. The results of the inquiry would determine the need to review expanding the qualified or adverse audit opinion exception guidance allowance allowed for 8.b.i entities (U.S. Insurance SCAs) to 8.b.iii entities.

<u>*Interested Parties' Comments:*</u>
Interested parties [are] not aware of any situations 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.

<u>*Recommended Action:*</u>
NAIC staff recommends that the Working Group dispose of this agenda item, noting no changes to statutory accounting. Based on the feedback received from Interested Parties as well as other informal comments received, NAIC staff believes the nonadmittance due to the inability to quantify a departure from U.S. GAAP, which was an issue raised to NAIC staff, is not prevalent, therefore, changes to SSAP No. 97 are not needed.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2020-41 SSAP No. 5R, 72, & 86 (Jake)	***ASU 2020-06: Convertible Instruments***	**11 – Agenda Item**	**No Comments**	**IP - 12**

<u>*Summary:*</u>
On Nov. 12, the Working Group exposed revisions to *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets*, *SSAP No. 72—Surplus and Quasi-Reorganizations*, and *SSAP No. 86—Derivatives* to reject ASU 2020-06 for statutory accounting. ASU 2020-06 address the 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. <u>The use of such models is not a practice recognized by statutory accounting</u>.

Amendments 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. <u>The Working Group has previously addressed liability vs. equity issues and the bifurcating of derivatives is not permitted under *SSAP No. 86—Derivatives*</u>.

<u>*Interested Parties' Comments:*</u>
Interested parties have no comments on this item.

<u>*Recommended Action:*</u>
NAIC staff recommends the Working Group adopt the exposed nonsubstantive 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.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2020-42 Appendix D (Jake)	***ASU 2020-07: Presentation and Disclosures by Not-for-Profit Entities***	**12 – Agenda Item**	**No Comments**	**IP - 12**

Summary:
On Nov. 12, the Working Group exposed revisions to reject ASU 2020-07 as not applicable for statutory accounting. FASB issued ASU 2020-07 to increase the transparency of contributed nonfinancial assets for not-for-profit (NFP) entities through enhancements to an NFP's financial statement presentation and related disclosures. The updates 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.

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

Recommended Action:
NAIC staff recommends adopting the exposed revisions to *Appendix D—Nonapplicable GAAP Pronouncements* to reject *ASU 2020-07: Presentation of Disclosures by Not-for-Profit Entities* as not applicable to statutory accounting.

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 #2020-22: Accounting for Perpetual Bonds
2. Ref #2020-37: Separate Account Product Mix
3. Ref #2020-38: Pension Risk Transfer Disclosure
4. Ref #2020-39: Interpretation Policy Statement
5. Ref #2020-40: Prescribed Practices
6. Ref #2020-36: Derivatives Hedging Fixed Indexed Products

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2020-22 SSAP No. 26R (Jim)	**Accounting for Perpetual Bonds**	**13 – Agenda Item**	**No Comments**	**IP - 9**

Summary:
On Nov. 12, 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 appreciated the opportunity to work directly with NAIC staff on this topic. After reviewing the modified proposal, we have one remaining comment, which has already been discussed with NAIC Staff. In paragraph 9, the proposal reads as follows:

> "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."

We recommend the language be "fine-tuned" as it implies those with a remaining premium would be amortized to the next effective call date. The language regarding amortization should be aligned with other bonds and reference the use of the yield to worst method, not the next effective call date. We suggest the following wording:

> "New footnote: For perpetual bonds with an effective call option, any applicable premium shall be amortized utilizing the yield-to-worst method."

Recommended Action:
NAIC staff recommends adopting the exposed revisions to *SSAP No. 26R—Bonds*, incorporating the edits as proposed by interested parties. NAIC staff believe the proposed edits remove any ambiguity in application and remain consistent with the long-standing application of the yield-to-worst concept required in SSAP No. 26R. With adoption, perpetual bonds that possess a future call date will retain bond accounting (i.e., accounted for at amortized cost); however, in the event that a perpetual bond does not possess a future call date, fair value accounting is required.

SSAP No. 26R – Proposed Updates for the March Interim Meeting:
Note – edits from the prior exposure are highlighted in grey below.

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 utilizing the yield-to-worst method. ~~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
2020-37 SSAP No. 56 (Jim)	**Separate Account Product Mix**	**14 – Agenda Item**	**In Agreement (minor edits)**	**IP – 10**

Summary:
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 financial statement users could more readily identify and review the products captured in separate accounts. Upon review of separate account general interrogatories in the 2019 financial statements, 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.

Accordingly, on Nov. 12, the Working Group exposed this agenda item, primarily to solicit comments regarding the degree of product identifying details needed to adequately assess the PRT and RILA product features and reserve liabilities. While this agenda item did not anticipate modifications to *SSAP No. 56—Separate Accounts*, depending on the nature of the comments received, it would likely result in a proposal to the Blanks (E) Working Group with annual statement instruction modifications regarding the separate account general interrogatories.

Interested Parties' Comments:
In response to the solicitation of feedback on additional product identifiers specifically for PRT and RILA transactions in the Separate Account General Interrogatories, the ACLI suggests adding a PRT and RILA product identifier. See example identifiers in bold:

1 Product Identifier	Not Registered with SEC 2 Private Placement Variable Annuity	 3 Private Placement Life Insurance	 4 Other (Not PPVA or PPLI)
Pension Risk Transfer Group Annuities			
All Other Group Annuities			
Registered Index Linked Annuities Individual Annuities			
All Other Individual Annuities			
Life Insurance			
Totals			

The addition of these identifiers would bifurcate out PRT and RILA transactions. Further, the use of these additional identifiers would show in General Interrogatory 1.01 if there were guarantees associated with these different products.

Recommended Action:

It is recommended that the Working Group expose this agenda item to allow for a concurrent exposure with the Blanks (E) Working Group. Consideration of this item will occur during an interim call to allow for adoption consideration to allow for blanks changes to be reflected in the statutory financials for year-end 2021. Pursuant to this agenda item and regulator comments received, the Working Group is sponsoring Blanks agenda item (2021-03BWG, see attachment 14.1) to modify the current General Interrogatory instructions and require that a distinct disaggregated product identifier be used for each product represented. The disaggregation will require that each separate account product filing or policy form be separately identified. For example, if a company has 5 different separate account group annuities, each annuity shall be separately reported. Additionally, the instructions will indicate that companies may eliminate proprietary information (e.g., such as XYZ company Pension Plan), however such elimination will still require the use of a unique reporting identifiers (such as PRT #1). This disaggregation of reporting will be utilized for all applicable General Interrogatories (e.g., 1.01, 2.4, 4.1) and was at the direct request of regulators and will assist in regulator review so that each product, primarily those in which may potentially expose the general account to funding risk, may be independently examined.

NAIC staff also notes that there is inconsistency in the current reporting of the separate account general interrogatories, as some companies aggregate based on overall product type and other companies already include a disaggregation of all separate account products. With the clarification that "each product" shall be captured, the regulators will have the information necessary to complete assessments and improve consistency in reporting. With the blanks proposal, there are no proposed revisions to statutory accounting principles.

An excerpt from the Blanks proposal is shown below:

A distinct disaggregated product identifier shall be used for each product and shall be used consistently throughout the interrogatory. Disaggregation of reporting shall be such that each product filing or policy form is separately identified. For example, if a company has 5 different separate group annuities, each annuity shall be separately reported. (Companies may eliminate proprietary information however such elimination will require the use of unique reporting identifiers).

1	Separate Account Assets		4	5	6	7
	2	3				
Product Identifier	Registered with SEC	Not Registered with SEC	Guarantees Associated with the Product Yes/No	Seed Money	Fees and Expenses Due to the General Account	Additional Required Surplus Amounts
1.01A Pension Risk Transfer Group Annuities						
	$	$		$	$	$
Total Pension Risk Transfer Group Annuities	$	$		$	$	$
1.01B All Other Group Annuities						
	$	$		$	$	$
Total All Other Group Annuities	$	$		$	$	$
1.01C Registered Index Linked Annuities Individual Annuities						

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2020-38 SSAP No. 56 (Jim)	**Pension Risk Transfer Disclosure**	**15– Agenda Item**	**Comments Received**	**IP - 11**

Summary:
On Nov. 12, the Working Group exposed this agenda item to solicit comments from state insurance regulators and industry regarding possible modifications to *SSAP No. 56—Separate Accounts*, specifically in terms of increased product identification and disclosure of pension risk transfer (PRT) transactions in the separate account financial statements. In response to the recent growth of PRT transactions, regulators expressed a desire for improved reporting so such items could be more readily identified and analyzed. While the information request was broad, regulators discussed several possible 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.*

Interested Parties' Comments:
NAIC Staff Note: Comments from both agenda item 2020-37 & 2020-38 have been included in this section. As these two agenda items are closely interrelated, concurrent consideration of the comments should be considered.

Comments on 2020-37:
In response to the solicitation of feedback on additional product identifiers specifically for PRT and RILA transactions in the Separate Account General Interrogatories, the ACLI suggests adding a PRT and RILA product identifier. See example identifiers in bold:

1 Product Identifier	Not Registered with SEC 2 Private Placement Variable Annuity	 3 Private Placement Life Insurance	 4 Other (Not PPVA or PPLI)
Pension Risk Transfer Group Annuities			
All Other Group Annuities			
Registered Index Linked Annuities Individual Annuities			
All Other Individual Annuities			
Life Insurance			
Totals			

The addition of these identifiers would bifurcate out PRT and RILA transactions. Further, the use of these additional identifiers would show in General Interrogatory 1.01 if there were guarantees associated with these different products.

Comments on 2020-38:
Pension risk transfer transactions differ from other separate account transactions in that PRT products are group products, not individual products. The American Council of Life Insurers believes that these differences are adequately addressed in the current disclosure requirements of SSAP No. 56 – Separate Accounts. Specifically, paragraphs 31c and 33a include disclosure requirements for products with guarantees, which may include PRT transactions. Further, these disclosure requirements extend to the General Account Annual Statement Note 35B. Additionally, the proposal above on Ref# 2020-37 will provide additional detail for PRT products in the General Interrogatories.

We believe that the current disclosures sufficiently capture PRT transactions however, we defer to the Working Group and regulators if these groups voice concern that they are not able to discern something specific.

Recommended Action:
It is recommended that the Working Group expose this agenda item to allow for a concurrent exposure with the Blanks (E) Working Group. Consideration of this item will occur during an interim call to allow for adoption consideration to allow for blanks changes to be reflected in the statutory financials for year-end 2021. Pursuant to this agenda item and regulator comments received, in conjunction with agenda item 2020-38, the Working Group is sponsoring Blanks agenda item (2021-03BWG, see attachment 14.1). This proposal clarifies reporting by each separate product filing or policy form and adds product identifiers specifically for PRT and RILA transactions in the Separate Account General Interrogatories. The grouping of PRT and RILA transactions, combined with the disaggregation by product filing or policy form will sufficiently assist with the regulators detailed review of the applicable transactions, guarantees, and reserve assumptions. With the blanks proposal, there are no proposed revisions to statutory accounting principles.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2020-39 Appendix F (Jim)	**Interpretation Policy Statement**	**16 – Agenda Item**	**Comments Received**	**IP - 11 & 14**

Summary:
On Nov. 12, the Working Group exposed revisions to Appendix F in the *NAIC Policy Statement on Maintenance of Statutory Accounting Principles* regarding the issuance and adoption of accounting interpretations (INT). The revisions clarified actions available to the Working Group (including but not limited to postponing the effective date until the item has been discussed by the Accounting Practice and Procedures (E) Task Force and the Financial Condition (E) Committee) as well as the voting requirements for when an INT can be overturned, amended, or deferred by the Task Force or E Committee.

Interested Parties' Comments:
Based upon interested parties' discussion with NAIC staff and our understanding of the objective of the changes to *NAIC Policy Statement on Maintenance of Statutory Accounting Principles* in *Appendix F—Policy Statements* (Appendix F), we've marked up Appendix F with edits that clarify the policy for issuing interpretations which amend, supersede, or conflict with existing SSAPs (please see attached). Specifically, the interested parties' proposed revisions clarify that such interpretations are temporary and restricted to circumstances requiring immediate, temporary guidance such as catastrophes or other emergencies. We believe the marked Appendix F is consistent with the intent to use interpretations in limited circumstances. Our proposed revisions explicitly establish

that interpretations are not intended as a shortcut to bypass the deliberative process for amending existing statutory accounting guidance or developing new guidance.

NAIC staff note: The language shaded below in grey was added by interested parties. The items shown as 'tracked changes' were a part of the original exposure.

Interpretations which amend, supersede, or conflict with existing SSAPs

11. In ~~rare~~ certain circumstances such as catastrophes or emergencies requiring immediate, temporary statutory accounting guidance, the Working Group may adopt an interpretation which creates a new SAP or conflicts with existing SSAPs. Historically, these interpretations temporarily modified statutory accounting principles and/or specific disclosures were developed in response to nationally significant events (e.g., Hurricane Sandy, September 11, 2001). Interpretations that conflict with existing SSAPs shall be temporary guidance and restricted to circumstances arising from the need to issue guidance for circumstance requiring immediate, temporary guidance. In order to adopt an interpretation that creates new SAP or conflicts with existing SSAPs, the Working Group must have 67% of its members voting (10 out of 15 members) with a super majority (7 out of 10, 8 out of 11 or 12, 9 out of 13, 10 out of 14, or 11 out of 15) supporting adoption.

a. These interpretations are effective upon Working Group adoption, unless stated otherwise, and shall be reported to the Accounting Practice and Procedures (E) Task Force as part of its public report during the next NAIC national meeting (or earlier if applicable). In circumstance where the Working Group adopts an interpretation (which creates new SAP or conflicts with existing SSAPs) that is controversial in nature (i.e., due to regulator or industry feedback or could have a policy level impact), 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.

b. These interpretations can be ~~adopted~~ overturned, amended or deferred by a two-thirds majority of the Task Force membership. For clarification, a two-thirds majority of the Task Force requires two-thirds of entire Task Force membership, not just those electing to vote. Additionally, interpretations can be overturned, amended, deferred, or referred to either the Task Force and/or the Working Group by a simple majority of the Financial Condition (E) Committee.

Recommended Action:

NAIC staff recommends that the Working Group adopt the exposed nonsubstantive revisions to the *NAIC Policy Statement on Maintenance of Statutory Accounting Principles*, with proposed additional edits to capture the intent of comments from interested parties. The interested parties' language has been revised to prevent use of INTs that provide temporary exceptions from SAP that may not be considered emergencies. Recent examples include the transition from Libor and the federal TALF program. While the revisions, as a whole, document the adoption and review of accounting interpretations, the proposed edits from the prior exposure, remove any outstanding ambiguity regarding the intent, use and implementation of such interpretations.

Appendix F – Proposed Updates for the March Interim Meeting:

Note – edits from the prior exposure are highlighted in grey below.

Development of Interpretations to SSAPs and Referencing Interpretations Within SSAPs

Interpretations which DO NOT amend, supersede, or conflict with existing SSAPs

9. Interpretations ~~will~~ may be developed to address~~, but will not be limited to~~ issues requiring timely application or clarification of existing SAP, which shall not amend, supersede or conflict with ~~existing,~~ effective SSAPs. Issues being considered as an interpretation must be discussed at no less than two open meetings. (Original introduction of the issue when the Working Group identifies the intent to address the issue as an "interpretation" during a public discussion is considered the first open meeting discussion.) The

process must allow opportunity for interested parties to provide comments, but as interpretations are intended to provide timely responses to questions of application or interpretation and clarification of guidance, no minimum exposure timeframe is required.

10. ~~The voting requirement to adopt an interpretation is a simple majority.~~ As these interpretations do not amend, supersede or conflict with existing SSAP guidance, the interpretation is effective upon Working Group adoption, unless specifically stated otherwise. The voting requirement to adopt an interpretation of this type is a simple majority. The Working Group shall report the adopted interpretation to the Accounting Practice and Procedures (E) Task Force as part of its public report during the next NAIC national meeting (or earlier if applicable). Interpretations can be overturned, amended or deferred ~~only~~ by a two-thirds majority of the Task Force membership. For clarification, a two-thirds majority of the Task Force requires two-thirds of the entire Task Force membership, not just those electing to vote. Additionally, interpretations can be overturned, amended, deferred, or referred to either the Task Force and/or the Working Group by a simple majority of the Financial Condition (E) Committee.

Interpretations which amend, supersede, or conflict with existing SSAPs

11. In ~~rare~~ certain circumstances such as catastrophes and other time-sensitive issues requiring immediate, temporary statutory accounting guidance, the Working Group may adopt an interpretation which creates a new SAP or conflicts with existing SSAPs. Historically, these interpretations temporarily modified statutory accounting principles and/or specific disclosures were developed in response to nationally significant events (e.g., Hurricane Sandy, September 11, 2001). (Examples of time sensitive issues that have been previously provided INT exceptions to SAP include the transition from LIBOR and special situations such at the federal TALF program.) Interpretations that conflict with existing SSAPs shall be temporary and restricted to circumstances arising from the need to issue guidance for circumstance requiring immediate guidance. In order to adopt an interpretation that creates new SAP or conflicts with existing SSAPs, the Working Group must have 67% of its members voting (10 out of 15 members) with a super majority (7 out of 10, 8 out of 11 or 12, 9 out of 13, 10 out of 14, or 11 out of 15) supporting adoption.

a. These interpretations are effective upon Working Group adoption, unless stated otherwise, and shall be reported to the Accounting Practice and Procedures (E) Task Force as part of its public report during the next NAIC national meeting (or earlier if applicable). In circumstance where the Working Group adopts an interpretation (which creates new SAP or conflicts with existing SSAPs) that is controversial in nature (i.e., due to regulator or industry feedback or could have a policy level impact), 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.

b. These interpretations can be ~~adopted~~ overturned, amended or deferred by a two-thirds majority of the Task Force membership. For clarification, a two-thirds majority of the Task Force requires two-thirds of entire Task Force membership, not just those electing to vote. Additionally, interpretations can be overturned, amended, deferred, or referred to either the Task Force and/or the Working Group by a simple majority of the Financial Condition (E) Committee.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2020-40 Preamble (Julie)	**Prescribed Practices**	**17 – Agenda Item**	**Comments Received**	**IP – 12 & 17**

Summary:
On Nov. 12, the Working Group exposed this agenda item to clarify the definition and application of prescribed practices as referenced in the NAIC *Accounting Practices & Procedures Manual* (AP&P Manual). As a preface 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 an insurer to file supplemental financial information that require or allow the use of different accounting practices in the supplementary filing than what is required in the AP&P manual. As companies generally do not have the ability to file two sets of financial statements (and thus not require two independent audits on differing statutory financial statements), each state in which the company is licensed could require supplemental financial information that requires or allows statutory accounting practices that differ from the AP&P manual. 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 the AP&P Manual, such provision would be considered a prescribed practice. If the company files supplemental financial information that reflect this practice(s), even if the supplemental financial information is filed only in the non-domiciliary state, then the prescribed practice disclosure of Note 1 shall apply.

Interested Parties' Comments:
Interested parties are concerned that the discussion of prescribed and permitted practices in this proposal are likely to cause confusion. An insurer's annual and quarterly statutory statements that are filed with the state of domicile and all states the insurer is licensed are prepared in accordance with the accounting practices prescribed or permitted by the state of domicile. However, in addition to the financial statements required by the domiciliary state, a non-domiciliary state in which the company is licensed may require an insurer to file supplemental financial information that require or allow the use of different accounting practices in the supplementary filing than provided in the AP&P manual. We believe the proposal should be amended to clarify that 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) in such **supplemental financial information** that is different from NAIC SAP, that practice(s) is also considered a prescribed practice. We recommend changes to the proposed wording to clarify these points (please see attached).

Proposed Revisions to the Preamble Questions and Answers:

2. Q: What is the difference between a permitted accounting practice and a prescribed practice?

A: **Permitted** accounting practices include practices specifically requested by an insurer that depart from NAIC Statutory Accounting Principles (SAP) and state prescribed accounting practices, as described below, and have received approval from the insurer's domiciliary state regulatory authority.

Prescribed accounting practices are those practices that are incorporated directly or by reference by state laws, regulations and general administrative rules applicable to all insurance enterprises domiciled and/or licensed in a particular state. The NAIC AP&P Manual is not intended to preempt states' legislative and regulatory authority. Prescribed accounting practices of the domiciliary state shall be reflected in the statutory financial statements filed with the NAIC. Non-domiciliary states may additionally require insurance entities licensed in their state to file **supplementary financial information that requires** or allow**s the use of** different accounting practices in the **supplementary filing than provided in the AP&P manual**.

If a reporting entity requests an accounting practice that differs from state prescribed accounting practices, but is in accordance with NAIC SAP, advance notice of approval is not required.

Recommended Action:

NAIC staff recommends that the Working Group adopt the exposed nonsubstantive revisions, with additional minor modifications (shown below) incorporating edits as proposed by interested parties to the Preamble Implementation Questions and Answers. The edits 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 subject to independent audit requirements. Additionally, the edits clarify that non-domiciliary states may require insurance entities licensed in their state to file supplementary financial information that requires or allows the use of different accounting practices in the supplementary filing than what is required in the AP&P manual.

NAIC staff note: Interested parties also proposed various edits to the body of the agenda item. These additional edits do not further modify the proposed authoritative language and have not been shown in this document. However, as agenda items are typically referenced for historical purposes, NAIC staff is supportive of modifying the original agenda item with the changes noted as tracked in the "description of issue" section of agenda item 2020-40 (attachment 17). These edits clarify the understanding that in addition to the financial statements required by the domiciliary state, a non-domiciliary state in which the company is licensed may require an insurer to file supplemental financial information that require or allow the use of different accounting practices in the supplementary filing than required in the AP&P manual.

Proposed updates for the March Interim Meeting - Preamble Questions and Answers:

Note – edits from the prior exposure are highlighted in grey below.

3. Q: What is the difference between a permitted accounting practice and a prescribed practice?

A: **Permitted** accounting practices include practices specifically requested by an insurer that depart from NAIC Statutory Accounting Principles (SAP) and state prescribed accounting practices, as described below, and have received approval from the insurer's domiciliary state regulatory authority.

Prescribed accounting practices are those practices that are incorporated directly or by reference by state laws, regulations and general administrative rules applicable to all insurance enterprises domiciled and/or licensed in a particular state. The NAIC AP&P Manual is not intended to preempt states' legislative and regulatory authority. Prescribed accounting practices of the domiciliary state shall be reflected in the statutory financial statements filed with the NAIC. Non-domiciliary states may additionally require insurance entities licensed in their state to file ~~financial statements in accordance with the prescribed accounting practices of that particular non-domiciliary state.~~ supplementary financial information that details the use of different accounting practices required or allowed by the non-domiciliary state that differs from the AP&P Manual.

If a reporting entity requests an accounting practice that differs from state prescribed accounting practices, but is in accordance with NAIC SAP, advance notice of approval is not required.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2020-36 SSAP No. 108 (Julie)	**Derivatives Hedging Fixed Indexed Products**	**18 – Agenda Item**	**Comments Received**	**IP - 29**

<u>*Summary:*</u>
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.

On Nov. 12, 2020, the Working Group moved this item to the active listing, categorized as substantive, and exposed 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 products. In addition to the two general options presented in the agenda item, the Working Group is open for additional commentary and suggestions, and directs NAIC staff to work with industry throughout the process similar to the collaborative efforts that occurred when developing the guidance in *SSAP No. 108—Derivatives Hedging Variable Annuity Guarantees*. With this exposure, notification to the Life Actuarial (E) Task Force will occur.

<u>*Interested Parties' Comments:*</u>
The comment deadline for this item was extended to Feb. 26, 2021.

The interested parties' response will be brief at this time as we continue our work reviewing the exposure, assessing the proposal and working on potential variances to the exposure. Interested parties are committed to working with NAIC staff and SAPWG on this very complicated and important topic.

<u>*Recommended Action:*</u>
NAIC staff recommends the Working Group re-expose this item to provide additional time for interested parties to develop a proposal. It is recommended that NAIC staff work with interested parties in the interim to discuss this agenda item and potential options.

<u>REVIEW of COMMENTS on EXPOSED ITEMS</u>

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

1. Ref #2019-34: Related Parties, Disclaimer of Affiliation and Variable Interest Entities
2. Ref #2019-24: Levelized and Persistency Commission

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**	**19 – Agenda Item**	**Comments Received**	**IP - 8**

<u>Summary:</u>

This agenda item is the result of questions and discussions between the Statutory Accounting Principles (E) Working Group and the Group Solvency Issues (E) Working Group and intends to clarify the 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. This agenda item was exposed on March 18, 2020 and on Nov. 12, 2020.

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.

<u>Interested Parties’ Comments:</u>

On December 10, 2020, some members of interested parties and NAIC staff had a conference call to discuss the November 12th draft and possible edits to address concerns that the draft unintentionally impacted passive investments held by insurers in addition to investment in insurers. Staff amended the draft to address these concerns and is taking the updated draft back to the Working Group for its consideration.

Interested parties thank the staff for meeting with industry and in working to address our concerns.

Recommended Action:

NAIC staff recommends that the Working Group adopt the exposed nonsubstantive revisions, with additional minor modifications from the exposure (shown below) proposed by Interested Parties, in *SSAP No. 25—Affiliates and Other Related Parties*. (The agenda item details the full tracked revisions.) The details of the revisions are included in the agenda item, and the additional changes that were agreed upon by the Interested Parties are highlighted within the updated SSAP No. 25. The edits made to the Nov. 12 exposure draft further clarify the scope of guidance for related parties but are not significant enough to require an additional exposure period. The final revisions made after the Nov. 12 exposure are listed below, highlighted in gray:

Paragraph 4f:

f. Any direct or indirect ownership greater than 10% of the reporting entity results in a related party classification regardless of any disclaimer of control or disclaimer of affiliation.

Paragraph 7d:

d. Agreements where direct or indirect non-controlling ownership interest is less than 10% where the parties have structured the arrangement in this structure to avoid the 10% threshold in paragraph 4.f. and paragraph 8.

Paragraph 8:

8. Any direct or indirect ownership interest of the reporting entity greater than 10% results in a related party classification regardless of any disclaimer of control or disclaimer of affiliation. The *Insurance Holding Company System Regulatory Act* (#440) and the *Insurance Holding Company System Model Regulation* (#450) include a provision that allows for the disclaimer of affiliation and/or the disclaimer of control for members of an insurance holding company system. The disclaimer must be filed with the state insurance commissioner. Entities whose relationship is subject to a disclaimer of affiliation or a disclaimer of control are related parties and are subject to the related party disclosures within this statement. Such a disclaimer does not eliminate a "related party" distinction or disclosure requirements for material transactions pursuant to SSAP No. 25.

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2019-24 SSAP No. 71 (Robin)	**Levelized and Persistency Commission**	**20 - Agenda Item 20.1 - Blanks proposal 21- Issue Paper**	**Comments Received**	**MT - 1 Former NC - 23 NCOIL - 26 IP – 3 Arcadia Capital - 21 Guggenheim - 25**

Summary:

Background:

The Working Group has been discussing this topic since August 2019. It has had several exposures. The initial issue presented to the Working Group was raised by a state which identified an issue during a financial examination. The larger issue is that insurers that are utilizing the practice under dispute, are using third parties to pay acquisition costs and are not recognizing the full liability to repay those third parties. Not recognizing the full liability to repay the parties who are paying acquisition costs on an insurer's behalf is inconsistent with the guidance on SSAP No. 71 which has provided statutory accounting guidance identifying such agreements as funding agreements which require full liability recognition since prior to 1998.

Actions
On November 12, 2020, the Working Group held a hearing to receive comments and based on those comments, took the following actions:

- Re-exposed the prior version of SSAP #71 with certain edits: – (1) the proposed effective date of Jan.1, 2021 was changed to be effective upon adoption, and (2) the revised text made explicit that the proposed revisions will apply to contracts in effect as of the date of adoption.

- Determined that the revisions to SSAP #71 met the due process for either a substantive or a non-substantive revision but concluded to keep the revision classified as nonsubstantive. The Working Group reiterated that it is not the impact of a change on an individual entity that determines whether a change is substantive or non-substantive, but whether the revision is in line with the original intent of the SSAP. The Working group noted that this is a clarification of existing guidance consistent with original intent. (Commissioner Donelon noted an objection to the classification as non-substantive.)

- Directed NAIC Staff to draft an Issue Paper to document the discussion on this topic for historical purposes.

Prior actions

- August 2019 - Exposed initial revisions to paragraphs 2, 3, 4 and 5 intended to clarify both levelized and persistency commission because it was identified that some entities were trying to characterize their funding agreements as persistency commission.
- December 2019 -
    - Exposed revisions which remove some of the language regarding overall recognition of commission expense, added clarifying phrases regarding persistency commission accrual, added phrased regarding levelized commission/ funding agreements, minor rewording of the footnote.
    - Directed notification of the exposure to the Life Actuarial (A) Task Force
- March 18, 2020 - Deferred discussion of this item for a subsequent call or meeting.
- July 2020 - Exposed revisions consistent with the 2019 Fall National Meeting exposure, with the inclusion of guidance to clarify that reporting entities that have not complied with the original intent shall reflect the change as a correction of an error, in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*, in the year-end 2020 financial statements. With a proposed effective date of Dec. 31, 2020.
- October 2020 -
    - Improved description of the funding agreements.
    - Deleted the previously proposed revisions regarding other types of commission to address the comments received regarding unintended impacts on traditional renewal commission.
    - Removed the language on correction of an error.
    - Proposed the nonsubstantive revisions apply to contracts in effect on Jan. 1, 2021.

Current Comment Letters

The Working Group received comments from six parties and their comments are presented in the following order 1) MT Commissioner (now U.S. Representative) Matthew M. Rosendale, Sr, 2) Former NC Commissioner – Wayne Goodwin, 3) National Council of Insurance Legislators (NCOIL), 4) Interested parties of the SAPWG, 5) Acadia Capital Management, and 6) Guggenheim.

1) *MT Commissioner (now U.S. Representative) Matthew M. Rosendale, Sr*

This is one of my final letters as the Montana Insurance Commissioner as my fellow Montanans have honored me with the privilege of representing them in the United States House of Representatives. I will continue to champion our state-based system of insurance regulation while I am a member of Congress.

With that noted, I do have a concern as I close out my term as Insurance Commissioner: the proposed changes to the SSAP 71. There is no reason to change the current SSAP 71 accounting principle. There has been no policyholder peril, fraud, or company financial impairment by using SSAP 71 as currently allowed since 1998.

I believe the changes being proposed constitute a significant change in application of this statutory accounting principle and therefore should be deemed a substantive change under the SSAP guidelines. The Statutory Accounting Principles Working Group (SAPWG) continues to conclude that the proposed changes simply clarify the intent of the working group, but the proposed changes would significantly change the way some companies report certain commission arrangements. These companies have been reporting these arrangements the same way for decades without, as far as I have been informed, any harm to policyholders.

Efforts to fix something that isn’t broken often have negative consequences, whether intentional or not. As a former state legislator and as an incoming federal legislator, I have always been a strong proponent for closely following appropriate processes and not taking shortcuts.

I encourage the SAPWG to take the necessary steps to study this issue further and give proposed substantive changes the appropriate attention they deserve.

2) *Former NC Commissioner – Wayne Goodwin*

It has come to my attention that the Statutory Accounting Principles (E) Working Group is accepting comments pertaining to the Revised Proposed Changes to SSAP No. 71 – Policy Acquisition Costs and Commissions.

Although I concluded my service as NC Insurance Commissioner four years ago, I served eight (8) years in that office and an additional four (4) years as Assistant Commissioner, for a total of 12 years as a state insurance regulator. During that time, I also served on the NAIC Executive Committee and as Vice Chair of the Southeast Zone. Further, I have experience both as a state legislator (8 years) and licensed attorney (28 years). To the best of my ability, I have remained aware of many contemporary issues, proposals, and agenda items before the NAIC and its various committees and working groups.

Before the comment period closes, I want to restate the compass points of my tenure as well as that of my predecessor, the late great Jim Long: (1) Consumer protection and (2) fair, stable, reasonable regulation of the insurance market. Paramount, first and foremost of course, is consumer protection.

Today I submit my comment *in opposition* to the revised proposed changes to SSAP No. 71 based on the following:

SSAP 71 has been in place approximately 30 years and, by most accounts of which I am familiar, it has worked well.

It is my understanding that during those three decades such levelized commission programs have gone through multiple official examinations by insurance regulators with few to no material issues having been noted.

To the best of my knowledge presently, there has been no policyholder peril, fraud, or company financial impairment by using the current version of SSAP 71. Accordingly, existing rules have apparently worked as intended.

The revised changes have been described as non-substantive but upon analysis by other current and past state insurance regulators whom I respect and trust, whose comments in opposition or expressing concern are incorporated by reference, and upon my own review, it is more evident that the proposal is, in fact, *substantive* – in part because the current proposal will apparently cause unnecessary financial damage to some carriers and their policyholders because rating agencies would consequently and unnecessarily downgrade any impacted company due to a retroactive drop in surplus/RBC numbers.

Among other consumer concerns is this: This proposed new reserving practice could cause further, unnecessary rate increases for guaranteed renewable products like Long Term Care insurance.

Respectfully, acknowledging the above and consumer protection most of all, it appears that a more detailed, comprehensive study is necessary before further consideration of the revised proposal. More feedback will be particularly enlightening and will provide the best counsel on what direction – if any -- to take on the proposal.

3) <u>National Council of Insurance Legislators (NCOIL) Comments:</u>

Without delving deeply into the specifics of the principle itself, with which you are well-versed, NCOIL has significant concerns about it. We note that SSAP No. 71 has been in effect since 1998, and inquire why, after 22 years, there needs to be a rush to implementation of this proposal for year-end?

Additionally, our members have heard differing opinions as to whether the proposed changes are substantive or non-substantive. Candidly, when NCOIL's legislators start to hear of substantive changes being made via a handbook or manual, it creates tension because it brings to mind the debate surrounding incorporation by reference (IBR) for substantive matters. Beyond this impairment of the legislative prerogative, I must note that there is a constitutional provision in California stating that no law shall be enacted except by statute and no statute except by bill.

Regardless of the determination on substantive vs non-substantive here though, there seems to be little debate that these changes could have a material and perhaps significant impact on insurers of adopted. If the impact is as large as some have told us, and we have heard of impacts as high as 30% of risk-based capital (RBC), it strikes NCOIL as quite bad timing to implement such changes as the entire global economy is suffering during this global pandemic. A number of companies from several states have advised us that the impact on their capital will be so great that these now-healthy companies would fall below the RBC regulatory action level if this change were to be implemented.

One of our most senior leaders has asked us, and we in turn ask you, if a solvent & healthy insurance carrier has been accounting for commissions in error due to a misunderstanding of SSAP No. 71, and the proposed change to SSAP No. 71 threatens to render that insurer insolvent, then is the proposed change really meeting its intent? It certainly would seem to fly in the face of the number one priority of the state regulatory system.

Accordingly, NCOIL requests and recommends that the WG delay implementation of the proposal until such time that staff completes the issue paper it is charged with drafting on the classification of the proposal. Moreover, NCOIL requests and recommends that in any case or at any point if the WG determines to move forward with the proposal, it be subject to a five year phase-in period in order to allow companies to maintain their health, soundness and solvency as the capital impact of the "clarification" to SSAP No. 71 takes effect.

On behalf of our member legislators, I thank you for your consideration of this matter.

4) *Interested Parties' Comments:*

Interested parties would like to again thank the Working Group for the opportunity to continue to comment on the most recent revisions to exposure Ref #2019-24 – Levelized and Persistency Commission (SSAP No. 71, Policy Acquisition Costs and Commissions) discussed on November 12, 2020 (the "Exposure").

These comments begin with industry comments regarding the Working Group's most recent revisions to the Exposure:

Paragraph #5 new comments pertain to the sentence below:
Having a third party pay commission costs to the selling agent is strong evidence of a potential funding arrangement which shall be recognized as a liability because the substance of the arrangement indicates that repayment is reasonable and probable, even if a contingency has been incorporated into the funding arrangement, until ~~unless~~ the underlying policy has been cancelled.

The Working Group has made a change to the last phrase of this sentence that still does not provide clarity as to its meaning and to the sentence as a whole. Assuming that the phrase refers to the contingency noted in the previous phrase within the sentence, industry disagrees with wording that creates a blanket statement across all third-party agreements with regard to recognizing a liability similar to a funding agreement. During the entire exposure/revision process, interested parties has consistently stated that agreements which include traditional elements such as persistency as part of a legally binding commission contract should be excluded from the funding agreement treatment as was provided in the original (current) SSAP No. 71 wording. If the last phrase "until the underlying policy has been cancelled" pertains to the recognition of the liability, it seems that the wording does not contemplate even a partial repayment of the liability during the period when the policy is active.

Paragraph #7 new comments pertain to the following:
The nonsubstantive revisions adopted TBD date regarding levelized commission are to clarify the original intent of this statement and apply to existing contracts ~~are effective~~ in effect on the date of adoption of the revisions ~~January 1, 2021~~.

Industry has consistently maintained that there has been a long-standing industry practice to link third party contracts to insurance elements such as persistency, including commission arrangements, reinsurance contracts, etc. Removing this link as has been indicated in the Working Group revisions is a substantive change. As such, we do not agree with the language in paragraph #7 that calls the revisions nonsubstantive and we disagree that such changes should be put in effect immediately upon adoption since they are substantive in nature and require further evaluation.

Certain of the third-party contracts noted above are complex and not quite as simple as the description of levelized commissions in the most recent draft of the Exposure. The Exposure depicts a simple arrangement whereby the insurer repays a third party over time, with interest, for making upfront heaped commissions to agents. This does not consider, for example, certain third-party contracts for which the insurer pays the third-party trail commissions based upon account value in-force in exchange for performing many contractual agency services other than simply funding and making upfront payments to selling agents. Such complex contracts require sufficient time to allow insurers to work with their state of domicile to determine the correct application of the revised guidance with respect to contracts which the regulator has already approved. Then, if establishment of a liability is indeed required, additional time would be necessary to calculate such an accrual and review with external auditors prior to reporting the change on a quarterly or annual statement. For these reasons, and as you suggested, Chairman Bruggeman, we propose that the revisions within the Exposure be adopted with an effective date no sooner than 12/31/21.

Comments previously made on existing revisions included for purposes of documentation:

Paragraph #4, most recent exposure:

4. Levelized commissions occur in situations where agents receive normal (non-level) commissions with payments made by a third party. It is intended, but not necessarily guaranteed, that the amounts paid to the agents by the third party would ultimately be repaid (with interest explicit or implied) to the third party by levelized payments (which are less than the normal first year commissions but exceed the normal renewal commissions) from the reporting entity. (Note: levelized repayments made by the reporting entity extend the repayment period but might not be a straight-line repayment.) These transactions are, in fact, funding agreements between a reporting entity and a third party, regardless of how the payment to the third party is characterized. The continuance of the stream of payments specified in the levelized commission contract is a mechanism which attempts to bypass recognition of those expenses which are ordinarily charged to expense in the first year of the contract. Consequently, the normal link between the persistency of the policy, the continuance of the premium payment or the maintenance of the agent's license with the reporting entity is not maintained with respect to the payment stream.

Paragraph #4, most recent exposure with highlighted edits:

4. Levelized commissions occur in situations where agents receive normal (non-level) commissions with payments made by a third party. It is intended, but not necessarily guaranteed, that the amounts paid to the agents by the third party would ultimately be repaid (with interest explicit or implied) to the third party by levelized payments (which are less than the normal first year commissions but exceed the normal renewal commissions) from the reporting entity over time. (Note: levelized repayments made by the reporting entity ~~extend the repayment period~~ but might not be a straight-line repayment.) In instances where the levelized commission is not tied to, or contingent upon, traditional elements such as policy persistency or premium payments, these transactions are, in fact, funding agreements between a reporting entity and a third party, ~~regardless of how the payment to the third party is characterized~~ when the contract between the reporting entity and the third party has no substance but to defer commission payments by the reporting entity. The continuance of the stream of payments specified in the levelized commission contract in these situations is a mechanism ~~which attempts~~ to bypass recognition of those expenses which are ordinarily charged to expense in the first year of the contract. Consequently, the normal link between the persistency of the policy, the continuance of the premium payment or the maintenance of the agent's license with the reporting entity is not maintained with respect to the payment stream.

Industry proposes to replace a large section of paragraph #5, including the Working Group recent revisions, with more concise language that expresses the need to establish a liability when an arrangement is in substance a funding agreement. The current revisions are lengthy and somewhat redundant. Industry continues to disagree with the current revisions which too broadly state that all third-party arrangements, even those with traditional insurance elements, are considered funding arrangements. Industry retained the concept of the link between the accrual of commissions and traditional elements such as policy persistency.

Excerpt from paragraph #5, most recent exposure requested to be deleted:

~~Arrangements that use a third party to pay agents who write policies for the reporting entity and the insured can be an attempt to de-link the relationship between the insurer and those agents and defer or levelize the acquisition commissions. The insurance reporting entity is required to recognize the full amount of earned commission costs to the direct policy writing agents even if those costs are paid indirectly to the agents by a third party through the use of levelized commission, or similar arrangement, which is in substance a funding arrangement. Having a third party pay commission costs to the selling agent is strong evidence of a potential funding arrangement which shall be recognized as a liability because the substance of the arrangement indicates that repayment is reasonable and~~

~~probable, even if a contingency has been incorporated into the funding arrangement,~~ until ~~the underlying policy has been cancelled. A third-party structure cannot recharacterize (e.g. by referencing policy persistency) and delay recognition of liabilities for initial sales commission owed from the writing of policies regardless of how a third-party arrangement is structured with regards to the timing of payment from the insurer. The amount owed for full initial sales commission shall be recognized immediately as the writing of an insurance contract is the event that obligates the insurer, and such action shall occur consistently among insurers. As such, this recognition is required regardless if the insurer owes a selling agent directly or if a third-party has been contracted to provide payment to the selling agent.~~

Interested parties highlighted wording to replace the above excerpt from paragraph #5:
The reporting entity is required to recognize the full repayment amount of earned commission costs by the direct policy writing agents even if those costs are paid indirectly by a third party through the use of levelized commission, or similar arrangement, which is in substance a funding arrangement. Recognition of those commission costs and recording a liability is required in such arrangements that are not linked to or contingent upon traditional elements. Such treatment shall occur consistently among insurers.

IP Summary:

Since its initial exposure in August 2019, industry has had concerns with the substantive nature of the proposed revisions and has consistently expressed these concerns.

- The last paragraph of the current SSAP No. 71 states: “The use of an arrangement where commission payments are not linked to traditional elements such as premium payments and policy persistency, but rather are linked to the repayment of an advance amount requires the establishment of a liability for the full amount of the unpaid principal and accrued interest which is payable to a third party related to levelized commissions.” This wording was revised to instead explicitly include arrangements linked to traditional elements with those that have no substance other than to link to the repayment of an advance amount. This is clearly a substantive change and not clarifying the original intent. It is a change to the intent.

- The current revisions require the accrual of a liability in situations that are inconsistent with the guidance SSAP No. 5R. Under a levelized commission program a third party has the obligation for the full initial sales commission. The insurer’s obligation under a levelized commission program that incorporates persistency should be accrued to the extent of legally contracted amounts owed. We do not believe the original intent of the SSAP required accruing for amounts that are not yet due and that may never be due. We strongly feel that the recognition of an obligation based on persistency is in accordance with the principles of SSAP 5R.

- The interpretation of SSAP No.71 that persistency is the obligating event for accrual of the levelized/persistency commissions is long standing industry practice that has been subject to both independent audits and state insurance department examinations without this interpretation being raised as an issue nor requiring adjustments to the companies’ financial statements.

- The current proposed language does not address the many varying product/distribution compensation arrangements in the industry and interested parties continue to believe this will cause unintended consequences.

- The existing SSAP No. 71 guidance is consistent in the application of persistency being part of the transfer of the risk(liability) to another party. If the lapse risk(persistency) is transferred to another party, the liability that the insurance company may have is also transferred to that party and the insurance company has no liability. Removing persistency as a factor in the accrual of commissions is a dangerous precedent. The differentiation between commissions based on real insurance risks versus payments based solely upon the passage of time in SSAP No. 71 goes directly to the risk transfer issue of one type of level commissions versus another. The proposed additional language eliminates this differentiation.

IP Conclusion:

Industry continues to maintain that the revisions exposed have changed the original intent of SSAP No. 71 and do not believe that they are nonsubstantive. Removing insurance elements from the determination of obligating events of third-party commission contracts may set a precedent that will have significant unintended consequences. As such, interested parties request that the Working Group consider these comments and proposed revisions. In addition, we request that this exposure be categorized as substantive, and given due process and an effective date.

5) *Acadia Capital Management Comments:*

We have reviewed the revised proposed changes to SSAP No. 71 – Policy Acquisition Costs and Commissions as outlined in Ref. #2019-24. We continue to question several elements of the proposal and strongly object to the revisions for the following reasons:

1. This continues to be a substantive change to existing policy, contrary to the characterization in the published exposure draft.

2. The proposal continues to alter the fundamental premise of statutory accounting by creating a situation in which certain historically period expenses, trail commission payments, are to be treated differently from other period expenses by way of an accrual methodology, which leads to:

    a. A hybrid of statutory, GAAP and tax accounting.

    b. Fundamentally and permanently different economics for products designed with trail commission payments, leading to the need for significant effort at primary writers to redesign and/or reprice such products, presumably at a cost to the consumer.

    c. Guaranteed renewable products, like Long Term Care Insurance, could be exposed to further rate increases if the fundamental profit dynamics of the products change as a result of the new reserving practices.

    d. New uncertainty within the statutory accounting framework as to which other period expenses should also be accrued or might be targeted for similar treatment.

    e. A situation whereby trail commission expenses have a greater impact on statutory capital than other, similar expenses.

    f. A disincentive for primary writers to align the interests of the writer, broker/agent and policyholder through trail commissions because of the unique treatment and resulting capital implications.

3. Should the proposed changes be adopted, primary writers will be exposed to new and substantial accounting and actuarial workload relating to the determination of accrual methodologies for each affected product and the related periodic 'true-up' required to adjust the new statutory reserves for actual performance.

4. There is no apparent benefit for the consumer, primary writer, investment community, or regulatory bodies. The additional costs involved are highly restrictive and will likely cause either a decline in product offering or result in a higher cost to the consumer, which will ultimately curb the ability for the average person to save some of their earnings for retirement, children's schooling or other reason.

5. Moreover, there will be a material adverse impact on the RBC ratios of carriers utilizing legitimate third-party distribution structures, which may in some cases be material enough to affect carrier capital solvency.

We understand some have expressed concerns that related party structures have been put in place to achieve a deferral of commission expense, and understand that in such circumstances existing accounting rules may appropriately require that a liability should be established - but we continue to be of the view that existing accounting standards provide both the necessary guidance and basis for enforcement. In cases – like Acadia's carrier contracts - where a third-party licensed agent is involved and applies a trail commission to in-force policies only, there is no obligation to pay commissions until the anniversary date of the policy and therefore no reason to recognise a liability. The proposed change ignores both of these material elements – the involvement of a third party, and fact that an obligation does not arise until the anniversary date – and sweeps up these materially different arrangements in the same basket as related-party structures.

It is manifestly contrary to the public interest to pursue a change where:

- there is no clear benefit or public interest in favour of it;
- there is ample clarity and scope under existing accounting rules;
- there is material adverse impact on carriers;
- there is resulting adverse impact on the public through higher prices, reduced access, or both.

We urge the NAIC to reject this poorly conceived and clearly material change which is rife with unintended consequences, and instead rely on the proven ample scope under the existing SSAP 71 which has been in effect for decades.

6) <u>Guggenheim</u>

Guggenheim Life and Annuity Company is writing to express our concern with the proposed changes to SSAP No. 71 set forth in agenda item *#2019-24: Levelized and Persistency Commission* ("2019-24"). There have been serious flaws in the exposure process, including the designation of the proposed change as "nonsubstantive," inconsistency regarding how to characterize the proposed changes, and a changing effective date.

Companies potentially impacted by 2019-24, in their attempt to provide input, have been aiming at a constantly moving target. 2019-24 has gone through several rounds of exposure, with significant variations to foundational aspects of the proposal, including how reporting entities should classify the proposed changes and the effective date of the proposed changes. The proposal has varied on the fundamental point of whether the change is a correction of error or change in accounting principle. Similarly, the effective date of the proposal has changed 3 times (from no effective date, to a January 1, 2021 effective date, to an "effective upon adoption" date).

We believe that a change to an accounting principle dating back to 1998 should be deemed a substantive change. The Statutory Accounting Principles Working Group has determined the process around 2019-24 has met the due process requirements of a substantive revision; however, we believe additional scrutiny and process should be given to this issue for several reasons. First, the proposed changes constitute a change to accounting principles that could have a significant impact on certain reporting entities. Second, decades of examinations and audits did not result in any objection to reporting entities' reporting of the commission arrangements at issue.[1] Third, companies have not harmed policyholders nor put themselves in financial impairment by reporting the way they have for decades. To

[1] Note also that a 2010 SEC complaint against a carrier explained that levelized commissions were a common practice in the insurance industry. There is no evidence in the complaint that the statutory accounting treatment was ever determined not to be in accordance with statutory accounting principles.

us, this change in accounting principle seems like a punitive measure against a small number of companies that have been reporting these commissions a certain way for decades.

We appreciate the opportunity to comment on 2019-24 and believe regulators should continue to explore this issue and come to a reasonable solution.

Recommended Action:
NAIC staff recommends that the Working Group take the following actions:

1. **Expose the issue paper to document the historical discussion**.

2. **Adopt the exposed revisions to SSAP No. 71 after discussion regarding whether to incorporate the revisions to paragraph 7 regarding the effective date** which is illustrated as shaded text below. The November 2020 exposure was for the revisions to be effective on adoption. This is because some members noted a preference for an early as possible effective date in 2021. Guggenheim and IPs comments requested an effective date no sooner than December 31, 2021 to allow time to work with regulators, auditors etc.

   In the event that the Working Group wants to consider the industry request, NAIC staff has provided language for a December 31, 2021 effective date as illustrated below. As the issue paper is to document the historical discussion there is not a need to delay the effective date for an issue paper that is not authoritative. A December 31, 2021 effective date would allow the issue paper to be adopted prior to the implementation of the revisions. Note that under SSAP No. 3, the impacts are still calculated using Jan. 1 numbers, but would not be initially reported until the year-end 2021 financial statements.

   Effective Date and Transition (shaded revisions to paragraph 7 are for discussion).

   7. This statement is effective for years beginning January 1, 2001. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*. The nonsubstantive revisions adopted TBD date regarding levelized commission are to clarify the original intent of this statement and apply to existing contracts in effect as of December 31, 2021 and new contracts thereafter ~~on the date of adoption of the~~.

3. **Note – It is recommended that the Working Group expose a blanks proposal (2021-04BWG, see attachment 20.1) to incorporate a new general interrogatory to assist with identifying the use of funding agreements** as a concurrent exposure with the Blanks (E) Working Group. This general interrogatory will require the identification of circumstances of when an insurer utilizes third parties to pay agent commissions in which the advances paid by the 3rd party are not settled in full within 90 days. The 90-day threshold for reporting was selected to not require reporting when an insurer a third-party for traditional payment processing. This proposal is attached at 20.1 and was developed with Working Group member input. (*Staff Note: Input from interested parties is requested to ensure that this GI is written to capture the desired information on companies using financing arrangements to pay commissions.)*

4. NAIC staff does not recommend any additional revisions for reasons noted below each item in the summary of key comments.

<u>NAIC Staff Summary of Key Comments with NAIC staff Responses:</u>

1. **No reason to change/opposed** (MT, Wayne Goodwin, Arcadia, Guggenheim)

    - Current programs have been around for decades, been subject to external audits and insurance examinations and have not previously been noted of concern. (MT, Wayne Goodwin, Arcadia, Guggenheim)

    NAIC Staff notes that identifying levelized commission transactions is difficult, without an in-depth review. When this was identified on a 2017 state examination, the reporting entity refused to recognize the full liability, which is why this issue was brought to the Working Group. The guidance to recognize the full liability amount for a levelized commission transaction has been a SAP requirement since before 1998. This guidance is in place to recognize that the substance of an arrangement that has a third party pay an insurer's sales commission costs, is a loan. This is because a third party would not pay out large amounts of costs on another's behalf without an expectation of repayment.

2. **Substantive change based on impact needs more study and review for unintended consequences** (MT, Wayne Goodwin, NCOIL, IPs, Arcadia, Guggenheim)

    - Incorporation by reference concerns arise when an item is substantive (NCOIL)
    - Trailing commission accounting and reporting concerns (Arcadia)

    Change classification - NAIC staff continues to recommend classifying the revision as nonsubstantive as previously discussed. Under the *NAIC Policy Statement on Maintenance of Statutory Accounting Principles*, it is not the impact of a change on an individual entity that determines whether a change is substantive or nonsubstantive. To the extent this is a clarification of existing guidance, the revisions are consistent with the nonsubstantive classification. It notes that:

    > Nonsubstantive revisions to SAP will be developed to address, but will not be limited to: 1) clarification of the intent or application of existing SSAPs; 2) new disclosures and modification of existing disclosures; 3) revisions that do not change the intent of existing guidance; and 4) revisions to Appendix A—Excerpts of NAIC Model Laws to reflect amendments to NAIC adopted model laws and regulations.

    Amount of Study - NAIC staff notes that this item has been under discussion since August 2019 and as detailed in the summary of issue section, the March meeting will be the sixth public discussion of this item. This item has been discussed: 1) Aug. 2019; 2) Dec. 2019; 3) July 2020; 4) Oct. 2020; 5) Nov. 2020. We note that the underreporting of commission liabilities appears to be a practice employed by only a very small number of reporting entities.

3. **Negative RBC impact** (Wayne Goodwin, NCOIL, Arcadia)

    - NCOIL notes that they have heard of impacts as high as 30% RBC, which could cause rating downgrades. Making a previously solvent healthy company have negative impacts.

    NAIC staff agrees that underreporting the full amount of commission expense may have negative impacts on reporting entities that have been previously underreporting their commission expense liabilities. This is why the adoption of this time was delayed from year-end 2020 to allow the small number of reporting entities which are employing the disputed practice the opportunity to have discussions with their regulators.

4. **Possible consumer rate increases on guaranteed renewable LTC** (Wayne Goodwin, Arcadia)

   NAIC staff notes that the disputed practice is underreporting incurred commission expense and the obligation to repay it to a funding agent. This financing activity is being used to delay / under report incurred commissions. However, the total commission cost is typically slightly higher as the funding agents charge a fee and or interest (implicit or explicit) for their services. So the full financial statement impact is not as clear cut as implied in this comment.

5. **Effective date**

   - Against a 2020 effective date (NCOIL) (appears to be a comment on the Oct. exposure).
   - Effective date no sooner than 12/31/21 to allow time to work with regulators, auditors etc.) (Guggenheim and IPs)
   - Requests delay for issue paper (NCOIL) and
   - Requests a five-year phase-in (NCOIL)

   Effective Date - NAIC staff have proposed language which allows a December 31, 2021 effective date for Working Group review (see recommendation above).

   Phase-in - NCOIL requested that the Working Group consider a 5-year phase-in for any such revisions. NAIC staff continues to believe that this is a practice employed by a small minority of reporting entities, but the potential impact is material. Some Working Group members and some members of industry have noted the unfair competitive advantage that entities which employ this practice are receiving, because it underrepresents the incurred liabilities. NAIC staff notes that prior Working Group discussions have indicated that a phase-in would need to be a permitted practice granted by the domiciliary regulator.

6. **Asserts that lapse risk can be transferred to a noninsurance entity** (IPs).

   - The existing SSAP No. 71 guidance is consistent in the application of persistency being part of the transfer of the risk(liability) to another party. If the lapse risk(persistency) is transferred to another party, the liability that the insurance company may have is also transferred to that party and the insurance company has no liability. Removing persistency as a factor in the accrual of commissions is a dangerous precedent. The differentiation between commissions based on real insurance risks versus payments based solely upon the passage of time in SSAP No. 71 goes directly to the risk transfer issue of one type of level commissions versus another. The proposed additional language eliminates this differentiation.

   NAIC staff notes that statutory accounting in Appendix A-791 on Life and Health Reinsurance identifies that lapse risk can be transferred via reinsurance. NAIC staff disagrees that lapse related liabilities can be extinguished with a commission agreement with a noninsurance entity, which seems to be the position of interested parties. NAIC staff note that the guidance in SSAP No. 71 requires full accrual of the funding agreement liability even if repayment is not guaranteed. We do not believe that the insertion of a contingency into a funding agreement in any way should delay or decrease the recognized liability for an advance that has already been made on behalf of an insurer.

   Because of the persistency feature in the funding agreement, interested parties' commenters are advocating to not recognize ANY commission expense in these arrangements until it is due to the third-party agent.

<u>This is the equivalent of a 100% lapse assumption</u>. This assertion is not consistent with any other assertions reflected in the recognition of these insurance policies in their financial statements.

NAIC staff disagrees with the comment by interested parties that under a levelized commission agreement another party is responsible for an insurer's acquisition costs. This is not appropriate as statutory accounting requires acquisition costs are expensed as incurred, not shifted to a non-insurance entity. IPs are asserting that even though a third party prepaid their acquisition costs that they don't have to recognize an accrual for the levelized commission funding agreement because in some situations such as future policy cancellation, they might not have to pay. They are asserting that including a persistency element in the funding agreement decreases the liability amount and the timing or recognition, to only be the next payment when it is fully earned. They are asserting the right to treat a funding agreement the same as traditional persistency commission even though they are different in substance.

The overall statutory accounting concepts of conservatism and consistency require that financial statements reflect assets available for policyholder claims with comparable financial information. Allowing delayed expense recognition of initial policy commission expenses will contradict both statutory accounting concepts, as assets will be included that are not actually available for policyholder claims (as they are needed for non-recognized commission expenses) and will result with financial statements that are not comparable to other insurance entities.

7. **Paragraph 4 comment** – Resubmitted some of the previously rejected proposed edits which seek to codify the industry position that funding agreements which incorporate contingencies linked to traditional elements should not be treated as a funding agreement (i.e. excluded from liability recognition). (IPs).

   NAIC staff does not recommend incorporating the industry proposed language to paragraph 4. The proposed language seeks to codify the treatment which has previously been rejected as inconsistent with the guidance in SSAP No. 71.

8. **Paragraph 5 comments**: (IPs)

   - Exposed language which describes funding agreements, is too broad. Notes a concern that interim pay downs are not mentioned.
   - Resubmitted previously rejected proposed edits to replace most of the exposed paragraph with language that is less detailed and which seeks to codify the industry position that funding agreements which incorporate contingencies linked to traditional elements should not be treated as a funding agreement (i.e. excluded from liability recognition).

   NAIC staff does recommend adding more guidance regarding interim payments to paragraph 5, because liabilities are always reduced when paid. This is detailed in *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets* and also discussed in *SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*.

   NAIC staff does not recommend incorporating the industry proposed language to paragraph 5. The proposed language seeks to codify the treatment which has previously been rejected as inconsistent with the guidance in SSAP No. 71.

9. **Persistency in a funding agreement** (IPs):

   - IP-comment: The current revisions require the accrual of a liability in situations that are inconsistent with the guidance SSAP No. 5R. Under a levelized commission program a third party has the

> obligation for the full initial sales commission. The insurer's obligation under a levelized commission program that incorporates persistency should be accrued to the extent of legally contracted amounts owed. We do not believe the original intent of the SSAP required accruing for amounts that are not yet due and that may never be due. We strongly feel that the recognition of an obligation based on persistency is in accordance with the principles of SSAP 5R.

NAIC staff disagrees and notes that SSAP No. 5R incorporates an obligation to recognize even contingent amounts that are probable and can be reasonably estimated. The difference is that a levelized commission arrangement is repaying a loan where in most cases the advance of the loan amount has already been made. The loan has contingency elements that may allow the loan repayment to be reduced in the future. Until the policy is cancelled there is a presumption that the amounts will be repaid. This is different from making a future commission payment on commission that has not yet been earned which occurs under traditional persistency commission.

10. **Complex contracts** (IPs)

- IP- comment: Certain of the third-party contracts noted above are complex and not quite as simple as the description of levelized commissions in the most recent draft of the Exposure. The Exposure depicts a simple arrangement whereby the insurer repays a third party over time, with interest, for making upfront heaped commissions to agents. This does not consider, for example, certain third-party contracts for which the insurer pays the third-party trail commissions based upon account value in-force in exchange for performing many contractual agency services other than simply funding and making upfront payments to selling agents.

NAIC Staff note that adding additional complexity can create confusion so we have not drafted any additional language. The SSAP guidance reflects the principle that should be followed for all lines of business. The issue is that companies are not identifying funding arrangements and are trying to indicate that a third party is responsible for paying upfront costs on behalf of an insurer.

SSAP No. 71 Nov. 12, 2020 exposure with shaded revisions to paragraph 7 for Spring 2021 discussion

2. Acquisition costs are those costs that are incurred in the acquisition of new and renewal insurance contracts and include those costs that vary with and are primarily related to the acquisition of insurance contracts (e.g., agent and broker commissions, certain underwriting and policy issue costs, and medical and inspection fees). Acquisition costs and commissions shall be expensed as incurred. Determination of when acquisition costs and commissions have been incurred shall be made in accordance with SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets.

3. Contingent commission liabilities shall be determined in accordance with the terms of each individual commission agreement. Commission liabilities determined on the basis of a formula that relates to loss experience shall be established for the earned portion. Assumptions used to calculate the contingent commission liability shall be consistent with the terms of the policy contract and with the assumptions made in recording other assets and liabilities necessary to reflect underwriting results of the reporting entity such as retrospective premium adjustments and loss reserves, including incurred but not reported.

4. Levelized commissions occur in situations where agents receive normal (non-level) commissions with payments made by a third party. It is intended, but not necessarily guaranteed, that the amounts paid to the agents by the third party would ultimately be repaid (with interest explicit or implied) to the third party by levelized payments (which are less than the normal first year commissions but exceed the normal renewal commissions) from the reporting entity. (Note: levelized repayments made by the reporting entity extend the repayment period but might not be a straight-line repayment.) These transactions are, in fact, funding agreements between a reporting entity and a third party, regardless of how the payment to the third party is characterized. The

continuance of the stream of payments specified in the levelized commission contract is a mechanism which attempts to bypass recognition of those expenses which are ordinarily charged to expense in the first year of the contract. Consequently, the normal link between the persistency of the policy, the continuance of the premium payment or the maintenance of the agent's license with the reporting entity is not maintained with respect to the payment stream.

5. The use of an arrangement such as a levelized commission arrangement where commission payments are not linked to traditional elements such as premium payments and policy persistency, but rather are linked to the repayment of an advance amount paid by a third party to the direct selling agents requires the establishment of a liability by the reporting entity for the full amount of the unpaid principal and accrued interest which is payable to a third party related to levelized commissions ~~FN~~. Arrangements that use a third party to pay agents who write policies for the reporting entity and the insured can be an attempt to de-link the relationship between the insurer and those agents and defer or levelize the acquisition commissions. The insurance reporting entity is required to recognize the full amount of earned commission costs to the direct policy writing agents even if those costs are paid indirectly to the agents by a third party through the use of levelized commission, or similar arrangement, which is in substance a funding arrangement. Having a third party pay commission costs to the selling agent is strong evidence of a potential funding arrangement which shall be recognized as a liability because the substance of the arrangement indicates that repayment is reasonable and probable, even if a contingency has been incorporated into the funding arrangement, until the underlying policy has been cancelled. A third-party structure cannot recharacterize (e.g. by referencing policy persistency) and delay recognition of liabilities for initial sales commission owed from the writing of policies regardless of how a third-party arrangement is structured with regards to the timing of payment from the insurer. The amount owed for full initial sales commission shall be recognized immediately as the writing of an insurance contract is the event that obligates the insurer, and such action shall occur consistently among insurers. As such, this recognition is required regardless of if the insurer owes a selling agent directly or if a third-party has been contracted to provide payment to the selling agent.

Effective Date and Transition

7. This statement is effective for years beginning January 1, 2001. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*. The nonsubstantive revisions adopted TBD date regarding levelized commission are to clarify the original intent of this statement and apply to existing contracts in effect as of December 31, 2021 and new contracts thereafter ~~on the date of adoption of the~~.

The comment letters are included in Attachment 22 (29 pages).

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Draft: 11/24/20

Statutory Accounting Principles (E) Working Group
Virtual Meeting *(in lieu of meeting at the 2020 Fall National Meeting)*
November 12, 2020

The Statutory Accounting Principles (E) Working Group of the Accounting Practices and Procedures (E) Task Force met Nov. 12, 2020. The following Working Group members participated: Dale Bruggeman, Chair (OH); Carrie Mears and Kevin Clark, Vice Chairs (IA); Richard Ford (AL); Kim Hudson (CA); William Arfanis and Kathy Belfi (CT); Rylynn Brown (DE); Eric Moser, Cindy Anderson and Kevin Fry (IL); James J. Donelon and Caroline Fletcher (LA); Judy Weaver (MI); Doug Bartlett (NH); Bob Kasinow (NY); Melissa Greiner (PA); Jamie Walker (TX); Doug Stolte and David Smith (VA); and Amy Malm (WI).

1. Adopted its Oct. 15, Oct. 13, Aug. 17 and Summer National Meeting Minutes

The Working Group met Oct. 15, Oct. 13, Aug. 17 and July 30. During its Oct. 15 meeting, the Working Group took the following action: 1) exposed revisions to *Statement of Statutory Accounting Principles (SSAP) No. 71—Policy Acquisition Costs and Commissions*; and 2) received an update on the federal Affordable Care Act (ACA) risk corridors. During its Oct. 13 meeting, the Working Group took the following action: 1) received comments on agenda items previously exposed, including the project to substantively revise *SSAP No. 43R—Loan-Backed and Structured Securities*; 2) rejected several U.S. generally accepted accounting principles (GAAP) accounting updates for statutory accounting; 3) adopted the option to allow for early application of *SSAP No. 32R—Preferred Stock*, which was previously effective Jan. 1, 2021; and 4) exposed a proposal to clarify what should be reported on Schedule D, Part 1 – Long-Term Bonds. During its Aug. 17 meeting, the Working Group took the following action: 1) adopted non-contested statutory accounting revisions; and 2) exposed agenda item 2020-31: Early Application of SSAP No. 32R for a 32-day public comment period ending Sept. 18.

Ms. Malm made a motion, seconded by Mr. Bartlett, to adopt the Working Group's Oct. 15 (Attachment One-A), Oct. 13 (Attachment One-B), Aug. 17 (Attachment One-C) and July 30 (*see NAIC Proceedings – Summer 2020, Accounting Practices and Procedures (E) Task Force, Attachment One*) minutes. The motion passed unanimously.

2. Adopted Non-Contested Positions

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

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

a. Agenda Item 2020-19

Mr. Bruggeman directed the Working Group to agenda item 2020-19: Clarifying Edits – Participating in Mortgages (Attachment One-E). Jim Pinegar (NAIC) stated that this nonsubstantive agenda item provides clarifying edits to the "financial rights and obligations" required for participating loan agreements in scope of SSAP No. 37. The clarifications direct that the financial rights and obligations for a participating loan do not require the participant to have the right to solely initiate legal action, foreclosure or under, normal circumstances, require the ability to communicate directly with the borrower.

b. Agenda Item 2020-23

Mr. Bruggeman directed the Working Group to agenda item 2020-23: Leasehold Improvements (Attachment One-F). Jake Stultz (NAIC) stated that this nonsubstantive agenda item provides 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 Accounting Standards Codification (ASC) Topic 842.

c. Agenda Item 2020-25EP

Mr. Bruggeman directed the Working Group to agenda item 2020-25: Editorial Updates (Attachment One-G). Robin Marcotte (NAIC) stated that this agenda item provides nonsubstantive editorial corrections. She stated that the revisions delete a redundant paragraph in *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets* and add a table of contents for questions addressed in Exhibit A in *SSAP No. 62R—Property and Casualty Reinsurance*.

d. Agenda Item 2020-17

Mr. Bruggeman directed the Working Group to agenda item 2020-17: SSAP No. 97 Update (Attachment One-H). Fatima Sediqzad (NAIC) stated that this nonsubstantive agenda item provides minor updates to improve the descriptive language in *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities.* Additionally, this agenda item modifies the method in which financial statement filers will retrieve their completed subsidiary, controlled and affiliated (SCA) entity reviews, with obtaining their reviews directly from VISION. She stated that state insurance regulators will receive one monthly report as opposed to the current process of receiving one email per review. She noted that NAIC staff concur with interested parties' proposed edits for the two informational addendum files (which are nonauthoritative). These changes will go into effect Jan 1, 2021.

e. Agenda Item 2020-20

Mr. Bruggeman directed the Working Group to agenda item 2020-20: Cash Equivalent Disclosures (Attachment One-I). Mr. Pinegar stated that this nonsubstantive agenda item expands the *SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments* disclosures previously adopted in agenda item 2019-20: Rolling Short-Term Investments. He stated that agenda item 2019-20 adopted principle concepts restricting the classification of certain related party or affiliated investments as a cash equivalent or short-term investment and requires disclosures of short-term investments (or substantially similar investments) that remain on the short-term schedule for more than one consecutive annual reporting period. This agenda item expands the disclosure requirements to include cash equivalent investments. He stated that NAIC staff concurred with interested parties' proposal to exclude money market mutual funds from the disclosure requirements as these investments were not noted as a concern to regulators. Additionally, the revisions clarify that the disclosure is satisfied through the use of a reporting code in the investment schedules.

f. Agenda Item 2020-21

Mr. Bruggeman directed the Working Group to agenda item 2020-21: SSAP No. 43R – Designation Categories for RMBS/CMBS Investments (Attachment One-J). Mr. Pinegar stated this nonsubstantive agenda item was drafted in response to a recent adoption by the Valuation of Securities (E) Task Force to the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual) for financially modeled residential mortgage-backed securities (RMBS) and commercial mortgage-backed securities (CMBS). He stated that while the current financial modeling process remains unaffected, the NAIC designations, as produced by the financial model, will now be mapped to a final NAIC designation category. Accordingly, this agenda item updates guidance in SSAP No. 43R for financially modeled securities to reflect the updated financial modeling guidance in the P&P Manual. Mr. Pinegar stated that additional edits from both NAIC SVO staff and interested parties have been proposed to further ensure consistency with the P&P Manual and to remove redundancy in various places. He stated that NAIC staff concur with the changes as outlined in the agenda and recommended one additional minor edit as proposed by interested parties to remove redundant language. In response to an inquiry from Mr. Bruggeman, the Working Group did not have concerns with the additional modification.

3. Reviewed Comments on Exposed Items

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

a. Agenda Item 2020-18

Mr. Bruggeman directed the Working Group to agenda item 2020-18: SSAP No. 97 Update. Ms. Sediqzad stated the Working Group adopted agenda item 2018-26: SCA Loss Tracking – Accounting Guidance, which incorporated guidance in SSAP No. 97 that reported equity method losses in an SCA would not create a negative value in the SCA investment, but would stop at zero. However, to the extent there is a financial guarantee or commitment, the guidance requires recognition under SSAP

No. 5R. She stated that this agenda item was drafted to propose a minor revision to the end of paragraph 9 to remove an outstanding reference that guarantees or commitments can result in a negative equity value for the SCA.

Ms. Sediqzad stated that comments were received from interested parties and New York Life, both expressing concern that the long-standing adjustments required for 8.b.iv (foreign insurers) could result in a negative equity valuation. She stated that proposed edits in this agenda item only remove a superseded statement that guarantees or commitments from the insurance reporting entity to the SCA could result in a negative equity valuation. She stated that the edits do not modify any current guidance regarding the paragraph 9, limited statutory basis adjustments, required for 8.b.ii (noninsurance SCA entities) and 8.b.iv entities. She stated that accordingly, NAIC staff recommend adoption of exposed revisions along with additional edits to Question 7 in Exhibit C, which would clarify that foreign insurance SCAs remain subject to equity adjustments as required in SSAP No. 97. She requested that the Working Group provide direction as to whether a separate agenda item is warranted, reviewing if some of the provisions of paragraph 9, which could result in negative SCA values, should no longer apply to 8.b.iv entities.

Mr. Stolte stated that the comments received from New York Life raised valid points concerning foreign insurance entities. He stated that he would recommend a separate agenda item to look further into the issue whether all the provisions of paragraph 9 should continue to apply to 8.b.iv entities.

Angelica Tamayo-Sanchez (New York Life), representing interested parties, stated that they support a separate agenda item reviewing the accounting treatment for foreign insurance entities. She stated that current SSAP No. 97 guidance requires similar equity adjustments for 8.b.ii and 8.b.iv. However, due to the differences between the types of entities, distinct accounting treatment should be considered. She stated that as foreign insurance entities have a valid business purpose, are subject to capital requirements and regulation by local insurance jurisdictions, and in many cases operate independently of the U.S. domestic owner, they should not be considered an extension of a domestic insurance company. As such, these entities should not be subject to the required adjustments of an 8.b.ii entity and should not be required to report a negative equity position.

Mr. Stolte made a motion, seconded by Ms. Weaver, to adopt the exposed nonsubstantive revisions to SSAP No. 97, with the additional edits to Exhibit C, Question 7. This motion also directed NAIC staff to prepare a separate agenda item to assess if changes to the valuation calculation are warranted for foreign insurance SCAs (Attachment One-K). The motion passed unanimously.

b. Agenda Item 2020-22

Mr. Bruggeman directed the Working Group to agenda item 2020-22: Accounting for Perpetual Bonds. Mr. Pinegar stated that this agenda item addresses the accounting treatment for perpetual bonds within scope of *SSAP No. 26R—Bonds.* He stated that due to the numerous payment similarities between perpetual bonds and perpetual preferred stock, this agenda item originally proposed similar accounting treatment for these instruments. However, perpetual bonds do maintain characteristics of bonds and, in most cases, contain a schedule of call dates. He stated that these call dates generally possess step-up call characteristics, providing an economic enticement to call the bond. Additionally, it is rare that a perpetual bond is not called in the first round or two of scheduled call dates, and it is even more rare that a perpetual bond does not possess a future call date. He stated that with these facts, this agenda item has been modified, and exposure is recommended to specify amortized cost treatment for perpetual bonds that have an upcoming, scheduled call date. The agenda item proposes fair value accounting for perpetual bonds that do not possess a future call date.

Diane Bellas (Allstate), representing interested parties, stated that interested parties will likely propose minor modification edits but agree with the bond treatment proposed in this updated agenda item.

Mr. Hudson made a motion, seconded by Ms. Weaver, to expose agenda item 2020-22. The motion passed unanimously.

c. Agenda Item 2019-34

Mr. Bruggeman directed the Working Group to agenda item 2019-34: Related Parties, Disclaimer of Affiliation and Variable Interest Entities. Mr. Stultz stated this agenda item is to clarify identification of related parties and affiliates in *SSAP No. 25—Affiliates and Other Related Parties* and to incorporate new disclosures to ensure state insurance regulators have the full picture of complicated business structures. He stated this agenda item has been modified from the last exposure to clarify that non-controlling ownership over 10% results in a related party classification regardless of any disclaimer of control or affiliation. Additionally, it clarifies the impact of a disclaimer of control or disclaimer of affiliation under statutory accounting, with such disclaimers affecting holding company group allocation and reporting as an SCA under SSAP No. 97, but do not eliminate the classification and disclosures required under SSAP No. 25. He stated that this agenda item incorporates the Group Solvency Issues (E) Working Group recommended new statutory disclosure to provide information on minority ownership interests, as well as significant relationships between minority owners and other U.S. domestic insurers. Mr. Stultz stated that in response to interested party comments, a supplemental reporting schedule will be proposed to the Blanks (E) Working Group to capture related party information.

Ms. Weaver made a motion, seconded by Mr. Smith, to expose the revised agenda item. The motion passed unanimously.

d. Agenda Item 2020-24

Mr. Bruggeman directed the Working Group to agenda item 2020-24: Accounting and Reporting of Credit Tenant Loans. Julie Gann (NAIC) stated that this agenda item was drafted to clarify the reporting of credit tenant loans (CTLs) for statutory accounting. She stated that in response to discussions at the Valuation of Securities (E) Task Force, this agenda item was drafted to provide timely guidance for the reporting of CTLs that do not meet the legal and structural analyses required in the P&P Manual for reporting on Schedule D-1 as a bond. She stated the previous exposure presented two options for consideration. The first option would continue to report conforming CTLs on Schedule D-1. However, non-conforming CTLs would be reported on Schedule B as a mortgage loan or on schedule BA as an other long-term invested asset. She stated reporting on Schedule B, in scope of *SSAP No. 37—Mortgage Loans*, is problematic as CTLs may be issued in the form of a security and securities are specifically excluded from SSAP No. 37. However, the alternative of reporting non-conforming CTLs on Schedule BA, or the reporting of all CTLs on Schedule BA, could result in overly punitive risk-based capital (RBC) charges.

Ms. Gann stated that in consideration of all comments received, there was support for continued reporting of conforming CTLs on Schedule D-1. However, the comment received noted that nonconforming CTLs shall also be reported on Schedule D-1 because they meet the broad bond definition. She recommended that conforming CTLs be in scope of SSAP No. 43R and nonconforming CTLs be reported on Schedule BA utilizing lines designated for investments with underlying assets that have characteristics of fixed income instruments. She proposed using the reporting lines that allow designations to influence RBC for life companies. She recommended a referral response to the Task Force to clarify that nonconforming CTLs that were reported on Schedule D-1 shall not be grandfathered for continued reporting on Schedule D-1. Lastly, she recommended a referral to the Securities Valuation Office (SVO) and Capital Markets Bureau requesting comments on an appropriate residual risk percentage to assess whether it is appropriate to revisit the 5% residual risk threshold as a restriction in determining whether a CTL is conforming, noting that the 5% residual risk threshold was established in 1994.

Ms. Gann stated that NAIC staff originally reviewed the known nonconforming CTL and drafted a document to detail the impact per company/state. However, she advised that a significant number of those nonconforming CTLs have been modified, such as obtaining a residual risk insurance contract, to mitigate nonconforming elements. She stated that through these steps, the remaining number of known nonconforming CTLs is limited. In addition, the remaining nonconforming CTLs could take similar steps to result in a conforming CTL and would then qualify for Schedule D-1 reporting. She stated that the provisions to only report conforming CTLs on Schedule D-1 is a longstanding principle and since SSAP No. 37 excludes securities, nonconforming CTLs should already be on Schedule BA. She stated that to avoid concerns with an RBC impact due to reporting on BA, NAIC staff have prepared a proposal to allow nonconforming CTLs to be reported with a credit rating provider (CRP) rating on schedule BA for year-end 2020 so that an improved RBC charge could be recognized, with all CTLs required to obtain an SVO-assigned NAIC designation in 2021.

Michael Reis (Northwestern Mutual), representing interested parties, stated it is important to note that private placement bonds have lower losses when compared to public bonds, and interested parties want to ensure private placement bonds are not made a less viable investment product for insurance entities. He stated that private placement investments, deemed to be conforming CTLs, should remain on Schedule D-1. He stated that the 5% residual asset risk currently required has likely contributed to the favorable historical performance of conforming CTLs. However, this methodology should not be applied to other bond investments as such application would remove a significant amount of bonds from qualifying for bond reporting, particularly those within scope of SSAP No. 26R or SSAP No. 43R. Mr. Reis stated that if the Working Group sends a referral to the SVO seeking input on increasing the 5% threshold, the resulting decision for accounting and reporting location should remain at this Working Group. He stated that if nonconforming CTLs are removed from Schedule D-1, Schedule BA is the most appropriate location for reporting these investments.

John Garrison, representing an industry group referred to as the “Lease-Backed Securities Working Group,” stated that they strongly agree that conforming CTLs shall remain in scope of SSAP No. 43R and be reported on Schedule D-1. He stated support for reviewing the 5% residual asset risk threshold, noting that this ceiling was set nearly 25 years ago and warrants revisiting. Mr. Garrison stated that the consideration to remove nonconforming CTLs from Schedule D-1 should be postponed, citing that the current SSAP No. 43R project and other exposure documents are proposing a review of many topics, including the definition of a bond and an asset backed security. He said that deciding on the placement of nonconforming CTLs in advance of that project is premature and inadvisable until the broader project questions are addressed. He stated that the review of a particular investment before the fundamental questions are answered could cause uncertainty with both the marketplace and investors. He stated that because a CTL does not meet the structural definitions as set forth by the P&P Manual does not mean the CTL is not a bond, and that it belongs on Schedule BA, as these items have been reported on Schedule D-1 for many years. Mr. Garrison stated that in his experience, the participation in CTLs is, in fact, a security offering, which is typically issued by trusts. These trusts possess the rights to future cash flows from rents from a single credit obligor, which are backed by a mortgage on the underlying property. He stated that despite the proposal to move nonconforming CTLs to Schedule BA so that they might receive favorable RBC charges, other items would need to be immediately addressed, such as carrying values and asset valuation reserve (AVR) and interest maintenance reserve (IMR) implications. He stated the possibility of moving these items to Schedule BA has recently frozen and disrupted current CTL markets and that he would recommend delaying a final decision until related discussions of the SSAP No. 43R project are resolved. Mr. Garrison stated that the Lease-Backed Securities Working Group would be willing to assist with the review of nonconforming CTLs to assist state insurance regulators in understanding the true risk structure and to demonstrate the similarity to conforming CTLs.

Mr. Bruggeman stated that he appreciates Mr. Garrison's comments and confirmed that there appears to be agreement with NAIC staff's recommendation to leave conforming CTLs on Schedule D-1 and to reevaluate the 5% residual risk ceiling. However, Mr. Bruggeman said the question remains about the reporting of nonconforming CTLs. Ms. Belfi inquired on the extent to which the nonconforming CTLs have surpassed the 5% residual risk ceiling. Ms. Gann stated the current known nonconforming CTLs have a residual risk greater than 27%–74%. However, she said there are examples with the residual risk being at 100% and greater. She advised that when the residual risk is greater than 100%, both the interest payments and principal payments are not covered over the term of the CTL. Ms. Gann stated that a significant number of known CTLs that were originally deemed to be nonconforming have subsequently been modified, through the use of a residual risk insurance contract, to result with a conforming CTL product that is permitted to be reported on Schedule D-1.

Michael Monahan (American Council of Life Insurers—ACLI) inquired if moving CTL assets to Schedule BA would create an uneven playing field as property/casualty (P/C) insurers do not obtain the same favorable RBC treatment that life insurers can receive. Mr. Bruggeman responded that this is not the intent with the proposal and noted that there has always been RBC differences between the two types of insurers due to the different risk profiles. Ms. Gann stated that the guidance for CTLs has been long-standing, and the proposed recommendation only confirms the guidance that only conforming CTLs are eligible for Schedule D-1 reporting. She stated that the reporting lines being proposed for nonconforming CTLs on Schedule BA were selected because they are not subject to the standard 30% RBC charge but will receive RBC charges based on the reported NAIC designation. Mr. Bruggeman stated he is concerned about creating an issue related to the movement of nonconforming CTLs, especially if they are subsequently deemed more appropriate for another reporting schedule. However, for year-end 2020 reporting, he stated support for the interim proposal to leave conforming CTLs on Schedule D-1 and moving nonconforming CTLs to Schedule BA with the potential for favorable RBC treatment.

Mr. Fry stated that while moving nonconforming CTLs to schedule BA to receive a 30% RBC charge would not be appropriate, perhaps they can remain on Schedule D-1 with additional identification. He stated he would be in support of postponing a decision to move the nonconforming CTLs. However, he said he would want additional transparency to identify them in the financial statements. Mr. Bruggeman stated he is uncertain how additional transparency could be achieved with the current reporting process on Schedule D-1, but that it would be achieved with the proposal of moving these items to Schedule BA. Ms. Gann stated that the guidance in the P&P Manual is very specific as to only allowing conforming CTLs on Schedule D-1, and the proposal was to only affirm the guidance remains applicable for 2020 year-end reporting. She stated that no changes to the current, long-standing guidance were proposed, and it may not be prudent to leave both conforming and nonconforming CTLs on Schedule D-1, especially since nonconforming CTL were not permitted to be captured on that schedule. Mr. Garrison stated that to assist state insurance regulators, the Lease-Backed Securities Working Group stands ready to review every identified nonconforming CTL. He stated there are likely mitigating factors in every issuance and as such, he suggested a postponement of a decision to move nonconforming CTLs to a different schedule until such time that state insurance regulators have reviewed the risk profile of each nonconforming security. Mr. Bruggeman clarified that the comment for improved transparency was intended to improve the ability to identify these investments on the financial statements.

Mr. Smith inquired if nonconforming CTLs should have been reported on Schedule BA and if delaying a decision would allow for misreporting. Ms. Gann stated that nonconforming CTLs were never eligible for Schedule D-1 reporting and that this was only discovered by SVO filings. She stated that it would not be logical to report both conforming and nonconforming CTLs in the same manner when to be deemed conforming, the securities must meet various criterion including legal and structural assessment requirements, with limitation that conforming CTLs are not filing exempt (meaning, they cannot use a CRP rating as an NAIC designation). She stated that nonconforming CTLs do not receive SVO scrutiny and if not originally structured in the form of a "security," they would have been captured in scope of SSAP No. 37. However, with the security-structure, if they do not conform to the P&P Manual requirements for D-1, the investments would be required to be reported on Schedule BA. She stated that as Schedule D-1 has additional criteria that must be satisfied, nonconforming CTLs have not met those requirements and should not be eligible for Schedule D-1 reporting. She advised that it would not make sense to require CTLs to be filed for a structural review at the SVO, if nonconforming CTLs would receive the same accounting and reporting treatment, with the ability to report a CRP rating as the NAIC designation. Mr. Smith stated that he recommends that nonconforming CTLs be moved to Schedule BA as they do not meet the requirements for Schedule D-1 reporting.

David Persky (Teachers Insurance and Annuity Association—TIAA) stated that the Working Group should consider delaying a decision to move nonconforming CTLs, but should require organizations that hold these securities to provide a list of such items to their domestic regulator. Mr. Bruggeman stated that disclosure would likely be required in the financial statements filed with the NAIC. However, due to the timing of year-end, reporting changes would likely not be able to be made for 2020 reporting.

Mr. Smith made a motion to move nonconforming CTLs to Schedule BA utilizing the reporting lines to allow CRP ratings to be reported for improved RBC. The motion failed for lack of a second.

Mr. Clark stated if there was not support for moving these securities to Schedule BA for year-end 2020 reporting, the Working Group could require all nonconforming CTLs be immediately filed with the NAIC SVO for review and designation, and if an SVO-assigned designation is obtained, then the security would be allowed to continue to be reported on Schedule D-1.

Mr. Fry made a motion, seconded by Mr. Clark, to require all nonconforming CTLs to be immediately filed with the SVO to remain on Schedule D-1. However, Schedule BA reporting will be required for those who are unable or will not file. Charles Therriault (NAIC) stated that while the SVO would consider an existing nationally recognized statistical rating organization's (NRSRO's) report for nonconforming CTLs, the SVO has not developed a methodology for assigning designations to such items. Mr. Bruggeman stated the motion included all the following elements: 1) confirm that conforming CTLs will remain in scope of SSAP No. 43R and reported on D-1; 2) direct a referral to the SVO to request information on the residual risk percentage permitted to be considered a conforming CTL; and 3) permit nonconforming CTLs filed with the SVO that receive an SVO-assigned NAIC designation to be reported on Schedule D-1. If the nonconforming CTLs are not filed or have not received a NAIC SVO designation before the March 1, 2021, filing date, the securities shall be reported on Schedule BA. The motion passed unanimously.

Subsequent Working Group Action:
Due to questions received on the adopted motion, on Nov. 18, the Working Group exposed a tentative interpretation to clarify the exception to the statutory accounting guidance. This tentative interpretation was exposed for a 16-day public comment period ending Dec. 4.

e. <u>Agenda Item 2020-30</u>

Mr. Bruggeman directed the Working Group to agenda item 2020-30: Premium Refunds and Other Adjustments. Ms. Marcotte stated this item was to seek industry feedback on the proposal to provide more explicit guidance on the return of premium and other premium adjustments. This agenda item highlights the need for more explicit guidance regarding policyholder refunds and other premium adjustments for accident and health (A&H) and P/C lines of business. The agenda item will also address premium adjustments as the result of newer policy form types, primarily those involving data telematics. Ms. Marcotte stated that comments were received from interested parties and the American Property Casualty Insurance Association (APCIA). She noted that the interested parties had provided some health-specific recommended language that highlighted the need to incorporate guidance regarding group health premiums, specifically related to the timing of billings versus the recognition of revenue. She recommended the Working Group direct NAIC staff to draft an agenda item for future Working Group review. In an inquiry from Mr. Bruggeman, no Working Group members opposed the recommended action.

f. Agenda Item 2019-24

Mr. Bruggeman directed the Working Group to agenda item 2019-24: Levelized and Persistency Commissions. Ms. Marcotte stated that a limited number of insurers have been identified as using third-party arrangements to make payments to agents in what SSAP No. 71 identifies as, in substance, a funding agreement with the intent to defer the recognition of commission expenses. She stated the proposed revisions are intended to clarify the original guidance in SSAP No. 71 regarding levelized commissions, which has been in place since 1998, and is based on pre-codification guidance. She noted that this issue was raised by a domiciliary state insurance regulator who identified the issue during an examination and that the Working Group has been discussing this issue since August 2019. She noted that the practice results in significant delays in the timing of commission expense recognition, affecting both consistency and comparability in statutory financial statements. This goes against long-standing statutory accounting guidance and results in those insurers presenting a better (than actual) financial position based on existing in-force insurance policies. She noted that it is believed that a vast majority of companies are following the guidance in SSAP No. 71 as originally intended and that the funding agreements in question are only being used by a small number of reporting entities.

Ms. Marcotte stated that SSAP No. 71 guidance requires full liability recognition of commission funding agreements where a third party pays the commission expense on behalf of the direct writer. She noted that the revisions exposed on Oct. 15: 1) improved the description of funding agreements; 2) deleted the previously proposed revisions regarding other types of commission in order to address concerns regarding inadvertent impact to the recognition of traditional persistency commission; 3) deleted the previously proposed revisions referencing application as a correction of an error; and 4) proposed that the nonsubstantive revisions would apply to contracts in effect on Jan. 1, 2021. She stated that the updated revisions intend to clarify the identification and recognition of funding agreements. Additionally, the revisions clarify that initial sales commission cannot be recharacterized as a "persistency" commission because of elements in a third-party agent contract that may delay when an insurer is required to provide payment.

Ms. Marcotte stated that comments were received from the Mississippi Department of Insurance (DOI), interested parties and Martin Carus Consulting. She stated that the comments from the July 30 and earlier exposures focused on separating traditional persistency commission from funding agreements that include persistency elements. She noted that the October exposure addressed the industry concerns on distinguishing traditional persistency commission from a funding agreement. Ms. Marcotte stated that the current comments from interested parties are different from the prior comments and appear to be seeking an explicit allowance to avoid full recognition of funding agreement liabilities if there is a persistency element inserted into a funding agreement.

Ms. Marcotte stated that given the year-end timing and the material impact for what is believed to be a very limited number of companies, it is recommended that the Working Group expose the previously exposed nonsubstantive revisions to SSAP No. 71 with minor edits to clarify that the revisions would apply to contracts in effect as of the effective date specified by the Working Group. She stated that the intent to apply to all contracts in effect on Jan. 1, 2021, was noted in the prior exposure discussion. However, NAIC staff recommend being clear that it applies to contracts in effect on either the date of adoption of the revisions or a stated effective date specified by the Working Group in the exposure. She stated that the Working Group should provide direction regarding the proposed effective date.

Ms. Marcotte stated that the Working Group could direct the development of an issue paper documenting the discussion of conclusions and revisions to SSAP No. 71. She stated that the revisions have already had the due process required for either a substantive or a nonsubstantive change since it has been under discussion for more than one year and the agenda item has had multiple exposures and public discussions. She stated that NAIC staff continue to believe that the proposed revisions are a nonsubstantive clarification of the intent or application of an existing SSAP as the revisions do not change the intent of the longstanding provisions of SSAP No. 71. Additionally, the provisions of SSAP No. 71 are understood to be disregarded by only a small number of entities, with the majority of reporting entities following the original intent. She stated that under the *NAIC Policy Statement on Maintenance of Statutory Accounting Principles,* it is not the impact of a change on an individual entity that determines whether a change is substantive or nonsubstantive. She stated that all the current commenters have requested that the issue be classified as substantive. She noted that NAIC staff defer to the Working Group regarding classification of the revisions.

Mr. Bruggeman noted that regarding the category of the revision, he recalled a prior Working Group decision to not draft an interpretation and to make the clarification on this topic directly into SSAP No. 71. He noted that this was viewed as a clarification regarding the original intent and that is why it was classified as nonsubstantive. He stated support for the preparation of an issue paper to document the discussion on this topic for future reference.

Commissioner Donelon asked if development of an issue paper would delay the implementation of the revisions. He stated that he has received feedback noting that one group with three or four companies was misapplying the guidance, but he has also received conflicting feedback that more entities are using the levelized commission funding agreements as discussed in this agenda item. He stated the supporters of the funding agreements have indicated to him that they view leveling of commission as being pro-consumer. He said that supporters have indicated to him that to not allow the treatment they are supporting would not be in the interests of consumers. He indicated concern with forcing reporting entities such as Guggenheim to implement the revisions at year-end, as it would result with an impact of hundreds of millions of dollars to those reporting entities. He asked for clarification regarding the proposed effective date and subsequent parent group review for adoptions.

Mr. Bruggeman noted that the current recommendation from NAIC staff is to re-expose the revisions until sometime in January 2021, so the revisions would not be effective and would not be considered for parent group reviews for year-end 2020. He stated that an issue paper is not required to be completed prior to the adoption or effective date of either a substantive or nonsubstantive revision. He noted that the issue paper was being recommended to document the discussion on the topic for historical reference and because the direct accounting guidance does not typically document the discussions that occur during development. He stated that the Working Group will need to consider an effective date. Mr. Bruggeman stated that sometime later in 2021 or even possibly 2022 were possible effective dates. He stated that commissions will ultimately be paid, so this issue is addressing the timing of when the recognition of the commission expense will reduce surplus. He stated that an expense is either recognized as paid, or a liability is established for the unpaid amount. Mr. Bruggeman noted that a levelized commission structure will often include an additional amount for the funding agent. Therefore, there is actually a higher cost incurred for the use of a levelized commission arrangement, which can result in a higher consumer cost for the product. He noted that recognition of acquisition costs upfront can also result in earlier surplus reduction, which could limit sales, if a company does not have enough capital to support the sales. As such, while there could be a consumer effect, it could be both negative (increased costs) and possibly less sales (a negative or positive), depending on the company circumstances and perspective.

Commissioner Donelon stated that his financial staff noted similar factors to him. Commissioner Donelon stated that his concern was the long-term hands-on engagement of the agent with the insured. He noted that his understanding is that leveling commission was a way of ensuring long-term engagement of the agent with the consumer.

Commissioner Donelon asked if the categorization of the revision as either substantive or nonsubstantive will affect the effective date of the revision. Mr. Bruggeman stated the categorization of the revision itself would not change the effective date. However, the current recommendation under consideration from the Working Group is to re-expose, which would result in an effective date after the previously exposed effective date of Jan. 1, 2021. Mr. Bruggeman noted that he does not think that companies would have enough time to adjust their practice if the Working Group applied a year-end 2020 or a Jan. 1, 2021, effective date. Commissioner Donelon stated that he would, therefore, not request for the revision to be reclassified as substantive. Mr. Bruggeman noted that it was helpful to hear that the Louisiana DOI staff described the accounting in a similar way.

Ms. Weaver stated support for drafting an issue paper to document the discussion. She stated concern that the majority of companies that are not using funding agreements are being competitively disadvantaged by the small minority of companies that are using funding agreements to defer commission expenses. She noted that under statutory accounting, the commissions are expensed upfront and that allowing a few companies to defer the commission expenses does not create a level playing field. She noted that the impact, and whether it is good for policyholders, depends on the perspective of which entity is being looking at. She stated she does not want to overly delay this guidance because she does not want to encourage others to pursue this practice, which would further result in an unlevel playing field. She stated that it is important to move forward with resolving this issue, and another exposure will allow companies to work with their domiciliary regulator to establish a resolution approach.

Ms. Marcotte stated that NAIC staff do not recommend adopting the revisions suggested by the most recent commenters. She noted that an illustration has been prepared to show the differences in positions between the exposure draft and the current comments received from interested parties. She stated that the illustration reflects both the reduction in initial commission expense recognized and the delay in commission expense timing suggested by the proposed interested parties' revisions. Mr. Bruggeman summarized that Ms. Weaver was supportive of an issue paper and at this point preferred to maintain the nonsubstantive classification of the revisions. Ms. Weaver confirmed that was correct.

Mr. Stolte stated support for an issue paper and also noted that the guidance being clarified predates codification. He noted that it is also supported by the Statutory Statement of Concepts. He said his state has a historical example that is relevant to this topic. He stated that in May 1991, Virginia had to take Fidelity Bankers Life Insurance Company, which was a $4 billion life company, into receivership. He noted that the primary cause of the insolvency was the failure of the junk bond market at that time. He stated that they took the company into receivership, and the company had a commission financing arrangement that was material. He stated that the financier of the funding agreement made a claim against the estate for the repayment of commission that was prepaid by the funding agent. He noted that trying to include lapse risk in a contract with a noninsurance entity, trying to call a funding agreement a persistency commission, making an assumption that all policies will lapse, and not setting up a liability of the funding agreement is ridiculous. He said that companies are trying to use such agreements to inappropriately obtain surplus relief. He said he was part of the development of the statutory accounting principles codification, and he is surprised that the Working Group is still discussing this topic after this long. Mr. Stolte noted that he could also make this prior insolvency example information available if needed.

Ms. Anderson stated she wanted to provide clarification regarding one of the comments from Commissioner Donelon regarding long-term engagement of the agent. She noted that the funding agreement under discussion typically makes an upfront payment to the agent She stated that the “funding agent” who pays the direct writing agent who wrote the policy is repaid over time by the insurance company. Ms. Anderson noted that paying the agent upfront does not encourage long-term involvement from the agent. She stated that under this situation, the direct writing agent might not have future engagement with the policyholder because the agent is paid upfront. She stated that she does not see any long-term consumer engagement benefit from these arrangements.

Mr. Bruggeman asked if any Working Group members objected to keeping the revisions categorized as nonsubstantive and directing NAIC staff to draft an issue paper. No objections were noted. Mr. Bruggeman stated that another prior key discussion point was persistency commission. He stated that the Working Group has tried to make a distinction between traditional persistency commission and the levelized commission funding agreements. He stated that is why the October exposure removed previously exposed language regarding persistency commission. He noted that the current exposure tried to focus on funding arrangements that attempt to defer acquisition costs. He noted one of the main purposes of SSAP No. 71 is to provide guidance that acquisition costs are expensed upfront under statutory accounting. Ms. Marcotte confirmed that the exposure is trying to focus on funding agreements that are in essence a loan because a third party has paid agents upfront on behalf of an insurer and there is an expectation of repayment to the third party over time. She noted that SSAP No. 71 requires accrual of the funding agreement repayable to the third party in full even if repayment is not guaranteed. SSAP No. 71 acknowledges that the arrangement is in substance a loan because arm’s length transactions do not have third parties pay amounts on an insurer’s behalf without an expectation of repayment. Mr. Bruggeman noted that the funding agent (or someone) has a receivable on their books, which is consistent with the example that Mr. Stolte provided of a funding agent seeking reimbursement of funding amounts from the insurer’s estate. Mr. Stolte noted that the insurer in his example was very skilled at hiding the funding agreement substance in their arrangement. He noted that he is also concerned with the current interested parties’ comments indicating that in their view insurance lapse risk has been assumed by the funding agent, which is an unregulated entity.

Mr. Reis stated that his comments are only on behalf of his company, Northwestern Mutual. He stated appreciation for the October exposed revisions, which ensure that traditional persistency commissions do not become caught up in the proposed revisions. He noted that his company is comfortable that the current exposure does not affect traditional persistency (trail) commissions, which are paid directly to the agents. He noted that this persistency commission ensures long-term engagement with the policyholders. Mr. Reis stated that Northwestern Mutual does have concerns that some entities are using funding agreements with third parties to try to circumvent the statutory accounting requirements to expense commissions upfront. Allowing some entities to defer acquisition costs does put companies that are not utilizing these arrangements at a competitive disadvantage. This puts pressure on other companies to consider similar strategies to remain competitive, and he said he supports closing any perceived loopholes. He thanked the Working Group for the prior revisions regarding traditional persistency commission.

Lynn Kelley (Delaware Life), representing interested parties, thanked the Working Group for the time and dialogue provided on this topic. She noted that the October revisions, which removed concerns regarding traditional persistency commission, were very helpful. She noted that from the standpoint of parties who have been involved in the funding agreements aspect of this agenda item, they still respectfully maintain that this would be a substantive revision. She noted that removing the correction of error guidance was also helpful. She stated that using a change in accounting principle is appropriate and noted this topic has been previously opined on by external auditors. Therefore, she said they believe that the revisions are substantive revisions from previous practice. She noted that interested parties will continue to be available to assist the Working Group on this topic. She noted that they are willing to provide a real example to talk through with the Working Group to assist with understanding this issue. Mr. Bruggeman noted that a contract walk-through with their domestic regulator and NAIC staff would be welcome, but he was hesitant to look at company-specific contracts in a public session.

Martin Carus (Martin Carus Consulting) noted that in the interest of time, the comments in his letter provide his position.

Mr. Bruggeman noted that the Working Group had discussed the nonsubstantive categorization and the proposed drafting of an issue paper. At this time, the Working Group needed to discuss the minor edits proposed by NAIC staff and an effective date. Commissioner Donelon stated that Louisiana would second a motion to categorize the revision to substantive, but failing a motion, they would vote no on the exposure. There was no motion to change the categorization of the revision to substantive.

Mr. Bruggeman requested input regarding the effective date to be exposed by the Working Group. He noted that the October exposure had an effective date of Jan. 1, 2021, and that date could be maintained. He stated that the Working Group could also change the effective date to Dec. 31, 2021, to allow company discussion, or as a nonsubstantive revision, the guidance could be effective upon adoption. Mr. Bruggeman stated his preference was for year-end 2021 to allow for company discussion with state insurance regulators, but he said he would like to hear from the Working Group. Mr. Smith stated a preference for guidance to be effective upon adoption. Mr. Clark stated he concurs and prefers the guidance to be effective upon adoption. Ms. Weaver stated she leans toward year-end 2021.

Mr. Stolte made a motion, seconded by Mr. Clark, to re-expose the nonsubstantive revisions, with the minor edits detailed in the materials He noted that the revisions apply to contracts in effect, with direction that the revisions are to be effective as of the date of adoption. He directed NAIC staff to draft an issue paper. The motion passed, with Louisiana voting opposed.

4. Reviewed Previously Adopted Interpretations for Possible Extension

Mr. Bruggeman directed the Working Group to receive an update and consider possible extensions on several accounting interpretations, stating that NAIC staff are not recommending an extension to the effective dates. Ms. Gann stated that the interpretations have been grouped to facilitate discussion based on periods in which they are effective. She stated that *INT 20-03: Troubled Debt Restructuring Due to COVID-19 (INT 20-03)* and *INT 20-07: Troubled Debt Restructuring of Certain Debt Instruments Due to COVID-19 (INT 20-07)* are related and follow the effective date of the federal Coronavirus Aid, Relief, and Economic Security Act (CARES Act) and are currently effective through Dec. 31. As such, extension at this time is not necessary. However, if the CARES Act is extended, the Working Group could consider a similar extension in 2021.

Ms. Gann stated that *INT 20-02: Extension of Ninety-Day Rule for the Impact of COVID-19* (INT 20-02*), INT 20-04: Mortgage Loan Impairment Assessment Due to COVID-19* (INT 20-04) and *INT 20-05 Investment Income Due and Accrued* (INT 20-05*)* expired after third-quarter 2020 reporting. She noted that she does not believe there is regulator support for extending these interpretations, but if there was Working Group support, a shortened comment period deadline would be recommended to facilitate discussion prior to year-end. Mr. Bruggeman asked the Working Group if there was a motion to consider extension of INT 20-02, INT 20-04 and INT 20-05. A motion was not made. Mr. Bruggeman stated that INT 20-02, INT 20-04 and INT 20-05 are considered nullified and that INT 20-03 and INT 20-07 may be reviewed if the CARES Act is extended.

5. Considered Maintenance Agenda – Pending Listing – Exposures

Mr. Bruggeman stated that due to time constraints, the topics planned for discussion as part of the maintenance agenda will not be discussed. However, he said summaries are in the meeting documents and will be included in the minutes.

Ms. Weaver made a motion, seconded by Mr. Hudson, to move agenda items 2020-32 through 2020-42 to the active listing, with classification as either nonsubstantive or substantive as recommended in the agenda item and expose all items for a 60-day public comment period ending Jan. 11, 2021. The motion passed unanimously.

a. Agenda Item 2020-32: SSAP No. 26R – Disclosure Update

This agenda item proposes nonsubstantive revisions to expand the called-bond disclosures in SSAP No. 26 to include bonds terminated through a tender offer.

b. Agenda Item 2020-33: SSAP No. 32R – Publicly Traded Preferred Stock Warrants.

This agenda item proposes nonsubstantive revisions to capture publicly traded preferred stock warrants in SSAP No. 32R and not in *SSAP No. 86—Derivatives*. This agenda specifies the warrants shall be reported at fair value.

c. Agenda Item 2020-34: SSAP No. 43R – GSE CRT Program

This agenda item proposes nonsubstantive revisions to SSAP No. 43R to incorporate modifications to reflect recent changes to the Freddie Mac Structured Agency Credit Risk (STACR) and Fannie Mae Connecticut Avenue Securities (CAS) programs, which allow credit risk transfer securities from these programs to remain in scope of SSAP No. 43R when issued through a Real Estate Mortgage Investment Conduit (REMIC) structure.

d. Agenda Item 2020-35: SSAP No. 97 – Audit Opinions

This nonsubstantive agenda item requests comments on the extent to which situations exist that hinder the admittance of SSAP No. 97, Subsection 8.b.iii. entities (U.S. and foreign noninsurance U.S. GAAP basis SCAs) due to the inability to quantify the departure from U.S. GAAP.

e. Agenda Item 2020-36: Derivatives Hedging Fixed Indexed Products

This substantive agenda item solicits comments from state insurance regulators and industry on establishing accounting and reporting guidance for derivatives hedging the growth in interest for fixed indexed products. Two general options have been presented, and the Working Group is open for additional commentary and suggestions. A notification of the exposure will be sent to the Life Actuarial (A) Task Force.

f. Agenda Item 2020-37: Separate Account Product Mix

This nonsubstantive agenda item solicits comments regarding the degree of product granularity that should be captured for products reported in scope of *SSAP No. 56—Separate Accounts*, specifically general interrogatory 1.01. With exposure, information was requested about when aggregate product reporting should be permitted.

g. Agenda Item 2020-38: Pension Risk Transfer Disclosure

This nonsubstantive agenda item solicits comments regarding possible modifications to SSAP No. 56 to address pension risk transfers (PRTs), including separate identification of transactions, guarantees, reserve assumptions, etc., within existing disclosure requirements or the addition of new general interrogatories and new schedules/exhibits.

h. Agenda Item 2020-39: Interpretation Policy Statement

This nonsubstantive agenda item proposes clarifying revisions regarding the issuance and adoption process of accounting interpretations in the *NAIC Policy Statement on Maintenance of Statutory Accounting Principles.*

i. Agenda Item 2020-40: Prescribed Practices

This nonsubstantive agenda item proposes revisions to 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 they are the financial statements subject to the independent auditor requirements. The prescribed practices issued by non-domiciliary states shall be reflected in the financial statements filed with those states.

j. Agenda Item 2020-41: *ASU 2020-06, Convertible Instruments*

This nonsubstantive agenda item proposes to reject *Accounting Standards Update (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* in SSAP No. 5R, *SSAP No. 72—Surplus and Quasi-Reorganizations* and SSAP No. 86.

k. Agenda Item 2020-42: *ASU 2020-07, Presentation and Disclosure by Not-for-Profit Entities*

This nonsubstantive agenda item proposes to reject *ASU 2020-07, Presentation and Disclosures by Not-for-Profit Entities* as not applicable to statutory accounting in *Appendix D—Nonapplicable GAAP Pronouncements*.

6. Discussed Other Matters

Mr. Bruggeman stated that due to time constraints, the topics planned for discussion as part of any other matters will not be discussed in detail. However, summaries are in the meeting documents and will be included in the minutes.

a. Agenda Item 2020-21: SSAP No. 43R – Update

The Working Group previously exposed the Iowa Insurance Proposal to define what should be captured in scope of Schedule D, Part 1: Long-Term Bonds for a public comment period ending Dec. 4. NAIC staff, industry and key state insurance regulators have been working to discuss the definition throughout the exposure period.

b. Deferred Items

NAIC staff have identified a couple of projects related to goodwill (agenda item 2019-12 and agenda item 2019-14) that have been deferred for discussion. While these items remain deferred, NAIC staff have proposed a project to holistically review the business combinations (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. Agenda Item 2019-49: Retroactive Reinsurance Exception – Update

This agenda item addresses a referral from the Committee on Property and Liability Financial Reporting (COPLFR) of the American Academy of Actuaries (Academy), which noted diversity in reporting regarding companies applying the retroactive reinsurance exception, which allows certain contracts to be reported prospectively. NAIC staff have held preliminary discussion with members of the Casualty Actuarial and Statistical (C) Task Force.

d. Review of GAAP Exposures:

A document detailing the current U.S. GAAP Exposures/Invitations to Comment was completed. No comments to the Financial Accounting Standards Board (FASB) by the Working Group are recommended during the exposure periods.

e. Other Items:

Ms. Marcotte stated that NAIC staff will likely be presenting the Working Group with an additional interpretation for consideration to provide an exception of the 90-day rule for certain policyholders affected by recent natural disasters, including hurricanes, wildfires and possibly the Iowa windstorms.

Mr. Bruggeman stated that the comment deadline for all exposed agenda items is Jan. 11, 2021.

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

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Draft: 12/15/20

Statutory Accounting Principles (E) Working Group
E-Vote
December 8, 2020

The Statutory Accounting Principles (E) Working Group of the Accounting Practices and Procedures (E) Task Force conducted an e-vote that concluded Dec. 8, 2020. The following Working Group members participated: Dale Bruggeman, Chair (OH); Kevin Clark, Co-Vice Chair (IA); Richard Ford (AL); Kim Hudson (CA); William Arfanis (CT); Rylynn Brown (DE); Eric Moser (IL); Stewart Guerin (LA); Judy Weaver (MI); Doug Bartlett (NH); Bob Kasinow (NY); David Smith (VA); and Amy Malm (WI).

1. Exposed INT 20-11

The Working Group conducted an e-vote to consider exposure of *Interpretation 20-11: Extension of Ninety-Day Rule for the Impact of 2020 Hurricanes, California Wildfires and Iowa Windstorms* (INT 20-11). This tentative interpretation provides a 60-day extension from the 90-day rule for uncollected premium balances, bills receivable, and amounts due from agents and for policies directly affected by the noted 2020 hurricanes, California wildfires and Iowa windstorms. This temporary relaxation of the 90-day rule for directly affected policies is similar to previous extensions that have been granted for other major national storms and hurricanes.

For this interpretation, as it encompasses a number of different disasters, the dates of emergency declarations vary. Therefore, for ease of application, the 60-day extension applies to uncollected premiums more than 90 days overdue from affected policies at year-end 2020, and it expires prior to the first quarter of 2021 financial statements on Feb. 28, 2021.

Mr. Guerin made a motion, seconded by Mr. Clark, to expose INT 20-11. The motion passed unanimously.

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

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Draft: 12/29/20

Statutory Accounting Principles (E) Working Group
Virtual Meeting
December 18, 2020

The Statutory Accounting Principles (E) Working Group of the Accounting Practices and Procedures (E) Task Force met Dec. 18, 2020. The following Working Group members participated: Dale Bruggeman, Chair (OH); Carrie Mears and Kevin Clark, Co-Vice Chairs (IA); Richard Ford (AL); Kim Hudson (CA); William Arfanis (CT); Rylynn Brown (DE); Kevin Fry (IL); Caroline Fletcher (LA); Kristin Hynes (MI); Doug Bartlett (NH); Bob Kasinow (NY); Kimberly Rankin (PA); Jamie Walker (TX); Doug Stolte and David Smith (VA); and Amy Malm (WI).

1. Reviewed Comments on Exposed Items

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

a. INT 20-11

Mr. Bruggeman directed the Working Group to *Interpretation (INT) 20-11: Extension of Ninety-Day Rule for the Impact of 2020 Hurricanes, California Wildfires and Iowa Windstorms*. He stated that in response to a higher catastrophe year, this INT provides a 60-day extension from the 90-day rule for uncollected premium balances, bills receivable, and amounts due from agents and for policies directly impacted by the noted 2020 hurricanes, California wildfires and Iowa windstorms. He stated that the INT expires Feb. 28, 2021, to allow for year-end 2020 application. In response to an inquiry from Mr. Bruggeman, Robin Marcotte (NAIC) stated that there were no comments received on this exposed INT. As this INT provides a temporary exception to the 90-day rule, the NAIC Policy Statement on Maintenance of Statutory Accounting Principles requires a two-thirds supermajority vote for adoption by the Working Group.

Ms. Malm made a motion, seconded by Mr. Hudson, to adopt INT 2020-11, providing limited time exceptions to the 90-day rule in *Statement of Statutory Accounting Principles (SSAP) No. 6—Uncollected Premium Balances, Bills Receivable for Premiums, and Amounts Due From Agents and Brokers* (Attachment One-B). The motion passed unanimously. Ms. Marcotte stated that INT 2020-11 will be publicly posted on the Working Group's webpage.

b. INT 20-10

Mr. Bruggeman directed the Working Group to *INT 20-10: Reporting Nonconforming Credit Tenant Loans (CTLs).* He stated that the Working Group met in public forum Nov. 12 and adopted guidance for the accounting and reporting of nonconforming CTLs for year-end 2020; however, due to inquiries received subsequent to that meeting, NAIC staff drafted the INT for clarity purposes. As the INT reflects the Working Group's previous action, the adoption can occur with a single majority vote, whereas changes to the INT will require a two-thirds majority vote for adoption in accordance with the NAIC Policy Statement on Maintenance of Statutory Accounting Principles.

Julie Gann (NAIC) stated that the original agenda item, 2020-24 Accounting and Reporting of Credit Tenant Loans, was initially drafted in response to a Valuation of Securities (E) Task Force referral regarding the accounting and reporting of nonconforming CTLs, which had incorrectly been captured in Schedule D, Part 1, Long-Term Bonds Owned December 31 of Current Year. She stated that the original agenda item exposed two options for the reporting of nonconforming CTLs. The first option is to reaffirm that the reporting of conforming CTLs were in scope of *SSAP No. 43R—Loan-Backed and Structured Securities* to be reported on Schedule D, Part 1. However, this option clarified that the reporting of nonconforming CTLs should occur on either Schedule B as a mortgage loan or on Schedule BA as an other invested asset. The second option was to classify all CTLs on Schedule BA as an other invested asset. Ms. Gann stated that despite these two initial options, the Nov. 12 decision of the Working Group was to allow an exception for year-end reporting, permitting nonconforming CTLs to remain on Schedule D, Part 1 only if they receive an assigned designation from the NAIC Securities Valuation Office (SVO). She stated that this option is preferred by the Working Group so nonconforming CTLs would not receive better treatment than conforming CTLs, as conforming CTLs are required to be filed with the SVO and receive a designation. In this decision, nonconforming CTLs that do not receive an SVO designation for any reason are to be reported on Schedule BA subject to a 30% capital charge.

Additionally, the Working Group decided that for entities reporting nonconforming CTLs on Schedules B or BA, continued reporting on these schedules should occur, and filing with the SVO would not be required.

Ms. Gann stated that comments received from the industry "Lease-Backed Securities Working Group" proposed several requests: 1) consideration that if the Working Group ultimately decides that nonconforming CTLs are in scope of SSAP No. 43R, they will remain filing exempt (FE), meaning the nonconforming CTLs can be reported with a credit rating provider (CRP) rating rather than require analysis by the SVO; 2) an extension of the Dec. 31, 2020, filing deadline for these types of securities; and 3) specifying that if nonconforming CTLs are moved to Schedule BA, they will be permitted to retain their bond-equivalent capital charge based on their current CRP ratings. In response to these requests, she stated that consideration on whether a nonconforming CTL would be FE eligible is a decision of the Valuation of Securities (E) Task Force, and it will not be in the purview of the Working Group. Additionally, the referenced Dec. 31, 2020, filing deadline was not published by either the SVO or in the INT. The prior discussion indicated only that the SVO designation would need to be received before the statutory financial statements are filed. Finally, NAIC staff did not recommend that the Working Group allow for bond-equivalent risk-based capital (RBC) charges on Schedule BA, as that would allow for reporting optionality. An entity could, in effect, choose which nonconforming CTLs to file with the SVO for Schedule D, Part 1 reporting and elect to report others on Schedule BA with an equivalent capital charge based on CRP ratings. Ms. Gann stated that additional comments, while not reflected in the hearing agenda due to the timing of receipt, were received from the Private Placement Investors Association (PPIA). The PPIA comments in the meeting attachments recommend delaying the proposal until after year-end 2020. If delaying is not an option, the PPIA would then recommend optionality in reporting on either Schedule D, Part 1 or Schedule BA. Finally, if neither of these options are acceptable, the PPIA would request that the Working Group consider that all nonconforming CTLs be reported on Schedule BA, with an RBC charge commensurate to the securities' CRP rating. Ms. Gann stated that reporting on Schedule BA with an RBC charge driven by a CRP rating was the original suggestion offered by NAIC staff on the Nov. 12 call; however, the motion that occurred for that action failed for lack of a second by the Working Group.

John Garrison (Lease-Backed Securities Working Group) stated appreciation for several previous Working Group decisions regarding the accounting and reporting of CTLs, including: 1) reporting conforming CTLs on Schedule D, Part 1; and 2) requesting analysis on whether the 5% uninsured residual asset risk threshold should be examined. He stated that the 5% threshold was established nearly 20 years ago; it was arbitrary at the time; and as other investment types possess residual risk greater than 5%, CTLs should benefit from a reexamination so that they are on an even playing field with other similar investment types. Additionally, he stated appreciation for the Working Group delay of the accounting and reporting determination of nonconforming CTLs until a final decision can be made regarding the definition of a bond in conjunction with the ongoing SSAP No. 43R/Schedule D, Part 1 project. He stated that in response to the requirement to file these investments with the SVO, many logistical issues have been discovered that are causing difficulties with filing. Examples include contracts not being in electronic form and in off-site storage to the length of documents, causing difficulty with submission to the SVO. Mr. Garrison stated that in addition, many reporting entities close their books early in January, which makes the requirement to receive an SVO-designation before filing not feasible for year-end 2020 reporting. He stated that due to year-end timing, combined with the logistical issues, and with the SVO having to designate an unknown number of nonconforming CTLs, the decision to require filing for 2020 is not feasible. He stated that with the proposal to move nonconforming CTLs to Schedule BA and be subject to a 30% capital charge, a charge equivalent to equity investments or default debt does not accurately reflect the economics of the transaction, as no evidence has been presented that these items have caused a negative credit or a solvency issue for a reporting entity. Additionally, many of these securities have been reported on Schedule D, Part 1 for up to 15 years, all without previous scrutiny or concern. Mr. Garrison stated in response to NAIC staff's comments regarding optionality in reporting, that he believes the SVO will determine Schedule D, Part 1 or Schedule BA reporting, not the reporting entity itself. He stated that the Lease-Backed Securities Working Group supports filing these items with the SVO; however, an interim 30% capital charge would be an unfair outcome. Mr. Fry, in response to an inquiry from Mr. Bruggeman, stated that if a deferral for year-end reporting is permitted, a deadline should be required for filing with the SVO, as all CTLs should require an NAIC SVO-assigned designation for 2021 reporting. Mr. Bruggeman stated that if deferred for year-end 2020, nonconforming CTLs should still be filed with the SVO by a filing deadline to be reported in the 2020 year-end financial statements on Schedule D, Part 1, even if the SVO has not provided the SVO-assigned designation.

Mr. Smith inquired about whether nonconforming CTLs are incorrectly being reported on Schedule D, Part 1 and whether a deferral would simply allow these items to improperly remain on Schedule D, Part 1. Mr. Bruggeman stated that through recent developments, it was discovered that nonconforming CTLs have been reported on Schedule D, Part 1, primarily due to an interpretation that these items, in good faith, are believed to be FE securities. Additionally, the timing required to receive an SVO-assigned designation, required for Schedule D, Part 1 reporting, is no longer feasible for year-end 2020. Mr. Bruggeman stated that the final result of the nonconforming CTL issue should be considered in conjunction with the ongoing SSAP No.

43R/Schedule D, Part 1 project. Ms. Gann stated that due to the legal structure of these investments being classified as securities, they are not eligible for *SSAP No. 37—Mortgage Loans*; thus, this caused uncertainty with their applicable SSAP and reporting location, with some reporting entities concluding that they were Schedule D, Part 1 eligible. In a response to an inquiry from Mr. Smith, Charles Therriault (NAIC) stated that a small number of nonconforming CTLs have been filed with the SVO, and more are anticipated. Mr. Arfanis stated support for deferral of a final decision regarding the reporting of nonconforming CTLs, but he would support special identification of such items in the year-end financial statements.

Sasha Kamper (American Equity), representing the PPIA, stated that the PPIA consists of 55 members, most of whom are U.S. domiciled insurance companies that invest regularly in the private placement debt market, including CTLs. She stated that the PPIA appreciates that the Nov. 12 Working Group call was an attempt to accommodate various industry requests; however, further review of the guidance has identified additional concerns. She stated that the INT requires insurers who have previously been carrying nonconforming CTLs on Schedule D, Part 1 to file all of these securities with the SVO immediately so that the SVO can review and decide whether to assign an NAIC designation to such securities on or before March 1, 2021. She stated that many reporting entities close their books in early January and would not be able to file the necessary documentation and receive a definitive answer in time to close the financial statements. Additionally, many records are in off-site storage or are so large that expediated filing with the SVO has proved difficult. Ms. Kamper also stated that there is industry concern regarding the SVO's ability to timely analyze and assign ratings for nonconforming CTLs. She stated that the SVO does not have an approved rating methodology, and when combined with the volume of details in each investment, difficulties in assigning a designation will occur. She stated that industry should be able to file all required documentation by the first quarter of 2021, and she would be supportive of a deferral until year-end 2021. She stated that the PPIA also has concerns regarding the proposed 30% capital charge if reported on Schedule BA, which would cause a major deterrent in the marketplace. She stated that these investments are not as volatile as equity investments, and they are akin to mortgage loans, which are only subject to a 5–7% capital charge. Requiring a 30% capital charge on a strong asset class would be punitive to investors. Ms. Kamper stated that in summary, the PPIA would support deferral or bifurcated reporting on Schedule D, Part 1 and Schedule BA with adjusted capital charge treatment, and if neither of these options were supported, she would request consideration for all nonconforming CTLs to be reported on Schedule BA with adjusted capital charge treatment. Mr. Bruggeman stated that he understands the PPIA's request as: 1) deferral with special identification of nonconforming CTLs in the year-end investment schedules; 2) bifurcated reporting on Schedule D, Part 1 (with an SVO-assigned designation) or Schedule BA with bond capital charge treatment; or 3) all nonconforming CTLs moved to Schedule BA with bond capital charge treatment. Mr. Garrison inquired about whether a capital charge "haircut" on Schedule BA could be considered, so if a bifurcated reporting approach is not approved by the Working Group, a capital charge less than 30% could be considered. Mr. Bruggeman stated that capital charges are not in the purview of the Working Group, and bifurcated reporting is not preferred, as it does allow for optionality in reporting. He stated that the main issue is for nonconforming CTLs to be reviewed with designations received from the SVO.

Mr. Clark stated that based on the responses received, the timing of filing remains the primary issue. He stated that from a long-term perspective, receiving SVO-assigned NAIC designations is the primary goal. However, in an effort to not overly complicate a solution, he said he would support deferral of this topic with a filing deadline that can be practically achieved in the current environment. In response to an inquiry from Mr. Fry, Ms. Gann stated that if the Working Group were to support Schedule BA reporting, a specific reporting line would be utilized to allow bond-like capital treatment based on the CRP rating; i.e., not subject to a 30% capital charge. Mr. Bruggeman stated that based on regulator discussions, Schedule D, Part 1 reporting does not appear to be the primary concern. The primary concern is related to the timing of filing and receipt of SVO-assigned designations. Mr. Bruggeman stated that a deferral could be considered with special identification of nonconforming CTLs in Note 1 of the financial statements. As this is a one-time special consideration, this note could be utilized to identify the amount of nonconforming CTLs reported in Schedule D, Part 1. This provision would only be allowed if the securities are filed for review, even if designations are not received before the statutory financial statements are filed with the NAIC. In response to an inquiry from Mr. Smith, Mr. Bruggeman stated that Schedule D, Part 1 reporting could be allowed with the continued use of Note 1 until the SVO has assigned a designation.

Mr. Bruggeman stated that due to the change in direction, he would recommend an exposure of a new INT documenting deferral of moving nonconforming CTLs from Schedule D, Part 1, subject to filing requirements. He stated that due to year-end, the timing of an exposure period would need to be minimal. Michael Monahan (American Council of Life Insurers—ACLI) stated that the ACLI would be supportive of an expedited exposure period of an INT supporting deferral of moving nonconforming CTLs from Schedule D, Part 1.

Ms. Gann electronically displayed a draft INT supporting deferral of moving nonconforming CTLs from Schedule D, Part 1. Mr. Bruggeman stated that he proposed a filing deadline of Feb. 15, 2021. As such, to continue reporting on Schedule D, Part 1, a reporting entity would have to file the nonconforming CTL with the SVO by Feb. 15, 2021. The INT only requires that an entity file the security with the SVO by Feb. 15, 2021, not that the entity receive the SVO-assigned designation prior to submitting their 2020 annual statutory financial statements. If an entity does not file the security with the SVO by Feb. 15, 2021, the investment shall be reported on Schedule BA, and it would not be reported with a CRP-determined NAIC designation, thus the CTL would be subject to a 30% capital charge. In addition, for nonconforming CTLs that have been filed with the SVO and retained on Schedule D, Part 1, the reporting entity is required to disclose the total amount of nonconforming CTLs reported on Schedule D, Part 1 in Note 1 as if it were a permitted practice. The reporting entity shall complete the permitted practice disclosures required by *SSAP No. 1—Accounting Policies, Risks & Uncertainties and Other Disclosures,* with two separate entries that detail the nonconforming CTLs that were reported on Schedule D, Part 1 on one line and the nonconforming CTLs that were not reported on Schedule BA on a separate line within this disclosure. Two lines are required in the disclosure to reflect the detail, as it is expected that there would be a net zero impact to statutory surplus. Ms. Gann stated that the INT also includes provisions for reporting entities that previously reported nonconforming CTLs on Schedule D, Part 1 that do not want to file with the SVO or do not want to disclose in Note 1. With the provisions, these entities are permitted to reclassify these CTLs to Schedule B or Schedule BA without NAIC designations. Ms. Gann stated that the effective date of the INT would apply for year-end 2020 and expire after third-quarter 2021 reporting.

Mr. Bruggeman stated that this INT would defer the final reporting schedule for nonconforming CTLs, but it would allow Schedule D, Part 1 reporting if the investments are filed with the SVO by the Feb. 15, 2021, deadline. Additionally, it would require Note 1 to be completed, detailing the amount of nonconforming CTLs reported in Schedule D, Part 1. He stated that to expedite potential adoption, if public comments are not contrary to adoption or do not propose significant edits, an email vote may occur. However, if substantial comments are received, a public call will be scheduled. Mr. Monahan stated that the INT will likely be conceptually supported, and it is not expected that industry would not provide substantial comments to the contrary. Mr. Clark made a motion, seconded by Mr. Hudson, to expose INT 2020-10 for a public comment period ending Dec. 22. The motion passed unanimously.

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

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Draft: 1/5/21

Statutory Accounting Principles (E) Working Group
E-Vote
December 28, 2020

The Statutory Accounting Principles (E) Working Group of the Accounting Practices and Procedures (E) Task Force conducted an e-vote that concluded Dec. 28, 2020. The following Working Group members participated: Dale Bruggeman, Chair (OH); Kevin Clark, Vice Chair (IA); Richard Ford (AL); Kim Hudson (CA); William Arfanis (CT); Stewart Guerin (LA); Judy Weaver (MI); Doug Bartlett (NH); Bob Kasinow (NY); Melissa Greiner (PA); David Smith (VA); and Amy Malm (WI).

1. INT 20-10

As directed by the Working Group during its Dec. 18 meeting, because public comments (Attachment One-A) were supportive of adoption, the Working Group held an e-vote to consider adoption of *Interpretation (INT) 2020-10: Reporting Nonconforming Credit Tenant Loans*. This INT provides a limited-time exception on the reporting of nonconforming credit tenant loans (CTLs). The temporary exception allows for continued reporting on Schedule D Part 1 – Long-Term Bonds Owned December 31 of Current Year for nonconforming CTLs that are filed with the NAIC Securities Valuation Office (SVO) by Feb. 15, 2021. This provision only requires that an entity file the security with the SVO, not that the entity receive the SVO-assigned designation prior to submitting its 2020 annual statutory financial statements. If an entity does not file with the SVO by Feb. 15, 2021, the investment shall be reported on Schedule BA – Other Long-Term Invested Assets. CTLs reported on Schedule BA are not eligible to be reported with a credit-rating provider (CRP)-determined NAIC designation.

For nonconforming CTLs that have been filed with the SVO and retained on Schedule D Part 1, the reporting entity is required to disclose the total amount of nonconforming CTLs reported on Schedule D Part 1 on Note 1 as if it were a permitted practice. The reporting entity shall complete the permitted practice disclosures required by *Statement of Statutory Accounting Principles (SSAP) No. 1—Accounting Policies, Risks & Uncertainties and Other Disclosures.*

Additionally, this INT provides that nonconforming CTLs that have been previously reported on a different reporting schedule may remain on the prior reporting schedule, as there is no requirement to pursue SVO-assigned designations. Reporting entities that have previously reported nonconforming CTLs on Schedule D Part 1 that do not want to file with the SVO or do not want to disclose in Note 1 are permitted to reclassify these CTLs to Schedule B – Mortgage Loans or Schedule BA without NAIC designations.

The exceptions granted in this INT are only applicable for year-end 2020 statutory financial statements. Nonconforming CTLs that have been filed with the SVO and are reported on Schedule D Part 1 shall continue Note 1 reporting for each 2021 quarterly financial statement until an SVO-assigned designation is received. The provisions within this INT and the ability to continue reporting nonconforming CTLs on Schedule D Part 1 with an SVO-assigned NAIC designation are limited time exceptions that extend only to Oct. 1, 2021.

Mr. Arfanis made a motion, seconded by Mr. Kasinow, to adopt INT 20-10 (Attachment One-B). The motion passed unanimously.

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

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Draft: 1/8/21

Statutory Accounting Principles (E) Working Group
E-Vote
January 6, 2021

The Statutory Accounting Principles (E) Working Group of the Accounting Practices and Procedures (E) Task Force conducted an e-vote that concluded Jan. 6, 2021. The following Working Group members participated: Dale Bruggeman, Chair (OH); Kevin Clark, Vice Chair (IA); Richard Ford (AL); Kim Hudson (CA); William Arfanis (CT); Rylynn Brown (DE); Eric Moser (IL); Stewart Guerin (LA); Judy Weaver (MI); Doug Bartlett (NH); Bob Kasinow (NY); David Smith (VA); and Amy Malm (WI).

1. <u>Exposed Agenda Item INT 20-03 and INT 20-07</u>

On Dec. 27, 2020, the federal Consolidated Appropriations Act of 2021 was signed into law, which extended certain provisions of the federal Coronavirus Aid, Relief, and Economic Security (CARES) Act. As the Working Group previously adopted two interpretations (INTs) specifically tied to the CARES Act, on Jan. 6, it conducted an e-vote to expose a possible extension of *INT 20-03: Troubled Debt Restructuring Due to COVID-19* and *INT 20-07: Troubled Debt Restructuring for Certain Debt Instruments Due to COVID-19* for a public comment period ending Jan. 22. A summary of the exposed INTs is as follows:

1) INT 20-03 – This INT clarifies 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,” and the provisions of the CARES Act in determining whether the modification shall be reported as a troubled debt restructuring. This INT has an effective date that mirrors the original CARES Act, and it terminated on Dec. 31, 2020. With a possible extension, the INT will be applicable through the earlier of Jan. 1, 2022, or the date that is 60 days after the date on which the national emergency concerning the COVID-19 outbreak terminates.

2) INT 20-07 – This INT provides temporary practical expedients in assessing whether modifications in response to COVID-19 are insignificant under *Statement of Statutory Accounting Principles (SSAP) No. 36—Troubled Debt Restructuring* and whether a modification shall be considered an exchange under *SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. This INT has an effective date that mirrors the original CARES Act, and it terminated on Dec. 31, 2020. With a possible extension, the INT will be applicable through the earlier of Jan. 1, 2022, or the date that is 60 days after the date on which the national emergency concerning the COVID-19 outbreak terminates.

Mr. Arfanis made a motion, seconded by Mr. Guerin, to expose INT 20-03 and INT 20-07 for extension consideration. The motion passed unanimously.

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

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Draft: 1/27/21

Statutory Accounting Principles (E) Working Group
E-Vote
January 25, 2021

The Statutory Accounting Principles (E) Working Group of the Accounting Practices and Procedures (E) Task Force conducted an e-vote that concluded Jan. 25, 2021. The following Working Group members participated: Dale Bruggeman, Chair (OH); Kevin Clark, Vice Chair (IA); Richard Ford (AL); Kim Hudson (CA); William Arfanis (CT); Eric Moser (IL); Stewart Guerin (LA); Judy Weaver (MI); Doug Bartlett (NH); Bob Kasinow (NY); David Smith (VA); and Amy Malm (WI).

1. Extended INT 20-03 and INT 20-07

As directed by the Working Group during its Jan. 6 e-vote, as public comments (Attachments One-A and One-B) were supportive of extending two previously adopted interpretations (INTs), the Working Group conducted an e-vote to consider extension of *INT 20-03: Troubled Debt Restructuring Due to COVID-19* and *INT 20-07: Troubled Debt Restructuring for Certain Debt Instruments Due to COVID-19.* A summary of the INTs is as follows:

1) INT 20-03 – This INT clarifies 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” and the provisions of the federal Coronavirus Aid, Relief and Economic Security (CARES) Act in determining whether the modification shall be reported as a troubled debt restructuring. This INT had an effective date that mirrored the original CARES Act, and it originally terminated on Dec. 31, 2020. As extended, the INT is now applicable through whichever date is earlier—Jan. 1, 2022, or the date that is 60 days after the date on which the national emergency concerning the COVID-19 outbreak terminates.

2) INT 20-07 – This INT provides temporary practical expedients in assessing whether modifications in response to COVID-19 are insignificant under *Statement of Statutory Accounting Principles (SSAP) No. 36—Troubled Debt Restructuring* and whether a modification shall be considered an exchange under *SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. This INT had an effective date that mirrored the original CARES Act, and it originally terminated on Dec. 31, 2020. As extended, the INT is now applicable through whichever date is earlier—Jan. 1, 2022, or the date that is 60 days after the date on which the national emergency concerning the COVID-19 outbreak terminates.

Mr. Guerin made a motion, seconded by Mr. Smith, to extend INT 20-03 (Attachment One-C) and INT 20-07 (Attachment One-D). The motion passed unanimously.

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

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Statutory Accounting Principles (E) Working Group
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Issue: SSAP No. 26R - Disclosure Update

Check (applicable entity):

	P/C	Life	Health
Modification of Existing SSAP	☒	☒	☒
New Issue or SSAP	☐	☐	☐
Interpretation	☐	☐	☐

Description of Issue: 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 investment income and capital gains/losses, due to early liquidation either through a call or a tender offer shall be similarly applied. This nonsubstantive update was effective on July 30; however, reporting entities that had historically applied a differing accounting methodology and required systems changes to properly account for the early termination of tendered bonds, were granted an effective date deferral of no later than January 1, 2021.

This agenda item is to expand an existing disclosure regarding called bonds to include tendered bond activity.

Existing Authoritative Literature: Only the relevant disclosures from *SSAP No. 26R—Bonds*, have been included below.

30. The financial statements shall include the following disclosures:

l. For securities sold, redeemed or otherwise disposed as a result of a callable feature (including make-whole call provisions), disclose the number of CUSIPs sold, disposed or otherwise redeemed and the aggregate amount of investment income generated as a result of a prepayment penalty and/or acceleration fee.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): Not Applicable

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

Convergence with International Financial Reporting Standards (IFRS): Not Applicable

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

30. The financial statements shall include the following disclosures:

l. For securities sold, redeemed or otherwise disposed as a result of a call~~able~~ or tender offer feature (including make-whole call provisions), disclose the number of CUSIPs sold, disposed or otherwise redeemed and the aggregate amount of investment income generated as a result of a prepayment penalty and/or acceleration fee.

Staff Review Completed by: Jim Pinegar, NAIC Staff
September 2020

Status:
On November 12, 2020, the Statutory Accounting Principles (E) Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to *SSAP No. 26R—Bonds*, as illustrated above, to expand the called bond disclosures to also include bonds terminated early through a tender offer.

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Statutory Accounting Principles (E) Working Group
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Issue: SSAP No. 32R – Publicly Traded Preferred Stock Warrants

Check (applicable entity):

	P/C	Life	Health
Modification of Existing SSAP	☒	☒	☒
New Issue or SSAP	☐	☐	☐
Interpretation	☐	☐	☐

Description of Issue: NAIC staff received inquiries on which standard and reporting schedule would be most appropriate for publicly traded preferred stock warrants. A stock warrant represents the right to purchase a company's stock at a specific price and at a specific date and are typically issued directly by a company to an investor. When a stock warrant is exercised, the shares of the stock received are issued directly from the company itself, rather than another investor.

Stock warrants generally fall into scope of *SSAP No. 86—Derivatives*, although there is a special carveout for publicly traded common stock (see existing authoritative literature section). However due to the fact that 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), NAIC staff believe that publicly traded preferred stock warrants should receive a similar carveout from SSAP No. 86 and similar accounting and reporting treatment.

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.

Existing Authoritative Literature:

Warrants, both public and private are described in SSAP No. 86, however publicly traded (common) stock warrants are scoped into *SSAP No. 30—Unaffiliated Common Stock* as highlighted below. (Note: only relevant excerpts have been included below.)

<u>SSAP No. 86:</u>

5. Derivative instruments include, but are not limited to; options, warrants used in a hedging transaction and not attached to another financial instrument, caps, floors, collars, swaps, forwards, futures, structured notes with risk of principal/original investment loss based on the terms of the agreement (in addition to default risk), and any other agreements or instruments substantially similar thereto or any series or combination thereof.

j. **"Warrants" are instruments that give the holder the right to purchase an underlying financial instrument at a given price and time or at a series of prices and times outlined in the warrant agreement**. Warrants may be issued alone or in connection with the sale of other securities, for example, as part of a merger or recapitalization agreement, or to facilitate divestiture of the securities of another business entity. **<u>Publicly traded stock warrants are captured in scope of *SSAP No. 30R—Unaffiliated Common Stock*</u>. All other warrants, including non-publicly traded stock warrants, shall be captured in scope of SSAP No. 86**.

Accordingly, as referenced in SSAP No. 86, publicly traded common stock warrants are captured within the scope of SSAP No. 30R, as highlighted below.

SSAP No. 30R:

4. In addition, the following equity investments are captured within scope of this statement:

a. Master limited partnerships trading as common stock and American deposit receipts only if the security is traded on the New York or NASDAQ exchange;

b. Publicly traded common stock warrants;

c. Shares of SEC registered Investment Companies captured under the Investment Company Act of 1940 (open-end investment companies (mutual funds), closed-end funds and unit investment trusts), regardless of the types or mix of securities owned by the fund (e.g., bonds or stocks);

d. Exchange Traded Funds, except for those identified for bond or preferred stock treatment, as identified in Part Three of the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* and published on the SVO's web page of *www.NAIC.org*;

e. Foreign open-end investment funds governed and authorized in accordance with regulations established by the applicable foreign jurisdiction. Other foreign funds are excluded from the scope of this statement; and

f. Equity interests in certified capital companies in accordance with *INT 06-02: Accounting and Reporting for Investments in a Certified Capital Company (CAPCO)*.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): None

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

Convergence with International Financial Reporting Standards (IFRS): N/A

Staff 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,* which would scope publicly traded preferred stock warrants into SSAP No. 32R. This would result in publicly traded preferred stock warrants receiving similar treatment as publicly traded common stock warrants. Additionally, the publicly traded preferred stock warrants would be accounted for as perpetual preferred stock, thus requiring to be accounted for at fair value.

Proposed edits to *SSAP No. 86—Derivatives*:

5. Derivative instruments include, but are not limited to; options, warrants used in a hedging transaction and not attached to another financial instrument, caps, floors, collars, swaps, forwards, futures, structured notes with risk of principal/original investment loss based on the terms of the agreement (in addition to default risk), and any other agreements or instruments substantially similar thereto or any series or combination thereof.

j. "Warrants" are instruments that give the holder the right to purchase an underlying financial instrument at a given price and time or at a series of prices and times outlined in the warrant agreement. Warrants may be issued alone or in connection with the sale of other securities, for example, as part of a merger or recapitalization agreement, or to facilitate divestiture of the securities of another business entity. Publicly traded stock warrants are captured in scope of *SSAP No. 30R—Unaffiliated Common Stock* or *SSAP No. 32R—Preferred Stock*. All other warrants, including non-publicly traded stock warrants, shall be captured in scope of SSAP No. 86.

Proposed edits to *SSAP No. 32R—Preferred Stock*:

SUMMARY CONCLUSION

3. Preferred stock which may or may not be publicly traded is a security that represents ownership of a corporation and gives the holder a claim prior to the claim of common stockholders on earnings and also generally on assets in the event of liquidation. Most preferred stock pays a fixed dividend that is paid prior to the common stock dividend, stated in a dollar amount or as a percentage of par value. Preferred stock does not usually carry voting rights. Preferred stock has characteristics of both common stock and debt. Preferred stock shall include:

   a. Redeemable preferred stock, which is preferred stock subject to mandatory redemption requirements or whose redemption is at the option of the holders. Redeemable preferred stock is any stock which 1) the issuer undertakes to redeem at a fixed or determinable price on the fixed or determinable date or dates, whether by operation of a sinking fund or otherwise; or 2) is redeemable at the option of the holders. Preferred stock which meet one or more of these criteria would be classified as redeemable preferred stock, regardless of other attributes such as voting rights or dividend rights.

   b. Perpetual preferred stock, which is preferred stocks which are not redeemable or for which redemption is not at the option of the holder (non-redeemable preferred stock). Perpetual preferred stock is any preferred stock which does not meet the criteria to be classified as redeemable preferred stock pursuant to paragraph 3.a.

   c. Publicly traded preferred stock warrants.

Balance Sheet Amount

11. Preferred stock shall be valued based on (a) the underlying characteristics (redeemable, perpetual or mandatory convertible), (b) the quality rating expressed as an NAIC designation, and (c) whether an asset valuation reserve (AVR) is maintained by the reporting entity:

    a. For reporting entities that do not maintain an AVR:

       i. Highest-quality or high-quality redeemable preferred stocks (NAIC designations 1 and 2), which have characteristics of debt securities, shall be valued at cost or amortized cost. All other redeemable preferred stocks (NAIC designations 3 to 6) shall be reported at the lower of cost, amortized cost, or fair value.

       ii. Perpetual preferred stock and publicly traded preferred stock warrants shall be reported at fair value, not to exceed any currently effective call price.

       iii. Mandatory convertible preferred stocks (regardless if the preferred stock is redeemable or perpetual) shall be reported at fair value, not to exceed any currently effective call price, in the periods prior to conversion. Upon conversion to common stock, these securities shall be in scope of SSAP No. 30R.

       iv. For preferred stocks reported at fair value, unrealized gains and losses shall be recorded as a direct credit or charge to unassigned funds (surplus)

    b. For reporting entities that maintain an AVR:

i. Highest-quality, high-quality or medium quality redeemable preferred stocks (NAIC designations 1 to 3) shall be valued at amortized cost. All other redeemable preferred stocks (NAIC designations 4 to 6) shall be reported at the lower of amortized cost or fair value.

ii. Perpetual preferred stock~~s~~ and publicly preferred stock warrants shall be valued at fair value, not to exceed any currently effective call price.

iii. Mandatory convertible preferred stocks (regardless if the preferred stock is redeemable or perpetual) shall be reported at fair value, not to exceed any currently effective call price, in the periods prior to conversion. Upon conversion to common stock, these securities shall be in scope of SSAP No. 30R.

iv. For preferred stocks reported at fair value, the accounting for unrealized gains and losses shall be in accordance with *SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve.*

Impairment of Perpetual Preferred Stock

14. For any decline in the fair value of perpetual preferred stock or publicly traded preferred stock warrants, which is determined to be other-than-temporary (INT 06-07), the perpetual preferred stock or warrant shall be written down to fair value as the new cost basis and the amount of the write down shall be accounted for as a realized loss. For reporting entities required to maintain an AVR, realized losses shall be accounted for in accordance with SSAP No. 7. Subsequent fluctuations in fair value shall be recorded as unrealized gains or losses. Future declines, which are determined to be other-than-temporary, shall be recognized as realized losses. A decline in fair value which is other-than-temporary includes situations where the reporting entity has made a decision to sell a preferred stock at an amount below its carrying value.

Staff Review Completed by: Jim Pinegar, NAIC Staff – September 2020

Status:
On November 12, 2020, the Statutory Accounting Principles (E) Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to *SSAP No. 32R—Preferred Stock* and *SSAP No. 86—Derivatives*, as illustrated above, to scope publicly traded preferred stock warrants into SSAP No. 32R with accounting at fair value.

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Issue: SSAP No. 43R – Government-Sponsored Enterprises – Credit Risk Transfer Transactions.

Check (applicable entity):

	P/C	Life	Health
Modification of Existing SSAP	☒	☒	☒
New Issue or SSAP	☐	☐	☐
Interpretation	☐	☐	☐

Description of Issue:

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.

Credit risk transfer securities are mortgage-referenced securities issued by government sponsored entities that are tied to a referenced pool of mortgages. These are instruments in which the payments received are linked to the interest and principal repayment of underlying mortgage loans from those identified in a particular pool of mortgages. For these instruments, investors may not receive a full return of principal as principal repayment is contingent on the ultimate repayment by the mortgage loan borrowers (as credit risk has been transferred to the investor). The program naming convention for CRT's was identified as Structured Agency Credit Risk (STACR) for Freddie Mac and Connecticut Avenue Securities (CAS) for Fannie Mae.

This agenda item has been drafted to reflect recent changes to the Freddie Mac STACR and Fannie Mae CAS programs. 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 is functionally equivalent to the original Freddie Mac STACR and Fannie Mae CAS programs, in that the trusts will pay interest and principal to investors on a monthly basis. All other material characteristics also remain unaffected as the investment represents a large, diversified reference pool, multiple tranches are available to accommodate various risk appetites, and the notes are highly liquid with an estimated $2 billion in buy/sale trades occurring each month. Also unchanged is that the STACR notes are not guaranteed by Freddie Mac (i.e. credit risk has been transferred) and Freddie Mac, and both entities maintain the senior risk tranche, which is unfunded and not issued for public investors.

The primary difference in the use of a REMIC trust is that counterparty risk exposure to Freddie Mac and Fannie Mae is reduced as the trust is designed to stand on its own. The trust's assets are intended to fund interest and principal payments on the notes, thus insulating investors from a possible Freddie Mac or Fannie Mae insolvency. While several other benefits are touted, the use of a REMIC will also not subject international investors to U.S. withholding tax requirements, likely resulting in higher international investor participation.

In collaboration with NAIC Securities Valuation Office (SVO) staff, SAPWG support staff has confirmed that the anticipated use of a <u>REMIC trust remains functionally equivalent and retains the same material risk structure as the original STACR and CAS programs</u>. 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 <u>are not eligible for filing exemption and are subject to assessment</u> 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.

Existing Authoritative Literature:

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

<u>The inclusion GSE CRT securities into the scope of SSAP No. 43R is referenced in paragraph 5:</u>

5. Mortgage-referenced securities do not meet the definition of a loan-backed or structured security but are explicitly captured in scope of this statement. In order to qualify as a mortgage-referenced security, the **security must be issued by a government sponsored enterprise[1] in the form of a "credit risk transfer" in which the issued security is tied to a referenced pool of mortgages**. These securities do not qualify as "loan-backed securities" as the pool of mortgages are not held in trust and the amounts due under the investment are not backed or secured by the mortgage loans. **Rather, these items reflect instruments in which the payments received are linked to the credit and principal payment risk of the underlying mortgage loan borrowers captured in the referenced pool of mortgages. For these instruments, reporting entity holders may not receive a return of their full principal as principal repayment is contingent on repayment by the mortgage loan borrowers in the referenced pool of mortgages.** Unless specifically noted, the provisions for loan-backed securities within this standard apply to mortgage-referenced securities.

<u>Financial modeling of CRT Securities is referenced in paragraph 27:</u>

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* 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. Securities where modeling results in zero expected loss in all scenarios are automatically considered to have a final NAIC designation of NAIC 1, 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 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. This final NAIC designation shall be applicable for statutory accounting and reporting purposes (including establishing the AVR

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

charges). The final designation is not used for establishing the appropriate carrying value method in Step 2 (paragraph 27.a.ii.).

b. All Other Loan-Backed and Structured Securities: For loan-backed and structured securities not subject to paragraphs 27.a. (financial modeling) follow the established designation procedures according to the appropriate section of the *Purposes and Procedures Manual of the NAIC Investment Analysis Office*. The NAIC designation shall be applicable for statutory accounting and reporting purposes (including determining the carrying value method and establishing the AVR charges). The carrying value method is established as described in paragraph 26. Examples of these securities include, but are not limited to, **mortgage-referenced securities**, equipment trust certificates, credit tenant loans (CTL), 5*/6* securities, interest only (IO) securities, securities with CRP ratings (excluding RMBS/CMBS), and loan-backed and structured securities with SVO assigned NAIC designations.

Specific Interim Reporting Guidance for RMBS/CMBS Securities

28. The guidance in this paragraph shall be applied in determining the reporting method for residential mortgage-backed securities (RMBS) and commercial mortgage-backed securities (CMBS) acquired in the current year for quarterly financial statements. Securities reported as of the prior-year end shall continue to be reported under the prior-year end methodology for the current-year quarterly financial statements. For year-end reporting, securities shall be reported in accordance with paragraph 27, regardless of the quarterly methodology used.

a. Reporting entities that acquired the entire financial modeling database for the prior-year end are required to follow the financial modeling methodology (paragraph 27.a.) for all securities acquired in the subsequent year that were included in the financial modeling data acquired for the prior year-end.

b. Reporting entities that acquired identical securities (identical CUSIP) to those held and financially modeled for the prior year-end are required to follow the prior year-end financial modeling methodology (paragraph 27.a.) for these securities acquired subsequent to year-end.

c. Reporting entities that do not acquire the prior-year financial modeling information for current-year acquired individual CUSIPS, and are not captured within paragraphs 28.a. or 28.b., are required to follow the analytical procedures for non-financially modeled securities (paragraph 27.b. as appropriate). Reporting entities that do acquire the individual CUSIP information from the prior-year financial modeling database shall use that information for interim reporting.

d. Reporting entities that acquire securities not previously modeled at the prior year-end are required to follow the analytical procedures for non-financially modeled securities (paragraph 27.b. as appropriate).

Purposes and Procedures Manual of the NAIC Investment Analysis Office **(P&P Manual); Part 4 –Mortgage Reference Securities:**

Definition

29. A Mortgage Referenced Security has the following characteristics: A Mortgage Referenced Security's coupon and/or principal payments are linked, in whole or in part, to prices of, or payment streams from, real estate, index or indices related to real estate, or assets deriving their value from instruments related to real estate, including, but not limited to, mortgage loans.

Not Filing Exempt

30. A Mortgage Referenced Security is not eligible for filing exemption but is subject to the filing requirement.

NAIC Risk Assessment

31. In determining the NAIC Designation of a Mortgage Referenced Security, **the SSG may use the financial modeling methodology discussed in this Part, adjusted (if and as necessary) to the specific reporting and accounting requirements applicable to Mortgage Referenced Securities.**

Quarterly Reporting for Mortgage Reference Securities

32. To determine the NAIC Designation to be used for quarterly financial statement reporting for a Mortgage Reference Security purchased subsequent to the annual surveillance described in this Part, the insurer uses the prior year-end modeling data for that CUSIP (which can be obtained from the NAIC) until the annual surveillance data is published for the current year. For a Mortgage Reference Security that is not in the prior year-end modeling data for that CUSIP, the insurer may follow the instructions in Part Two of this manual for the assignment of the SVO Administrative Symbol "Z" provided the insurer owned security meets the criteria for a security that is in transition in reporting or filing

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): None

Information or issues (included in *Description of Issue*) not previously contemplated by the Working Group: Relevant background from agenda item 2018-18 was included in the 'Description of Issue' section.

Convergence with International Financial Reporting Standards (IFRS): N/A

Staff 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.

5. Mortgage-referenced securities do not meet the definition of a loan-backed or structured security but are explicitly captured in scope of this statement. In order to qualify as a mortgage-referenced security, the security must be issued by a government sponsored enterprise[2] or by a special purpose trust in a transaction sponsored by a government sponsored enterprise in the form of a "credit risk transfer" in which the issued security is tied to a referenced pool of mortgages and. ~~These securities do not qualify as "loan-backed securities" as the pool of mortgages are not held in trust and the amounts due under the investment are not backed or secured by the mortgage loans. Rather, these items reflect instruments in which~~ the payments received are linked to the credit and principal payment risk of the underlying mortgage loan borrowers captured in the referenced pool of mortgages. For these instruments, reporting entity holders may not receive a return of their full principal as principal repayment is contingent on repayment by the mortgage loan borrowers in the referenced pool of mortgages. Unless specifically noted, the provisions for loan-backed securities within this standard apply to mortgage-referenced securities.

[2] Currently, only Fannie Mae and Freddie Mac are the government sponsored entities that either directly issue qualifying mortgage-referenced securities or sponsor transactions in which special purpose trust issues qualifying mortgage-reference securities. However, this guidance would apply to mortgage-referenced securities issued by any other government sponsored entity that subsequently engages in the transfer of ~~residential~~ mortgage credit risk

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* provides detailed guidance. A general description of the processes is as follows:

a. Financial Modeling: Pursuant to the P&P manual, ~~T~~the NAIC identifies select 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. Securities where modeling results in zero expected loss in all scenarios are automatically considered to have a final NAIC designation of NAIC 1, 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 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. This final NAIC designation shall be applicable for statutory accounting and reporting purposes (including establishing the AVR charges). The final designation is not used for establishing the appropriate carrying value method in Step 2 (paragraph 27.a.ii.).

b. All Other Loan-Backed and Structured Securities: For securities ~~loan-backed and structured securities~~ not subject to paragraph~~s~~ 27.a. (financial modeling) follow the established designation procedures according to the appropriate section of the *Purposes and Procedures Manual of the NAIC Investment Analysis Office*. The NAIC designation shall be applicable for statutory accounting and reporting purposes (including determining the carrying value method and establishing the AVR charges). The carrying value method is established as described in paragraph 26. Examples of these securities include, but are not limited to~~, mortgage-referenced securities,~~ equipment trust certificates, credit tenant loans (CTL), 5*/6* securities, interest only (IO) securities, securities with CRP ratings (excluding RMBS/CMBS), ~~and~~ loan-backed and structured securities and mortgage-referenced securities with SVO assigned NAIC designations.

Specific Interim Reporting Guidance Financially Modeled ~~for RMBS/CMBS~~ Securities

28. For securities that will be financially modeled under paragraph 27, ~~T~~the guidance in this paragraph shall be applied in determining the reporting method for such securities~~residential mortgage-backed securities (RMBS) and commercial mortgage-backed securities (CMBS)~~ acquired in the current year for quarterly financial statements. Securities reported as of the prior-year end shall continue to be reported under the prior-year end methodology for the current-year quarterly financial statements. For year-end reporting, securities shall be reported in accordance with paragraph 27, regardless of the quarterly methodology used.

a. Reporting entities that acquired the entire financial modeling database for the prior-year end are required to follow the financial modeling methodology (paragraph 27.a.) for all securities acquired in the subsequent year that were included in the financial modeling data acquired for the prior year-end.

b. Reporting entities that acquired identical securities (identical CUSIP) to those held and financially modeled for the prior year-end are required to follow the prior year-end financial modeling methodology (paragraph 27.a.) for these securities acquired subsequent to year-end.

c. Reporting entities that do not acquire the prior-year financial modeling information for current-year acquired individual CUSIPS, and are not captured within paragraphs 28.a. or 28.b., are required to follow the analytical procedures for non-financially modeled securities (paragraph 27.b. as appropriate). Reporting entities that do acquire the individual CUSIP information from the prior-year financial modeling database shall use that information for interim reporting.

d. Reporting entities that acquire securities not previously modeled at the prior year-end are required to follow the analytical procedures for non-financially modeled securities (paragraph 27.b. as appropriate).

Staff Review Completed by:
Jim Pinegar –August 2020
NAIC Staff

Status:
On November 12, 2020, the Statutory Accounting Principles (E) Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to *SSAP No. 43R—Loan-Backed and Structures Securities*, as illustrated above, to incorporate 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 of SSAP No. 43R when a REMIC structure is used in the STACR program or CAS program.

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Statutory Accounting Principles (E) Working Group
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Issue: SSAP No. 97 – Audit Opinions

Check (applicable entity):

	P/C	Life	Health
Modification of Existing SSAP	☒	☒	☒
New Issue or SSAP	☐	☐	☐
Interpretation	☐	☐	☐

Description of Issue: *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities* provides guidance for the various audit opinions that can be issued when an entity records certain investments utilizing the U.S. GAAP equity method of accounting.

The complete guidance for the various audit opinions is included in the 'Existing Authoritative Literature," however the relevant guidance is summarized as:

- Disclaimers of opinion shall be nonadmitted.
- Qualified opinions due to a scope limitation can only be admitted if the limitation is quantified, then the quantified limitation is nonadmitted.
- Qualified opinions due to a GAAP departure 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 GAAP (in such cases, a quantification of the departure is not required).
- Adverse opinions due to a GAAP departure can only be admitted if the departure is quantified (then the quantified departure is nonadmitted), OR if the departure is as the result of utilizing a statutory accounting principle in lieu of following 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.

Existing Authoritative Literature: The entity types (8.b.i, 8.b.ii, etc.) referenced in the 'Description of Issue,' the audit opinion requirements and the permitted exceptions to the unqualified opinion requirements within SSAP No. 97 are below. Relevant guidance has been **bolded** for emphasis.

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

Applying the Market Valuation, Audited Statutory Equity and Audited GAAP Equity Methods

8. The admitted investments in SCA entities shall be valued using either the market valuation approach (as described in paragraph 8.a.), or one of the equity methods (as described in paragraph 8.b.) adjusted as appropriate in accordance with the guidance in *SSAP No. 25—Affiliates and Other Related Parties*, paragraph 17.d.

a. In order to use the market valuation approach for SCA entities, the following requirements apply:

i. The subsidiary must be traded on one of the following major exchanges: (1) the New York Stock Exchange, (2) the NASDAQ, or (3) the Japan Exchange Group;

ii. The reporting entity must submit subsidiary information to the NAIC SCA analysts for calculation of the subsidiary's market value. Such calculation could result in further discounts in market value above the established base discounts based on ownership percentages detailed below;

iii. Ownership percentages for determining the discount rate shall be measured at the holding company level;

iv. If an investment in a SCA results in an ownership percentage between 10% and 50%, a base discount percentage between 0% and 20% on a sliding scale basis is required;

v. If an investment in a SCA results in an ownership percentage greater than 50% up to and including 80%, a base discount percentage between 20% and 30% on a sliding scale basis is required;

vi. If an investment in a SCA results in an ownership percentage greater than 80% up to and including 85%, a minimum base discount percentage of 30% is required.

vii. Further, the SCA must have at least two million shares outstanding, with a total market value of at least $50 million in the public's control; and

viii. Any ownership percentages exceeding 85% will result in the SCA being recorded on an equity method.

b. If a SCA investment does not meet the requirements for the market valuation approach in paragraph 8.a. or, if the requirements are met, but a reporting entity elects not to use that approach, the reporting entity's proportionate share of its investments in SCAs shall be recorded as follows:

i. **Investments in U.S. insurance SCA entities shall be recorded based on either** 1) the underlying audited statutory equity of the respective entity's financial statements, adjusted for any unamortized goodwill as provided for in *SSAP No. 68—Business Combinations and Goodwill* or 2) **the underlying audited statutory equity of the respective entity's financial statements**, adjusted for any unamortized goodwill, modified to remove the impact of any permitted or prescribed accounting practices that depart from the NAIC *Accounting Practices and Procedures Manual*. Reporting entities shall record investments in U.S. insurance SCA entities on at least a quarterly basis, and shall base the investment value on the most recent quarterly information available from the SCA. Entities may recognize their investment in U.S. insurance SCA entities based on the unaudited statutory equity in the SCAs year-end annual statement if the annual SCA audited financial statements are not complete as of the filing deadline. The recorded statutory equity shall be adjusted for audit adjustments, if any, as soon as the annual audited financial statements have been completed. Annual consolidated or combined audits are allowed if completed in accordance with the Model Regulation Requiring Annual Audited Financial Reports as adopted by the SCA's domiciliary state;

iii. **Investments in both U.S. and foreign noninsurance SCA entities that do not qualify under paragraph 8.b.ii., shall be recorded based on the audited U.S. GAAP equity of the investee.** Foreign SCA entities are defined as those entities incorporated or otherwise legally formed under the laws of a foreign country. Additional guidance on investments in downstream holding companies is included in paragraphs 22-27. Additional guidance on the use of audited foreign GAAP basis financial statements for the U.S. GAAP equity valuation amount is included in paragraph 23.b.

Qualified Versus Unqualified Opinions

21. Various opinions can be issued in which an entity can record certain investments under the GAAP Equity method of accounting. The reporting entity shall record investments that require audited GAAP equity in the manner described below when the audit opinion on the GAAP financial statements contains the following language:

a. The investment shall be nonadmitted if the audit opinion contains a disclaimer of opinion for the most recent statement of financial position presented in the financial statements.

b. The investment shall be nonadmitted if the audit opinion contains a qualified opinion due to a scope limitation that impacts the most recent statement of financial position presented in the financial statements and the impact of the scope limitation cannot be quantified. However, if the impact of the scope limitation is quantified in the audited financial statements or the audit opinion, the investment shall be admitted and the reporting entity's valuation of the investment shall be determined based on the GAAP equity of the investee, adjusted to exclude the impact of the quantified scope limitation.

c. **The investment shall be nonadmitted if the audit opinion contains a qualified opinion due to a departure from GAAP** that impacts the most recent statement of financial position presented in the financial statements and the impact of such departure is not quantified in either the auditor's report or the footnotes to the financial statements (see quantification exception related to the valuation of a U.S. insurance entity on the basis of U.S. statutory accounting principles discussed below). However, if the impact of the departure from GAAP is quantified in the audited financial statements or the audit opinion, the investment shall be admitted and the reporting entity's valuation of the investment shall be determined based on the GAAP equity of the investee, adjusted to exclude the impact of the quantified departure from GAAP. **EXCEPTION: There is no need to quantify the impact of a departure from GAAP in either the auditor's report or the footnotes to the financial statements if a qualified audit opinion is issued due to a departure from GAAP and the departure is related to the valuation of an U.S. insurance entity on the basis of U.S. statutory accounting principles. In such cases, the investment shall be admitted without quantifying the departure.**

d. **The investment shall be nonadmitted if the audit opinion contains an adverse opinion due to a departure from GAAP** that impacts the most recent statement of financial position presented in the financial statements and the impact of such departure is not quantified in either the auditor's report or the footnotes to the financial statements (see quantification exception related to the valuation of a U.S. insurance entity on the basis of U.S. statutory accounting principles discussed below). However, if the impact of the departure from GAAP is quantified in the audited financial statements or the audit opinion, the investment shall be admitted and the reporting entity's valuation of the investment shall be determined based on the GAAP equity of the investee, adjusted to exclude the impact of the quantified departure from GAAP. **EXCEPTION: There is no need to quantify the impact of a departure from GAAP in either the auditor's report or the footnotes to the financial statements if an adverse audit opinion is issued due to a departure from GAAP and the departure is related to the valuation of an U.S. insurance entity on the basis of U.S. statutory accounting principles. In such cases, the investment shall be admitted without quantifying the departure.**

e. The investment shall be nonadmitted if the audit report or accompanying financial statements/notes contains explanatory language indicating there is an unalleviated substantial doubt about the investee's ability to continue as a going concern.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): None

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

Convergence with International Financial Reporting Standards (IFRS): Not Applicable

Staff 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.

Staff Review Completed by: Jim Pinegar - NAIC Staff – September 2020

Status:
On November 12, 2020, the Statutory Accounting Principles (E) Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed this agenda item with a request for comments on the extent in which situations exist that hinder admittance of 8.b.iii. entities due to the inability to quantify a departure from U.S. GAAP.

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Statutory Accounting Principles (E) Working Group
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Issue: ASU 2020-06 - Convertible Instruments

Check (applicable entity):

	P/C	Life	Health
Modification of Existing SSAP	☒	☒	☒
New Issue or SSAP	☐	☐	☐
Interpretation	☐	☐	☐

Description of Issue: *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. Complexity associated with the accounting is a significant contributing factor to numerous U.S. GAAP financial statement restatements and has resulted in complexity for users attempting to understand the results of applying the current guidance.

Under current 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. Convertible preferred stock also is required to be assessed under similar models. The amendments in ASU 2020-06 provide financial statement users with a simpler and more consistent starting point to perform analyses across entities. The amendments also improve the operability of the guidance and reduce, to a large extent, the complexities in the accounting for convertible instruments and the difficulties with the interpretation and application of the relevant guidance.

The amendments 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.

ASU 2020-06 also provides updated guidance on earnings per share calculations.

Existing Authoritative Literature:

1. Earnings per share – Rejected as Not Applicable for Statutory Accounting:

The concept of earnings per share (Topic 260) has previously been reviewed with the following U.S. GAAP standards rejected as not applicable in *Appendix D—Nonapplicable GAAP Pronouncements:*

- *FASB Statement No. 128, Earnings per Share* (FAS 128)
- *EITF 07-04, Application of the Two-Class Method under FASB Statement No. 128 to Master Limited Partnerships*

2. Distinguishing Liabilities from Equity / Derivatives and Hedging:

SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets defines a liability with excerpts below:

Financial Instruments with Characteristics of both Liabilities and Equity

27. Issued, free-standing financial instruments with characteristics of both liability and equity shall be reported as a liability to the extent the instruments embodies an unconditional obligation of the issuer. (Pursuant to SSAP No. 86, embedded features in derivative contracts shall not be separated from the host contract for separate recognition.) Free-standing financial instruments that meet any of the criteria below meet the definition of a liability:

a. A mandatorily redeemable financial instrument shall be classified as a liability unless the redemption is required to occur only upon the liquidation or termination of the issuing reporting entity.

b. A financial instrument, other than an outstanding share, that at inception both 1) embodies an obligation to repurchase the issuer's equity shares or is indexed to such an obligation and 2) requires or may require the issuer to settle the obligation by transferring assets.

c. Obligations that permit the holder to require the issuer to transfer assets.

d. A financial instrument is a liability if the issuer must settle the obligation by issuing a variable number of its equity shares and the obligation's monetary value is based solely or predominantly on: 1) a fixed monetary amount, 2) variation in something other than the fair value of the issuer's equity shares, or 3) variations inversely related to changes in the fair value of the issuer's equity shares.

e. Instruments in which the counterparty (holder) is not exposed to the risks and benefits that are similar to those of a holder of an outstanding share of the entity's equity shall be classified as a liability.

28. If a free-standing financial instrument will be redeemed only upon the occurrence of a conditional event, redemption of that instrument is conditional and, therefore, the instrument does not meet the definition of mandatorily redeemable financial instrument. However, that financial instrument shall be assessed each reporting period to determine whether circumstances have changed such that the instrument meets the definition of a mandatorily redeemable instrument (that is, the event is no longer conditional). If the event has occurred, the condition is resolved, or the event has become certain to occur, the financial instrument shall be reclassified as a liability.

29. The classification of a free-standing financial instrument as a liability or equity shall only apply to the instrument issuer. Holders or purchasers of such instruments shall refer to the appropriate investment statement for valuation and reporting.

SSAP No. 72—Surplus and Quasi-Reorganizations

Capital Stock

3. The articles of incorporation set forth the number of authorized shares of capital stock and the par value of each share. The capital stock account represents the number of shares issued times the par value of each share. When no par value is set forth, the reporting entity shall declare a "stated value" and record such amount in the capital stock account. Changes in the par value of a reporting entity's capital stock shall be reflected as a reclassification between the capital stock account and gross paid-in and contributed surplus. Issued, free-standing financial instruments with characteristics of both liability and equity shall be reported as a liability to the extent described in SSAP No. 5R.

SSAP No. 104R—Share-Based Payments, Exhibit A – Classification Criteria: Liability or Equity

Mandatorily Redeemable Financial Instruments

3. A mandatorily redeemable financial instrument shall be classified as a liability unless the redemption is required to occur only upon the liquidation or termination of the reporting entity.

4. A financial instrument that embodies a conditional obligation to redeem the instrument by transferring assets upon an event not certain to occur becomes mandatorily redeemable if that event occurs, the condition is resolved, or the event becomes certain to occur.

5. In determining if an instrument is mandatorily redeemable, all terms within a redeemable instrument shall be considered. The following items do not affect the classification of a mandatorily redeemable financial instrument as a liability:

   a. A term extension option

   b. A provision that defers redemption until a specified liquidity level is reached

   c. A similar provision that may delay or accelerate the timing of a mandatory redemption.

6. If a financial instrument will be redeemed only upon the occurrence of a conditional event, redemption of that instrument is conditional and, therefore, the instrument does not meet the definition of mandatorily redeemable financial instrument in this statement. However, that financial instrument would be assessed at each reporting period to determine whether circumstances have changed such that the instrument now meets the definition of a mandatorily redeemable instrument (that is, the event is no longer conditional). If the event has occurred, the condition is resolved, or the event has become certain to occur, the financial instrument is reclassified as a liability.

Obligations to Repurchase Issuer's Equity Shares by Transferring Assets

7. An entity shall classify as a liability (or an asset in some circumstances) any financial instrument, other than an outstanding share, that, at inception, has both of the following characteristics:

   a. It embodies an obligation to repurchase the issuer's equity shares, or is indexed to such an obligation, and

   b. It requires or may require the issuer to settle the obligation by transferring assets.

8. In this statement, "indexed to" is used interchangeably with "based on variations in the fair value of." The phrase "requires or may require" encompasses instruments that either conditionally or unconditionally obligate the issuer to transfer assets. If the obligation is conditional, the number of conditions leading up to the transfer of assets is irrelevant.

9. Examples of financial instruments that meet the criteria in paragraph 7 of this Exhibit include forward purchase contracts or written put options on the issuer's equity shares that are to be physically settled or net cash settled.

10. All obligations that permit the holder to require the issuer to transfer assets result in liabilities, regardless of whether the settlement alternatives have the potential to differ.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): The Working Group addressed similar issue in agenda item 2019-43, and adopted language that was included in the "Existing Authoritative Literature" section, primarily in SSAP No. 5R.

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

Convergence with International Financial Reporting Standards (IFRS): N/A

Staff 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).

Staff Review Completed by:
Jake Stultz, NAIC Staff – September 2020

Status:
On November 12, 2020, the Statutory Accounting Principles (E) Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets*, *SSAP No. 72—Surplus and Quasi-Reorganizations* and *SSAP No. 86—Derivatives*, 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 illustrated below.

SSAP No. 5R

38. This statement rejects *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*.

SSAP No. 72

30. This statement rejects *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*.

SSAP No. 86

69. This statement rejects *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, *ASU 2018-03, Recognition and Measurement of Financial Assets and Financial Liabilities*, and *ASU 2016-03, Intangibles—Goodwill and Other, Business Combinations, Consolidation, Derivatives and Hedging*.

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Statutory Accounting Principles (E) Working Group
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Issue: *ASU 2020-07 - Presentation and Disclosures by Not-for-Profit Entities*

Check (applicable entity):

	P/C	Life	Health
Modification of Existing SSAP	☒	☒	☒
New Issue or SSAP	☐	☐	☐
Interpretation	☐	☐	☐

Description of Issue: *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.

Existing Authoritative Literature: Disclosure requirements are included in most SSAPs, but none are specific to only not-for-profit entities.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): None

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

Convergence with International Financial Reporting Standards (IFRS): None

Staff 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.

Staff Review Completed by:
Jake Stultz, NAIC Staff – September 2020

Status:
On November 12, 2020, the Statutory Accounting Principles (E) Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed 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.

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Issue: Accounting for Perpetual Bonds

Check (applicable entity):

	P/C	Life	Health
Modification of Existing SSAP	☒	☒	☒
New Issue or SSAP	☐	☐	☐
Interpretation	☐	☐	☐

Description of Issue: Questions have arisen regarding 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 <u>does not</u> 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.

Perpetual bonds possess characteristics very similar to that of perpetual preferred stock in that both offer a projected return for an indefinite of time. The similarities of these two securities extend beyond both having indefinite lives and receiving periodic, scheduled income cash flows (i.e. interest for perpetual bonds and dividends for perpetual preferred stock). Both investments 1) have a higher than average duration from their perpetual cashflows reflecting a greater market value sensitivity, up and down, to interest rate movements, 2) generally are subject to issuer call provisions, and 3) do not possess voting rights. The only primary cashflow difference between perpetual bonds and perpetual preferred stock is seniority in the event of a liquidation (bond typically place higher in the liquidation hierarchy) – which is why perpetual preferred stock may warrant a higher yield to compensate for seniority risk.

Existing Authoritative Literature:

<u>SSAP No. 26R does not contain specific or differing valuation and reporting guidance for perpetual bonds</u>. These investments would be captured in the existing valuation and reporting guidance for bonds that are not mandatory convertible, which anticipate a scheduled maturity date. Under this existing guidance, bonds are held at amortized cost ***or*** lower of amortized cost or fair value, depending on NAIC designation of the bond. Due to perpetual bonds lacking a maturity date (and possessing indefinite lives), <u>they are unable to experience accretion or amortization to yield an amortized cost basis</u>.

<u>SSAP No. 26R—Bonds</u>

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.**

b. Mandatory convertible bonds: Mandatory convertible bonds are subject to special reporting instructions and are not assigned NAIC designations or unit prices by the SVO. **The**

balance sheet amount for mandatory convertible bonds shall be reported at the lower of amortized cost or fair value during the period prior to conversion. This reporting method is not impacted by NAIC designation or information received from credit rating providers (CRPs). Upon conversion, these securities will be subject to the accounting guidance of the statement that reflects their revised characteristics. (For example, if converted to common stock, the security will be in scope of *SSAP No. 30R—Unaffiliated Common Stock*, if converted to preferred stock, the security will be in scope of *SSAP No. 32—Preferred Stocks*.)

Due to the numerous payment similarities between perpetual bonds and perpetual preferred stock, the accounting and reporting guidance for perpetual preferred stock is below. (Note: guidance below is from agenda item 2019-04: SSAP No. 32 – Investment Classification Project.) This agenda item substantially revises *SSAP No. 32—Preferred Stock* as a part of the Investment Classification Project. This guidance is anticipated for adoption during the Summer 2020 National Meeting)

SSAP No 32R—Preferred Stock

10. Preferred stock shall be valued based on (a) the underlying characteristics (redeemable, **perpetual** or mandatory convertible), (b) the quality rating expressed as an NAIC designation, and (c) whether an asset valuation reserve (AVR) is maintained by the reporting entity:

a. For reporting entities that do not maintain an AVR:

i. Highest-quality or high-quality redeemable preferred stocks (NAIC designations 1 and 2) shall be valued at amortized cost. All other redeemable preferred stocks (NAIC designations 3 to 6) shall be reported at the lower of amortized cost or fair value.

ii. Perpetual preferred stocks shall be reported at fair value, not to exceed any currently effective call price.

iii. Mandatory convertible preferred stocks (regardless if the preferred stock is redeemable or perpetual) shall be reported at fair value, not to exceed any currently effective call price, in the periods prior to conversion. Upon conversion to common stock, these securities shall be in scope of SSAP No. 30R.

iv. For preferred stocks reported at fair value, unrealized gains and losses shall be recorded as a direct credit or charge to unassigned funds (surplus).

b. **For reporting entities that maintain an AVR**:

i. Highest-quality, high-quality or medium quality redeemable preferred stocks (NAIC designations 1 to 3) shall be valued at amortized cost. All other redeemable preferred stocks (NAIC designations 4 to 6) shall be reported at the lower of amortized cost or fair value.

ii. Perpetual preferred stocks shall be valued at fair value, not to exceed any currently effective call price.

iii. Mandatory convertible preferred stocks (regardless if the preferred stock is redeemable or perpetual) shall be reported at fair value, not to exceed any currently effective call price, in the periods prior to conversion. Upon conversion to common stock, these securities shall be in scope of SSAP No. 30R.

iv. For preferred stocks reported at fair value, the accounting for unrealized gains and losses shall be in accordance with *SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve* (SSAP No. 7).

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): While not specific to perpetual bonds, in agenda item 2019-04: SSAP No. 32 – Investment Classification Project, the Working Group has agreed in principle with the accounting for perpetual preferred stock, which from an investor perspective, is materially similar to perpetual bonds.

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

Convergence with International Financial Reporting Standards (IFRS): N/A

Staff Recommendation:
NAIC Staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to *SSAP No. 26R—Bonds* to clarify that perpetual bonds shall be reported at fair value, not to exceed any current effective call price. Although this is considered a nonsubstantive change, if a stated effective date is preferred (instead of immediately upon adoption), NAIC staff recommends an effective date of Jan. 1, 2021, with early application permitted. (Although these bonds cannot amortize without a maturity date, NAIC staff notes that the specific reference to fair value may cause a change for reporting entities immediately before year-end. However, it is also noted that these types of bonds are not believed to be overly prevalent.)

SSAP No. 26R – Proposed Updates

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, the bonds shall be reported at fair value regardless of NAIC designation, not to exceed any current effective call price.

b. Mandatory convertible bonds: Mandatory convertible bonds are subject to special reporting instructions and are not assigned NAIC designations or unit prices by the SVO. The balance sheet amount for mandatory convertible bonds shall be reported at the lower of amortized cost or fair value during the period prior to conversion. This reporting method is not impacted by NAIC designation or information received from credit rating providers (CRPs). Upon conversion, these securities will be subject to the accounting guidance of the statement that reflects their revised characteristics. (For example, if converted to common stock, the security will be in scope of *SSAP No. 30R—Unaffiliated Common Stock*, if converted to preferred stock, the security will be in scope of *SSAP No. 32—Preferred Stocks*.)

Effective Date and Transition

36. Revisions adopted April 2019, to explicitly exclude securities for which the contract amount of the instrument to be paid at maturity (or the original investment) is at risk for other than failure of the borrower to pay the contractual amount due, are effective December 31, 2019.

~~36.~~37. The reporting of perpetual bonds at fair value shall be effective January 1, 2021, with early adoption permitted.

Staff Review Completed by: Jim Pinegar, NAIC Staff – May 2020

Status:
On July 30, 2020, the Statutory Accounting Principles (E) Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to *SSAP No. 26R—Bonds*, as illustrated above, to clarify that perpetual bonds shall be reported at fair value, not to exceed any current effective call price. Although this is considered a nonsubstantive change, a stated effective date of Jan. 1, 2021, with early application permitted, has been proposed to allow time for reporting entities to make measurement changes as needed.

On November 12, 2020, the Statutory Accounting Principles (E) Working Group exposed revisions to *SSAP No. 26R—Bonds*, as illustrated below, to clarify that perpetual bonds are within scope as a "bond," and shall apply the yield-to-worst concept. Additionally, for perpetual bonds that do not possess or no longer possess a call feature shall follow fair value reporting.

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 that 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

9. Amortization of bond premium or discount shall be calculated using the scientific (constant yield) interest method taking into consideration specified interest and principal provisions over the life of the bond 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.

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

Issue: Separate Account – Product Identifiers

Check (applicable entity):

	P/C	Life	Health
Modification of Existing SSAP	☒	☒	☒
New Issue or SSAP	☐	☐	☐
Interpretation	☐	☐	☐

Description of Issue:
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. 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.

For example, upon review of the 2019 separate account annual statements filed with the NAIC, it was found that while some reporting entities included reporting details such as "XYZ Company Pension Risk Transfer" (a preferred method of disclosure), most entities grouped their separate account products in 3-4 broad categories. Common categories included variable life, variable annuity, indexed annuity and group variable annuity (the latter of which is likely where PRT's would be captured).

SSAP No. 56 requires several disclosure elements separated by "product identifier." These situations include:

- 1.01 – Separate account assets by SEC registration, guarantees, seed money, etc.
- 1.01A – Identification of private placement variable annuities / life insurance (PPVA or PPLI)
- 2.5 – Risk charges
- 4.2 – Investment Process and their treatment (e.g., to policyholder, to GA, or retained in SA)

As detailed in the separate account instructions, "a distinct product identifier shall be used for each product and shall be used consistently throughout the interrogatory." Even with this direction, most reporting entities appear to be aggregating product types for reporting. This has made it difficult to assess the reserve requirements or guarantees for the specific products. Additionally, regulators have indicated that upon their examination of the product mix general interrogatory in which the assets reflect if they are supported with a guarantee from the general account, due to the broad grouping of products, some products which do not have guarantees were grouped with those that did have guarantees.

Existing Authoritative Literature:

The disclosures for separate account assets are detailed in *SSAP No. 56—Separate Accounts*:

36. The Separate Account Annual Statement Blank shall include detailed information on the characteristics of the separate account assets, specifically categorizing separate account assets in accordance with the following characteristics:

a. Identification of separate account assets that are legally insulated from the general account and those which are not legally insulated.

b. Aggregation of separate account assets from products registered with the SEC and separate account assets from products excluded from registration. In addition to the overall aggregation, this disclosure shall specifically identify separate account assets from private placement variable annuities (PPVA) and private placement life insurance (PPLI). The disclosures in this paragraph (36.b.) are effective December 31, 2018.

c. Amount of separate account assets that represent seed money, other fees and expenses due to the general account, and additional required surplus amounts. This disclosure shall include the amount of seed money and other fees and expenses currently included in the separate account, as well as the amount of seed money received and repaid to the general account during the current year. This disclosure shall also include information on insulation (if applicable), the time duration for which seed money and other fees and expenses due the general account are retained in the separate account, and information on how whether seed money is invested pursuant to general account directives or in accordance with stated policies and procedures.

d. Identification of the separate account assets in which the investment directive is not determined by a contractholder. (In most instances, having multiple investment choices at the option of a contractholder would be considered a situation in which the investment directive is determined by a contractholder. This is not true for situations in which the asset is invested in a manner that mirrors the investment directives of the general account.) Situations in which the investment directive is not determined by the contractholder (and situations in which the reporting entity is the contractholder) shall include disclosure regarding whether the investments of the respective separate account assets, if included within the general account investments, would have resulted with the reporting entity exceeding any investment limitations imposed on the general account.

e. Identification of the separate account assets in which less than 100% of investment proceeds are attributed to a contractholder. This shall include identification of the separate account investment income attributed to the reporting entity during the reporting period and whether such income was transferred to the general account or reinvested within the separate account. Instances in which such income is reinvested within the separate account shall include disclosure on whether the subsequent investments, if categorized with investments in the general account, would have exceeded investment limitations imposed on the general account.

39. **Identify all products reported as a separate account product under statutory accounting principles and identify whether each product was classified differently under GAAP.** For products that resulted with different classifications between GAAP and SAP, identify the characteristic(s) of the product that prevented it from receiving a separate account classification under GAAP. This disclosure is applicable for all reporting entities. Thus, if GAAP financial statements were not filed, the reporting entity should complete this disclosure as if GAAP financials had been completed.

The annual statement instructions as well as an example of note 1.01 are below.

As the product identifier is used **throughout the interrogatory, examples of other items potentially impacted are as follows:**

1.01A For the products (and related assets) that are not registered with the SEC, identify whether the products are considered private placement variable annuity products or private placement life insurance.

1	Not Registered with SEC		
Product Identifier	2 Private Placement Variable Annuity	3 Private Placement Life Insurance	4 Other (Not PPVA or PPLI)
	$		
Totals	$		

Allocation of Investment Proceeds of Separate Account Activity

4.1 Does the reporting entity have separate account assets in which less than 100% of investment proceeds (net of contract fees and assessments) are attributed to a contract holder? (This should identify any situations where there is a ceiling on investment performance results.)

4.2 If yes, provide detail on the net investment proceeds that were attributed to the contract holder, transferred to the general account and reinvested within the separate account:

1 Product Identifier	2 Net Investment Proceeds	3 Attributed to Contract Holder	4 Transferred to General Account	5 Reinvested Within the Separate Account
	$	$	$	$
	$	$	$	$
	$	$	$	$

8.3 Identify all separate account products and identify whether each product was classified within a separate account for GAAP reporting purposes. (For non-GAAP filers, this disclosure should reflect whether the GAAP classification would have been the same if GAAP financials had been completed.) For products that were (or would have been) reported differently, identify which SOP 03-1 condition prevented separate account GAAP classification for that particular product.

1 Product Identifier	2 Same as GAAP / Condition that Requires GAAP General Account Reporting

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

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

Convergence with International Financial Reporting Standards (IFRS): N/A

Staff 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.

Staff Review Completed by:
Jim Pinegar - NAIC Staff, October 2020

Status:
On November 12, 2020, the Statutory Accounting Principles (E) Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed 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 in the separate account. Particularly, this is requesting feedback on how to obtain increased product identifier reporting granularity in question 1.01 (product mix) of the separate account general interrogatories (GI 1.01). Additionally, feedback is requested regarding if a threshold should be established for when aggregate reporting would be permitted.

NAIC BLANKS (E) WORKING GROUP

Blanks Agenda Item Submission Form

DATE: **02/17/2021**	**FOR NAIC USE ONLY**
CONTACT PERSON:	Agenda Item # 2021-03BWG
TELEPHONE:	Year 2021
EMAIL ADDRESS:	Changes to Existing Reporting [X]
ON BEHALF OF:	New Reporting Requirement [ ]
NAME: **Dale Bruggeman**	**REVIEWED FOR ACCOUNTING PRACTICES AND PROCEDURES IMPACT**
TITLE: **Chair SAPWG**	No Impact [X] Modifies Required Disclosure [ ]
AFFILIATION: **Ohio Department of Insurance**	**DISPOSITION**
ADDRESS: **50W. Town St., 3rd Fl., Ste. 300**	[ ] Rejected For Public Comment [ ] Referred To Another NAIC Group [ ] Received For Public Comment [ ] Adopted Date ______ [ ] Rejected Date ______
Columbus, OH 43215	[ ] Deferred Date ______ [ ] Other (Specify) ______

BLANK(S) TO WHICH PROPOSAL APPLIES

[X] **ANNUAL STATEMENT** [ ] **INSTRUCTIONS** [ ] **CROSSCHECKS**
[ ] **QUARTERLY STATEMENT** [X] **BLANK**

[ ] Life, Accident & Health/Fraternal [X] Separate Accounts [ ] Title
[ ] Property/Casualty [ ] Protected Cell [ ] Other ______
[ ] Health [ ] Health (Life Supplement)

Anticipated Effective Date: Annual 2021

IDENTIFICATION OF ITEM(S) TO CHANGE

Modify the tables for Interrogatory Questions 1.01, 1.01A, 2.5 and 4.2 in the Separate Accounts General Interrogatories by adding category lines to reflect additional granularity in the reporting on those tables.

REASON, JUSTIFICATION FOR AND/OR BENEFIT OF CHANGE**

The purpose of the proposal is to modify select tables on the Separate Accounts General Interrogatories to reflect the increased granularity in the product identifiers per by the Statutory Accounting Principles (E) Working Group agenda item (Ref #2020-37 & Ref #2020-38).

NAIC STAFF COMMENTS

Comment on Effective Reporting Date: ______

Other Comments:

**** This section must be completed on all forms.** **Revised 7/18/2018**

ANNUAL STATEMENT BLANK – LIFE\FRATERNAL

GENERAL INTERROGATORIES

Product Mix

1.01 Identify the product types in the separate account, quantify the assets associated with those products, indicate if there are any guarantees associated with those products, quantify seed money and quantify other fees and expenses due to the general account. For the products (and related assets) that are not registered with the SEC, identify whether the products are considered private placement variable annuity products or private placement life insurance.~~:~~

Note: A distinct disaggregated product identifier shall be used for each product and shall be used consistently throughout the interrogatory. Disaggregation of reporting shall be such that each product filing or policy form is separately identified. For example, if a company has 5 different separate group annuities, each annuity shall be separately reported. (Companies may eliminate proprietary information however such elimination will require the use of unique reporting identifiers).

Additional Required Surplus Amounts is defined as additional or permanent surplus that is required to be retained in the separate account in accordance with state law or regulation. These amounts should not include reinvested separate account investment proceeds that have not been allocated to separate account contract holders.

1	Separate Account Assets		4	5	6	7
	2	3				
Product Identifier	Registered with SEC	Not Registered with SEC	Guarantees Associated with the Product Yes/No	Seed Money	Fees and Expenses Due to the General Account	Additional Required Surplus Amounts
1.01A Pension Risk Transfer Group Annuities						
	$	$		$	$	$
Total Pension Risk Transfer Group Annuities	$	$		$	$	$
1.01B All Other Group Annuities						
	$	$		$	$	$
Total All Other Group Annuities	$	$		$	$	$
1.01C Registered Index Linked Annuities Individual Annuities						
	$	$		$	$	$
Total Registered Index Linked Annuities Individual Annuities	$	$		$	$	$
1.01D All Other Individual Annuities						
	$	$		$	$	$
Total All Other Individual Annuities	$	$		$	$	$
1.01E Life Insurance						
	$	$		$	$	$
Total Life Insurance	$	$		$	$	$
1.01F Totals	$	$	XXX	$	$	$

~~Note: Additional Required Surplus Amounts is defined as additional or permanent surplus that is required to be retained in the separate account in accordance with state law or regulation. These amounts should not include reinvested separate account investment proceeds that have not been allocated to separate account contract holders.~~

~~1.01A For the products (and related assets) that are not registered with the SEC, identify whether the products are considered private placement variable annuity products or private placement life insurance.~~

1	Not Registered with SEC		
Product Identifier	~~2~~8 Private Placement Variable Annuity	~~3~~9 Private Placement Life Insurance	~~4~~10 Other (Not PPVA or PPLI)
1.01A Pension Risk Transfer Group Annuities			
	$	$	$
Total Pension Risk Transfer Group Annuities	$	$	$
1.01B All Other Group Annuities			
	$		
Total All Other Group Annuities	$	$	$
1.01C Registered Index Linked Annuities Individual Annuities			
	$		
Total Registered Index Linked Annuities Individual Annuities	$	$	$
1.01D All Other Individual Annuities			
	$		
Total All Other Individual Annuities	$	$	$
1.01E Life Insurance			
	$		
Total Life Insurance	$	$	$
1.01F Totals	$		

Detail Eliminated to Conserve Space

2.4 To compensate the general account for the risk taken, for any separate account products with general account guarantees, does the separate account remit risk charges to the general account related to separate account guarantees? Yes [ ] No [ ]

2.5 If yes, identify the separate account products with risk charges that are remitted to the general account and whether the risk charge for that product is reviewed and opined upon:

1 Product Identifier with Risk Charges	2 Risk Charge Reviewed and Opined Upon	3 Name and Title of Individual Who Provided Opinion on Risk Charges
2.5A Pension Risk Transfer Group Annuities		
2.5B All Other Group Annuities		
2.5C Registered Index Linked Annuities Individual Annuities		
2.5D All Other Individual Annuities		
2.5E Life Insurance		

Detail Eliminated to Conserve Space

4.1 Does the reporting entity have separate account assets in which less than 100% of investment proceeds (net of contract fees and assessments) are attributed to a contract holder? (This should identify any situations where there is a ceiling on investment performance results.) Yes [ ] No [ ]

4.2 If yes, provide detail on the net investment proceeds that were attributed to the contract holder, transferred to the general account and reinvested within the separate account:

1 Product Identifier	2 Net Investment Proceeds	3 Attributed to Contract Holder	4 Transferred to General Account	5 Reinvested Within the Separate Account
4.2A Pension Risk Transfer Group Annuities				
	$	$	$	$
Total Pension Risk Transfer Group Annuities	$	$	$	$
4.2B All Other Group Annuities				
	$	$	$	$
Total All Other Group Annuities	$	$	$	$
4.2C Registered Index Linked Annuities Individual Annuities				
	$	$	$	$
Total Registered Index Linked Annuities Individual Annuities	$	$	$	$
4.2D All Other Individual Annuities				
	$	$	$	$
Total All Other Individual Annuities	$	$	$	$
4.2E Life Insurance				
	$	$	$	$
Total Life Insurance	$	$	$	$
4.2F Totals	$	$	$	$

Detail Eliminated to Conserve Space

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

Issue: Pension Risk Transfer – Separate Account Disclosure

Check (applicable entity):

	P/C	Life	Health
Modification of Existing SSAP	☐	☒	☒
New Issue or SSAP	☐	☐	☐
Interpretation	☐	☐	☐

Description of Issue:
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.

As a brief background, a pension risk transfer is when a defined-benefit pension provider seeks to remove some or all of its obligation to pay guaranteed retirement income to plan participants. In these transactions, the pension providers will generally transfer assets to an insurer, for which the insurer assumes the annuity risk for plan participants. According to AM Best, there were over 500 single premium pension contract buyouts totaling $28 billion in 2019. Due to organizations wanting to alleviate their pension liability, it is expected that PRT transactions will not subside in the near future.

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). For reference, GI 1.01 is shown below:

> 1.01 Identify the product types in the separate account, quantify the assets associated with those products, indicate if there are any guarantees associated with those products, quantify seed money and quantify other fees and expenses due to the general account:

1	Separate Account Assets		4	5	6	7
	2	3	Guarantees Associated with the Product Yes/No			
Product Identifier	Registered with SEC	Not Registered with SEC		Seed Money	Fees and Expenses Due to the General Account	Additional Required Surplus Amounts
	$	$		$	$	$
Totals	$	$	XXX	$	$	$

Upon review of the 2019 separate account annual statements filed with the NAIC, it was found that most entities did not individually detail PRT activity, but rather broadly combine this product into other product categories (i.e. group variable annuity).

While other details of the broadly categorized products are captured in various other general interrogatories (as shown below in Existing Authoritative Literature), 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.*

Existing Authoritative Literature:

There are numerous disclosure elements in *SSAP No. 56—Separate Accounts* that would be applicable for PRT transactions (the most relevant disclosures have been bolded below). However as described above, PRTs are generally reported in an aggregated manner with other similar products, thus the disclosures below do not currently provide the level of detail sought by regulators.

Disclosures

31. The general account financial statement shall include detailed information on the reporting entity's separate account activity. These disclosures shall include:

a. **A narrative of the general nature of the reporting entity's separate account business.**

b. Identification of the separate account assets that are legally insulated from the general account claims.

c. **Identification of the separate account products that have guarantees backed by the general account. This shall include:**

i. Amount of risk charges paid by the separate account to the general account for the past five (5) years as compensation for the risk taken by the general account; and

ii. Amount paid by the general account due to separate account guarantees during the past five (5) years.

d. Discussion of securities lending transactions within the separate account, separately including the amount of any loaned securities within the separate account, and if policy and procedures for the separate account differ from the general account.

32. For each grouping (as detailed in paragraph 33), the following shall be disclosed:

a. Premiums, considerations or deposits received during the year;

b. Reserves by the valuation basis of the investments supporting the reserves at the financial statement date. List reserves for separate accounts whose assets are carried at fair value separately from those whose assets are carried at amortized cost/book value;

c. **Reserves by withdrawal characteristics**, including whether or not the separate account is subject to discretionary withdrawal. For reserves subject to discretionary withdrawal, the below categories are included if applicable:

i. With market value adjustment;

ii. at book value without market value adjustment and with surrender charge of 5% or more;

iii. at fair value;

iv. at book value without market value adjustment and with surrender charge of less than 5%;

d. Reserves for asset default risk, as described in paragraph 18.b., that are recorded in lieu of AVR.

33. For the disclosures required in paragraph 32, separate accounts shall be addressed in the following groupings (which are the same as those used for risk-based capital):

a. **Separate Accounts with Guarantees**:

i. Indexed separate accounts, which are invested to mirror an established index which is the basis of the guarantee;

ii. Nonindexed separate accounts, with reserve interest rate at no greater than 4% and/or fund long-term interest guarantee in excess of a year that does not exceed 4%;

iii. Nonindexed separate accounts, with reserve interest rate at greater than 4% and/or fund long-term interest guarantee in excess of a year that exceeds 4%.

b. Nonguaranteed Separate Accounts—Variable separate accounts, where the benefit is determined by the performance and/or fair value of the investments held in the separate account. Include variable accounts with incidental risks, nominal expense, and minimum death benefit guarantees.

34. **Provide a reconciliation of the amount reported as transfers to and from separate accounts in the Summary of Operations of the separate accounts statement and the amount reported as net transfers to or from separate accounts in the Summary of Operations of the general accounts statement**.

35. The disclosures in *SSAP No. 51R—Life Contracts*, and *SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance* related to the withdrawal characteristics of products include separate account products and shall be completed in the general account disclosures.

36. The Separate Account Annual Statement Blank shall include detailed information on the characteristics of the separate account assets, specifically categorizing separate account assets in accordance with the following characteristics:

a. **Identification of separate account assets that are legally insulated from the general account and those which are not legally insulated**.

b. Aggregation of separate account assets from products registered with the SEC and separate account assets from products excluded from registration. In addition to the overall aggregation, this disclosure shall specifically identify separate account assets from private placement variable annuities (PPVA) and private placement life insurance (PPLI). The disclosures in this paragraph (36.b.) are effective December 31, 2018.

c. Amount of separate account assets that represent seed money, other fees and expenses due to the general account, and additional required surplus amounts. This disclosure shall include the amount of seed money and other fees and expenses currently included in the separate account, as well as the amount of seed money received and repaid to the general account during the current year. This disclosure shall also include information on insulation (if applicable), the time duration for which seed money and other fees and expenses due the general account are retained in the separate account, and information on how whether seed money is invested pursuant to general account directives or in accordance with stated policies and procedures.

d. Identification of the separate account assets in which the investment directive is not determined by a contractholder. (In most instances, having multiple investment choices at the option of a contractholder would be considered a situation in which the investment directive is determined by a contractholder. This is not true for situations in which the asset is invested in a manner that mirrors the investment directives of the general account.)

Situations in which the investment directive is not determined by the contractholder (and situations in which the reporting entity is the contractholder) shall include disclosure regarding whether the investments of the respective separate account assets, if included within the general account investments, would have resulted with the reporting entity exceeding any investment limitations imposed on the general account.

e. Identification of the separate account assets in which less than 100% of investment proceeds are attributed to a contractholder. This shall include identification of the separate account investment income attributed to the reporting entity during the reporting period and whether such income was transferred to the general account or reinvested within the separate account. Instances in which such income is reinvested within the separate account shall include disclosure on whether the subsequent investments, if categorized with investments in the general account, would have exceeded investment limitations imposed on the general account.

37. For all separate account assets not reported at fair value, indicate the measurement basis (amortized cost or other method) for each asset (or asset class) and whether the measurement method was grandfathered in under the transition guidance in this SSAP, or whether the measurement method is allowed under a prescribed or permitted practice. This disclosure shall include a comparison of the assets' reported value to fair value with identification of the resulting unrealized gain/loss that would have been recorded if the assets had been reported at fair value.

38. For all separate accounts that include securities lending transactions, disclose the reporting entity's use and policy of securities lending within the separate account, including the amount of loaned securities from the separate account at the reporting date, the percentage of separate account assets lent as of that date, a description for which type of accounts (e.g., book value accounts, market value account accounts) are lent, if the separate account policyholder is notified or approves of such practices, the policy for requiring collateral, whether the collateral is restricted and the amount of collateral for transactions that extend beyond one year from the reporting date. This disclosure requires the entity to provide the following information as of the date of the statement of financial position: (1) the aggregate amount of contractually obligated open collateral positions (aggregate amount of securities at current fair value or cash received for which the borrower may request the return of on demand) and the aggregate amount of contractually obligated collateral positions under 30-day, 60-day, 90-day, and greater than 90-day terms, (2) the aggregate fair value of all securities acquired from the sale, trade and use of the accepted collateral (reinvested collateral), and (3) information about the sources and uses of that collateral.

39. Identify all products reported as a separate account product under statutory accounting principles and identify whether each product was classified differently under GAAP. For products that resulted with different classifications between GAAP and SAP, identify the characteristic(s) of the product that prevented it from receiving a separate account classification under GAAP. This disclosure is applicable for all reporting entities. Thus, if GAAP financial statements were not filed, the reporting entity should complete this disclosure as if GAAP financials had been completed.

As previously shown, GI 1.01 is the primary interrogatory which capture PRT transactions, however additional details are captured in the following tables.

1.01A For the products (and related assets) that are not registered with the SEC, identify whether the products are considered private placement variable annuity products or private placement life insurance.

1	Not Registered with SEC		
Product Identifier	2 Private Placement Variable Annuity	3 Private Placement Life Insurance	4 Other (Not PPVA or PPLI)
	$		
Totals	$		

Allocation of Investment Proceeds of Separate Account Activity

4.1 Does the reporting entity have separate account assets in which less than 100% of investment proceeds (net of contract fees and assessments) are attributed to a contract holder? (This should identify any situations where there is a ceiling on investment performance results.)

4.2 If yes, provide detail on the net investment proceeds that were attributed to the contract holder, transferred to the general account and reinvested within the separate account:

1 Product Identifier	2 Net Investment Proceeds	3 Attributed to Contract Holder	4 Transferred to General Account	5 Reinvested Within the Separate Account
	$	$	$	$
	$	$	$	$
	$	$	$	$

8.3 Identify all separate account products and identify whether each product was classified within a separate account for GAAP reporting purposes. (For non-GAAP filers, this disclosure should reflect whether the GAAP classification would have been the same if GAAP financials had been completed.) For products that were (or would have been) reported differently, identify which SOP 03-1 condition prevented separate account GAAP classification for that particular product.

1 Product Identifier	2 Same as GAAP / Condition that Requires GAAP General Account Reporting

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

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

Convergence with International Financial Reporting Standards (IFRS): N/A

Staff 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.

Staff Review Completed by:
Jim Pinegar - NAIC Staff, October 2020

Status:
On November 12, 2020, the Statutory Accounting Principles (E) Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed the agenda item to solicit comments from state insurance regulators and industry regarding possible modifications to *SSAP No. 56—Separate Accounts* specific to pension risk transfer (PRT) products. 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.

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Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
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Issue: Interpretation Policy Statement Updates

Check (applicable entity):

	P/C	Life	Health
Modification of Existing SSAP	☒	☒	☒
New Issue or SSAP	☐	☐	☐
Interpretation	☐	☐	☐

Description of Issue: This agenda item proposes edits to Appendix F of the *NAIC Policy Statement on Maintenance of Statutory Accounting Principles,* clarifying the requirements regarding the issuance and adoption of accounting interpretations.

Existing Authoritative Literature:

NAIC Policy Statement on Maintenance of Statutory Accounting Principles (Appendix F) documents the requirements of interpretation issuances and adoptions.

Development of Interpretations to SSAPs and Referencing Interpretations Within SSAPs

9. Interpretations will be developed to address, but will not be limited to issues requiring timely application or clarification of existing SAP, which shall not amend, supersede or conflict with existing, effective SSAPs. Issues being considered as an interpretation must be discussed at no less than two open meetings. (Original introduction of the issue when the Working Group identifies the intent to address the issue as an "interpretation" during a public discussion is considered the first open meeting discussion.) The process must allow opportunity for interested parties to provide comments, but as interpretations are intended to provide timely responses to questions of application or interpretation and clarification of guidance, no minimum exposure timeframe is required.

10. The voting requirement to adopt an interpretation is a simple majority. As interpretations do not amend, supersede or conflict with existing SSAP guidance, the interpretation is effective upon Working Group adoption unless specifically stated otherwise. The Working Group shall report the adopted interpretation to the Task Force as part of its public report during the next NAIC national meeting (or earlier if applicable). Interpretations can be overturned, amended or deferred only by a two-thirds majority of the Task Force membership.

11. In rare circumstances, the Working Group may adopt an interpretation which creates new SAP or conflicts with existing SSAPs. Historically, these interpretations temporarily modified statutory accounting principles and/or specific disclosures were developed in response to nationally significant events (e.g., Hurricane Sandy, September 11, 2001). In order to adopt an interpretation that creates new SAP or conflicts with existing SSAPs, the Working Group must have 67% of its members voting (10 out of 15 members) with a super majority (7 out of 10, 8 out of 11 or 12, 9 out of 13, 10 out of 14, or 11 out of 15) supporting adoption. These interpretations can be adopted, overturned, amended or deferred only by a two-thirds majority of the Task Force membership.

12. As new SSAPs are developed, it is essential to review and, if necessary, update the status of interpretations related to SSAPs that are being replaced and/or new SSAPs being developed. The following options are available to the Working Group when a SSAP with existing interpretations is replaced:

a. **Interpretation of the new SSAP -** If the Working Group would like to maintain the interpretation, the new SSAP can be added to the list of statements interpreted by the interpretation. In addition, the status section of the new SSAP will list the interpretation number next to the heading "Interpreted by."

b. **Nullification** - When an interpretation is nullified by a subsequent SSAP or superseded by another interpretation, the interpretation is deemed no longer technically helpful, is shaded and moved to Appendix H (Superseded SSAPs and Nullified Interpretations), and the reason for the change is noted beneath the interpretation title. The status section of the SSAP describes the impact of the new guidance and the effect on the interpretation (for example, nullifies, incorporated in the new SSAP with paragraph reference, etc.).

c. **Incorporation** - When an interpretation is incorporated into a new SSAP, the Working Group can choose from the following two options:

   i. If the interpretation only interprets one SSAP, then the interpretation is listed as being nullified under the "affects" section of the SSAP and is not referenced under the "interpreted by" section of the status page of the SSAP.

   ii. If the interpretation references additional SSAPs, and the Working Group intends to maintain the guidance, the interpretation is unchanged (no nullification). The new SSAP (Summary of Issue section) reflects that the interpretation issue has been incorporated into the new statement.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): None

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

Convergence with International Financial Reporting Standards (IFRS): N/A

Staff 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.

Development of Interpretations to SSAPs and Referencing Interpretations Within SSAPs

Interpretations which DO NOT amend, supersede, or conflict with existing SSAPs

9. Interpretations ~~will~~ may be developed to address~~, but will not be limited to~~ issues requiring timely application or clarification of existing SAP, which shall not amend, supersede or conflict with ~~existing,~~ effective SSAPs. Issues being considered as an interpretation must be discussed at no less than two open meetings. (Original introduction of the issue when the Working Group identifies the intent to address the issue as an "interpretation" during a public discussion is considered the first open meeting discussion.) The process must allow opportunity for interested parties to provide comments, but as interpretations are intended to provide timely responses to questions of application or interpretation and clarification of guidance, no minimum exposure timeframe is required.

10. ~~The voting requirement to adopt an interpretation is a simple majority.~~ As these interpretations do not amend, supersede or conflict with existing SSAP guidance, the interpretation is effective upon Working Group adoption, unless specifically stated otherwise. The voting requirement to adopt an interpretation of this type is a simple majority. The Working Group shall report the adopted interpretation to the Accounting Practice and Procedures (E) Task Force as part of its public report during the next NAIC national meeting (or earlier if applicable). Interpretations can be overturned, amended or deferred ~~only~~ by a two-thirds majority of the Task Force membership. For clarification, a two-thirds majority of the Task Force requires

two-thirds of the entire Task Force membership, not just those electing to vote. Additionally, interpretations can be overturned, amended, deferred, or referred to either the Task Force and/or the Working Group by a simple majority of the Financial Condition (E) Committee.

Interpretations which amend, supersede, or conflict with existing SSAPs

11. In ~~rare~~ certain circumstances, the Working Group may adopt an interpretation which creates a new SAP or conflicts with existing SSAPs. Historically, these interpretations temporarily modified statutory accounting principles and/or specific disclosures were developed in response to nationally significant events (e.g., Hurricane Sandy, September 11, 2001). In order to adopt an interpretation that creates new SAP or conflicts with existing SSAPs, the Working Group must have 67% of its members voting (10 out of 15 members) with a super majority (7 out of 10, 8 out of 11 or 12, 9 out of 13, 10 out of 14, or 11 out of 15) supporting adoption.

a. These interpretations are effective upon Working Group adoption, unless stated otherwise, and shall be reported to the Accounting Practice and Procedures (E) Task Force as part of its public report during the next NAIC national meeting (or earlier if applicable). In circumstance where the Working Group adopts an interpretation (which creates new SAP or conflicts with existing SSAPs) that is controversial in nature (i.e. due to regulator or industry feedback or could have a policy level impact), 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.

b. These interpretations can be ~~adopted~~ overturned, amended or deferred by a two-thirds majority of the Task Force membership. For clarification, a two-thirds majority of the Task Force requires two-thirds of entire Task Force membership, not just those electing to vote. Additionally, interpretations can be overturned, amended, deferred, or referred to either the Task Force and/or the Working Group by a simple majority of the Financial Condition (E) Committee.

Staff Review Completed by: Jim Pinegar, NAIC Staff – August 2020

Status:
On November 12, 2020, the Statutory Accounting Principles (E) Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to *NAIC Policy Statement on Maintenance of Statutory Accounting Principles* in *Appendix F—Policy Statements* regarding the issuance and adoption of accounting interpretations, as illustrated above.

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

Issue: Clarification of Prescribed Practices

Check (applicable entity):

	P/C	Life	Health
Modification of Existing SSAP	☒	☒	☒
New Issue or SSAP	☐	☐	☐
Interpretation	☐	☐	☐

Description of Issue:
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. The AP&P Manual is not intended to preempt states' legislative and regulatory authority.

- 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, in addition to the financial statements required by the domiciliary state, a non-domiciliary state in which the company is licensed may require an insurer to file supplemental financial information that require or allow the use of different accounting practices in the supplementary filing than provided [for] in the AP&P manual. ~~in the financial statements filed in that state. Ideally,~~ T~~t~~o prevent reporting entities from having to file ~~different~~ financial statements or reports prepared on different basis of accounting with differnt~~ing~~ states, the practices permitted or prescribed by a domiciliary state will be accepted in all states in which a company is licensed. However, as noted above, the provisions of the AP&P Manual are not intended to preempt states' legislative or regulatory authority. Accordingly, each state in which a company is licensed could ~~allow or~~ require supplemental financial information that required or allows statutory accounting practices that differ from the AP&P manual.~~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) in such supplemental financial information that is different from NAIC SAP, that practice (s) ~~this provision~~ is also 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.

Examples of two possible situations:

Scenario 1: Non-domiciliary State A issues a state statute / bulletin that requires the filing of supplemental financial information and which requires the use of a~~n~~ prescribed accounting practice for all companies that are licensed and doing business within State A. Domiciliary State B does not issue a comparable state statute / bulletin.

Scenario 1 Conclusion: The reporting entity shall file statutory financial statements with their domiciliary state and the NAIC in accordance with the statutory accounting practices permitted or prescribed by the domiciliary state (State B). (These financial statements would be subject to the independent audit requirements per Model 205.) The reporting entity also shall file supplemental financial information ~~separate financial statements~~ with State A in accordance with the accounting practice mandated by that non-domiciliary state but shall also include the prescribed practice disclosure of Note 1 in the supplemental financial information.

Scenario 2: Non-domiciliary State A issues a state statute / bulletin that allows an accounting practice for all companies that are licensed and doing business within State A. Domiciliary State B does not issue a comparable state statute / bulletin.

Scenario 2 Conclusion: The reporting entity shall file statutory financial statements with their domiciliary state and the NAIC in accordance with the statutory accounting practices permitted or prescribed by the domiciliary state (State B). (These financial statements would be subject to the independent audit requirements per Model 205.) The reporting entity then has the ability, but is not required, to file supplemental financial information ~~statements~~ in State A that reflects the accounting practice prescribed by that non-domiciliary state and shall include the prescribed practice disclosure of Note 1 in the supplemental financial information.

Existing Authoritative Literature:

Preamble

12. Codification is not intended to preempt state legislative and regulatory authority. While Codification is expected to be the foundation of a state's statutory accounting practices, it may be subject to modification by practices prescribed or permitted by a state's insurance commissioner. Statutory financial statements will continue to be prepared on the basis of accounting practices prescribed or permitted by the states. As a result, in 1998 the AICPA's Insurance Companies Committee determined that it will not be necessary for the Auditing Standards Board to grant the Codification status as an OCBOA since it will not be the sole basis for preparing statutory financial statements. Further, auditors will be permitted to continue to provide audit opinions on practices prescribed or permitted by the insurance department of the state of domicile.

Preamble Questions and Answers
Permitted Practices Advance Notification Requirement – Implementation Questions and Answers

2. Q: What is the difference between a permitted accounting practice and a prescribed practice?

A: **Permitted** accounting practices include practices specifically requested by an insurer that depart from NAIC Statutory Accounting Principles (SAP) and state prescribed accounting practices, as described below, and have received approval from the insurer's domiciliary state regulatory authority.

Prescribed accounting practices are those practices that are incorporated directly or by reference by state laws, regulations and general administrative rules applicable to all insurance enterprises domiciled in a particular state. The NAIC AP&P Manual is not intended to preempt states' legislative and regulatory authority.

If a reporting entity requests an accounting practice that differs from state prescribed accounting practices, but is in accordance with NAIC SAP, advance notice of approval is not required.

The NAIC Model laws do not contain a definition of "prescribed practice," but references to prescribed practices are noted in the Model laws below. These are provided as reference. There are no revisions proposed to the Model Laws:

Model 205 – Annual Financial Reporting Model Regulation

Section 6 - Designation of Independent Certified Public Accountant

B. The insurer shall obtain a letter from the accountant, and file a copy with the commissioner stating that the accountant is aware of the provisions of the insurance code and the regulations of the Insurance Department of the state of domicile that relate to accounting and financial matters and affirming that the accountant will express his or her opinion on the financial statements in terms of their conformity to the statutory accounting practices prescribed or otherwise permitted by that Insurance Department, specifying such exceptions as he or she may believe appropriate.

Model 450 – Insurance Holding Company System Model Regulation with Reporting Forms and Instructions

Item 12. Financial Statements and Exhibits

The annual financial statements of the applicant shall be accompanied by the certificate of an independent public accountant to the effect that such statements present fairly the financial position of the applicant and the results of its operations for the year then ended, in conformity with generally accepted accounting principles or with requirements of insurance or other accounting principles prescribed or permitted under law. If the applicant is an insurer which is actively engaged in the business of insurance, the financial statements need not be certified, provided they are based on the Annual Statement of the person filed with the insurance department of the person's domiciliary state and are in accordance with the requirements of insurance or other accounting principles prescribed or permitted under the law and regulations of the state.

Model 785 – Credit for Reinsurance Model Law

Section 4. Qualified U.S. Financial Institutions

4.c. Maintains at least $250 million in capital and surplus when determined in accordance with the NAIC Accounting Practices and Procedures Manual, including all amendments thereto adopted by the NAIC, excluding the impact of any permitted or prescribed practices; and is

Model 787 – Term and Universal Life Insurance Reserve Financing Model Regulation

Section 6. The Actuarial Method

B. Valuation used for Purposes of Calculations

For the purposes of both calculating the Required Level of Primary Security pursuant to the Actuarial Method and determining the amount of Primary Security and Other Security, as applicable, held by or on behalf of the ceding insurer, the following shall apply: (1) For assets, including any such assets held in trust, that would be admitted under the NAIC Accounting Practices and Procedures Manual if they were held by the ceding insurer, the valuations are to be determined according to statutory accounting procedures as if such assets were held in the ceding insurer's general account and without taking into consideration the effect of any prescribed or permitted practices; and

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): None

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

Convergence with International Financial Reporting Standards (IFRS): Not Applicable

Staff 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. (NAIC staff do not believe revisions are necessary to paragraph 12 of the Preamble as that guidance does not limit practices to the domiciliary state and already confirms that the domiciliary state practices shall be reflected in the financial statements subject to audit. For reference paragraph 12 is below.)

12. Codification is not intended to preempt state legislative and regulatory authority. While Codification is expected to be the foundation of a state's statutory accounting practices, it may be subject to modification by practices prescribed or permitted by a state's insurance commissioner. Statutory financial statements will continue to be prepared on the basis of accounting practices prescribed or permitted by the states. As a result, in 1998 the AICPA's Insurance Companies Committee determined that it will not be necessary for the Auditing Standards Board to grant the Codification status as an OCBOA since it will not be the sole basis for preparing statutory financial statements. **Further, auditors will be permitted to continue to provide audit opinions on practices prescribed or permitted by the insurance department of the state of domicile**.

Proposed Revisions to the Preamble Questions and Answers:

2. Q: What is the difference between a permitted accounting practice and a prescribed practice?

A: **Permitted** accounting practices include practices specifically requested by an insurer that depart from NAIC Statutory Accounting Principles (SAP) and state prescribed accounting practices, as described below, and have received approval from the insurer's domiciliary state regulatory authority.

Prescribed accounting practices are those practices that are incorporated directly or by reference by state laws, regulations and general administrative rules applicable to all insurance enterprises domiciled and/or licensed in a particular state. The NAIC AP&P Manual is not intended to preempt states' legislative and regulatory authority. Prescribed accounting practices of the domiciliary state shall be reflected in the statutory financial statements filed with the NAIC. Non-domiciliary states may additionally require insurance entities licensed in their state to file financial statements in accordance with the prescribed accounting practices of that particular non-domiciliary state.

If a reporting entity requests an accounting practice that differs from state prescribed accounting practices, but is in accordance with NAIC SAP, advance notice of approval is not required.

Staff Review Completed by:
Julie Gann - NAIC Staff
July 2020

Status:
On November 12, 2020, the Statutory Accounting Principles (E) Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed proposed revisions to the Preamble Implementation Questions and Answers to clarify prescribed practices, as illustrated above. 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 audit requirements.

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Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
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Issue: Derivatives Hedging Fixed Indexed Products

Check (applicable entity):

	P/C	Life	Health
Modification of Existing SSAP	☒	☒	☒
New Issue or SSAP	☐	☐	☐
Interpretation	☐	☐	☐

Description of Issue:
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.

For purposes of discussion, the following definitions apply:

- Fixed Indexed Annuity (FIA) - Zero risk of loss to the policyholder (and subject to standard nonforfeiture minimum accumulation rates), interest credited based on performance of referenced index. *(This product is addressed in this agenda item.)*

- Registered Index-Linked Annuity (RILA) - Hybrid of a fixed indexed and variable annuity. Has risk of loss to policyholder, but subject to buffers / floors. (Components may be bifurcated between the general and separate account, but aspects captured in the separate account are not subject to nonforfeiture minimums). Subject to registration as a security with the SEC. *(This product may also be referred to as a "structured" index-linked annuity. This product will be discussed in a separate agenda item.)*

Current statutory accounting guidance for the accounting and reporting for derivatives is captured in *SSAP No. 86—Derivatives* and *SSAP No. 108—Derivatives Hedging Variable Annuity Guarantees*. The provisions of these SSAPs are briefly summarized as follows:

- SSAP No. 86 requires derivatives to be reported at fair value, with unrealized gains and losses recognized through surplus unless the derivative qualifies as an effective hedge. If the derivative qualifies as an effective hedge, the derivative follows "hedge accounting," with the derivative reported at a measurement method that mirrors the hedged item. The types of hedging relationships, and criteria that determines effective hedge treatment, generally mirror U.S. GAAP. With these provisions, derivatives used to hedge fixed indexed annuities would often not qualify as effective hedges, so the derivatives would be reported at fair value. From initial assessments, the hedge of a portfolio of FIA/IUL contracts, as well as the identification as an embedded derivative, preclude obtaining a hedge effectiveness under existing U.S. GAAP and SAP. Although FASB has issued ASU 2017-12, which is still pending full statutory accounting review, from initial review, the revisions in that ASU do not assist in qualifying these hedges as effective.

- SSAP No. 108 was issued in 2018 for the specific intent to establish guidance for derivatives that effectively hedge variable annuity guarantees. This guidance was necessary due to financial statement volatility caused by a mismatch of reporting for the derivatives and the variable annuity guarantee reserve. With the adopted provisions, all derivatives are reported at fair value, but the change in fair value is recognized differently based on when the change offsets a change in the reserve (with the use of deferred assets). This approach mitigates the financial statement volatility caused by the fair value changes in qualifying derivatives. The guidance in SSAP No. 108 is significantly different from SSAP No. 86 and U.S. GAAP as it permits qualifying effective hedging assessments in dynamic and macro hedging programs. Use of SSAP No. 108 is restricted, and is limited to annuity contracts and other contracts involving certain guaranteed annuity benefits similar to those offered with variable annuities that are reserved for in accordance with *Valuation Manual 21: Requirements for Principal-Based Reserves for Variable Annuities* (VM-21).

<u>Accounting / Reporting Issue</u>
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 FIA 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 FIA/IUL crediting rate.

<u>Proposed Concepts to Address Reporting Mismatch:</u>
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. <u>Approach 1: Establish guidance that permits effective hedge treatment that is in line with SSAP No. 86.</u> 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. The key provisions would include:

a. Establishing guidance that permits derivatives to qualify as effective hedges. As the hedged item is a portfolio of contracts resulting with an ongoing reserve liability, the guidance would likely need to consider concepts that permit structures that would not qualify as effective under existing SSAP No. 86 provisions.

b. Guidance that directs the reporting of derivative changes at settlement as net investment income (or realized gains and losses) to offset the indexed-based interest credited to FIA/IUL reserves.

This approach is partly in line with the legislation prescribed by the IA Insurance Division. However, that legislation addresses both derivative measurement method and the process to recognize the reserve change. (The IA legislation guidance permits recognizing the reserve change in the same timeframe that the contract holder is credited the reserve change.) From initial industry discussion, if only derivative measurement method is addressed under SAP, this could create greater volatility, even if using an amortized cost measurement method. Additionally, the IA approach only permits certain derivatives to be reported at amortized cost under this approach (e.g., call spreads). Futures, swaps and swaptions are required to be reported at fair value even if they are part of the overall effective hedging program.

2. <u>Approach 2: Establish guidance that permits effective hedge treatment that is in line with SSAP No. 108.</u> 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. The key provisions would include:

   a. Establishing guidance that permits derivatives to qualify as effective hedges. As the hedged item is a portfolio of contracts resulting with an ongoing reserve liability, the guidance would likely need to consider concepts that permit structures that would not qualify as effective under existing SSAP No. 86 provisions. *(This provision is consistent between the two options.)*

   b. Incorporation of guidance that directs the reporting of fair value changes based on whether they offset the reserve crediting rate. If mirroring the concepts of SSAP No. 108:

      i. Create a timing match to offset the reserve change in the income statement with the derivative change in fair value. This option would likely utilize the "deferred asset" concept for fair value fluctuations that occur in interim periods before settlement. For example, if the product credits interest from the index change on an annual basis, and there are effective hedges that mirrors this timeframe, the fair value change in the interim periods would be recognized as deferred assets/liabilities, rather than as unrealized gains and losses. With the recognition of the reserve change, the deferred item would be reversed for a coinciding change to net investment income (or realized gains and losses). Although similar to SSAP No. 108, it is anticipated that deferred items would be eliminated over a shorter timeframe, with reversal immediately with the policy reserve change, and not amortized over time. It is expected that most product rate changes occur annually, but variations with 2-year, 5-year and perhaps longer stated periods may exist.

ii. Review and establish guidance (as appropriate) for the recognition of derivative fair value changes, for derivatives identified to as in effective hedges, that do not offset the reserve change from interest credited. (For example, is following concepts from SSAP No. 108, those changes would continue to be reflected as unrealized gains or losses until the derivative closed.) Discussion is expected to identify the presence of such situations and differing dynamics for derivatives hedging indexed products in comparison to variable annuity products.

Existing Authoritative Literature:

- ***SSAP No. 86—Derivatives:*** This SSAP establishes statutory accounting principles for derivative instruments and hedging, income generation and replication (synthetic asset) transactions using selected concepts outlined in FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities.

  Overview of SAP Accounting – SSAP No. 86

  1. Derivative instruments used in hedging transactions that meet the criteria of a highly-effective hedge are considered "effective" and are permitted to be valued and reported in a manner consistent with the hedged asset or liability (referred to as hedge accounting). (P. 20)

  2. Derivative instruments used in hedging transactions that do not meet, or no longer meet the criteria of a highly-effective hedge, or that meets the required criteria by the entity has chosen not to apply hedge accounting, shall be accounted for at fair value, with changes in fair value recorded as unrealized gains or unrealized losses (referred to as fair value accounting). (P. 20)

  3. Entities are permitted to designate instruments to hedge changes in fair value, variations in cash flows or foreign currency exposure. Although these hedging categories are consistent with U.S. GAAP, U.S. GAAP has more restrictions than SAP for when designations may occur, and U.S. GAAP identifies specific instruments ineligible for designation as hedging instruments. (P. 23)

  4. Measurement of hedge effectiveness for a particular hedging relationship shall be consistent with the entity's risk management strategy and the method of assessing hedging effectiveness that was documented at the inception of the hedging relationship (P. 37)

  5. For contracts that qualify for hedge accounting, the change in the carrying value or cash flow of the derivative is to be recorded consistently with how changes in the carrying value or cash flow of the hedged item is recorded. Upon termination of a derivative that qualifies for hedge accounting, the gain or loss shall adjust the basis of the hedged item and be recognized in income in a manner that is consistent with the hedged item. Alternatively, if the item is being hedged is subject to IMR, the gain or loss on the hedging derivative may be realized and shell be subject to IMR after termination.) Entities who choose the alternative method shall apply it consistently thereafter. (P. 22)

- ***SSAP No. 108—Derivatives Hedging Variable Annuity Guarantees:*** This SSAP establishes statutory accounting principles for limited derivatives hedging variable annuity guarantee benefits subject to fluctuations as a result of interest rate sensitivity. The provisions within this statement are separate and distinct from the guidance in SSAP No. 86, as the items subject to the scope of this guidance, and the provisions within, would not qualify for hedge effectiveness under SSAP No. 86. The provisions within this statement are only permitted if all of the components of the statement are met and shall not be inferred as an acceptable statutory accounting approach for derivative transactions that do not meet the state qualifications or that are not specially addressed within the guidance.

Overview of SAP Accounting – SSAP No. 108

1. All derivative instruments are recognized at fair value. (P. 12)

2. Changes in fair value attributed to the hedged risk are recognized as either immediate offsets to the change in reserve liability as realized gains/losses or recognized as deferred assets and liabilities and amortized into realized gain or losses based on the duration of benefit cash flows, not to exceed 10 years. Changes in derivatives that are not attributable to the hedged risk shall be recognized as unrealized gains or losses. (Special surplus is allocated for the net deferred asset or liability.) (P. 13-14)

3. Guidance allows entities to utilize a specified derivative, or a portfolio of specified derivative as the hedging instrument. The hedging instrument can also reflect a dynamic hedging strategy in which a portfolio of derivatives can be rebalanced in accordance with changes to the hedged item in order to adhere to a the specified, documented hedging strategy. (Meaning, the derivatives can be rebalanced to reflect the annuity reserve – taking into consideration the termination / addition of annuity contracts.) (P. 5)

4. Guidance requires specific hedge effectiveness criteria, with the hedging relationship being highly effective in achieving offsetting changes in fair value attributed to the hedge risk during the period that the hedge is designated. This requires reporting entities to calculate the fair value of the hedged item at inception and on an ongoing basis and comparing the fair value change of the hedged item to the fair value change of the hedging instruments to determine whether the relationship is highly effective on a cumulative basis. (P. 10)

5. Application of SSAP No. 108 requires explicit approval from the domiciliary commissioner as well as actuarial certifications. Specific disclosures, as well as a separately Schedule DB-E reporting schedule tracks specific information for the derivatives and the recognition of deferred assets/liabilities. (P. 6 & 23.)

Overview of U.S. GAAP Accounting – U.S. GAAP guidance is based on four cornerstones (815-10-10-1):

1. Derivative instruments represent rights or obligations that meet the definitions of assets or liabilities and should be reported on the financial statements.

   In making this decision, the FASB noted that derivatives are assets or liabilities because they represent rights or obligations and that recognizing those assets and liabilities will make financial statements more complete and more informative. The FASB noted that prior to FAS 133, many derivatives were off-balance-sheet, because, unlike conventional financial instruments (such as stocks, bonds and loans), derivatives often reflect at their inception only a mutual exchange of promises with little or no transfer of tangible consideration. *FAS 133, BOC – 219.*

2. Derivative instruments should be measured at fair value, and adjustments to the carrying amount of hedged items should reflect changes in their fair value (that is gains or losses) that are attributable to the risk being hedged and that arise while the hedge is in effect.

   In making this decision, the FASB identified that fair value is the only relevant measurement attribute for derivatives. They noted that amortized cost is not a relevant measure for derivatives because the historical cost of a derivative often is zero, yet a derivative can be settled or sold at any time for an amount equivalent to its fair value. The reasoning for "held to maturity" instruments being held at amortized cost, was noted as not suitable for derivatives. *FAS 133, BOC - Paragraph 223.*

3. Only items that are assets or liabilities should be reported in the financial statements.

   In making this decision, the FASB identified that derivatives are assets and liabilities, but the gains and losses that result in changes in the fair value of derivatives are not separate assets or liabilities because they have none of the essential characteristics of assets or liabilities. The FASB identified that the act of designating a derivative as a hedging instrument does not convert a subsequent loss or gain into an asset or a liability. A loss is not an asset because no future economic benefit is associated with it. The loss cannot be exchanged for cash, a financial asset, or a nonfinancial asset used to produce something of value or used to settle liabilities. Similarly, a gain is not a liability because no obligation exists to sacrifice assets in the future. *FAS 133, BOC – 229.*

4. Special accounting for items designated as being hedged should be provided only for qualifying items. One aspect of qualification should be an assessment of the expectation of effective offsetting changes in fair value or cash flows during the term of the hedge for the risk being hedged.

   In making this decision, the FASB noted that a primary purpose of hedge accounting is to link items or transactions whose changes in fair values or cash flows are expected to offset each other. The FASB decided that one of the criteria for qualification for hedge accounting should focus on the extent to which offsetting changes in fair values or cash flows on the derivative and the hedged item or transaction during the term of the hedge are expected and ultimately achieved. *FAS 133, BOC – 230.*

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): The following items are noted as recent actions:

- SSAP No. 108 was adopted in 2018, with a Jan. 1, 2020 effective date, to establish specific guidance for derivatives hedging variable annuity guarantees.

- In August 2017, the FASB issued *ASU 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities* to improve the financial reporting of hedging relationships to better portray the economic results of an entity's risk management activities in its financial statements. In addition, the amendments make certain targeted improvements to simplify the application of the hedge accounting guidance in current U.S. GAAP based on feedback received from preparers, auditors, users and other stakeholders. The ASU did not make any modifications to the four U.S. GAAP cornerstones on the accounting for derivatives in ASC 815-10-10-1. Although a separate agenda item incorporated limited provisions from this ASU into SSAP No. 86 related to hedge effectiveness (Ref #2018-30), the review of this complete ASU (and overall derivatives for SAP) is a pending item for the Working Group. Although the ASU is over 400 pages, the revisions can be briefly categorized as follows:

    1. Amendments permit hedge accounting for risk components in hedging relationships involving nonfinancial risk and interest rate risk in specific scenarios.

    2. Amendments change the guidance for designating fair value hedges of interest rate risk and for measuring the change in fair value of the hedged item in fair value hedges of interest rate risk.

    3. Amendments align the recognition and presentation of the effects of the hedging instrument and the hedged item in the financial statements to increase the understandability of the entity's intended hedging strategies. The revisions require an entity to present the earnings effect of the hedging instrument in the same income statement line item in which the earnings effect of the hedged item

is reported. Furthermore, these amendments eliminate the separate measurements and reporting of hedge ineffectiveness.

4. Amendments expand the components in a hedging instrument allowed to be excluded in the assessment of hedge effectiveness and provide elective accounting guidance for the excluded components.

5. Amendments include targeted improvements to ease the application of assessing hedge effectiveness.

6. Amendments modify existing disclosures and incorporate a tabular disclosure related to the effect on the income statement of fair value cash flow hedges.

- In November 2018, the Working Group adopted revisions to SSAP No. 86 to incorporate revisions to reflect hedge documentation and assessment efficiencies from *ASU 2017-12, Derivatives and Hedging – Targeted Improvements to Accounting for Hedging Activities.*

- The Iowa Insurance Division has shared the following guidance that is permitted in their state: *(Per IA, although both are permitted, a majority of their domestic companies elect to follow the legislation.)*

    - Legislation / *Chapter 97: Accounting for Certain Derivative Instruments Used to Hedge the Growth in Interest Credited for Indexed Insurance Products and Accounting for the Indexed Insurance Products Reserve*. This guidance permits, at the election of the entity, amortized cost for eligible derivative assets. (It specifically excludes derivatives that do not have an amortized cost, including futures, swaps and swaptions.) Additionally, it utilizes a reserve calculation methodology in which interest credits based upon one or more indices are included in the reserve only after those interest credits have been credited to the contract holder under the terms of the annuity contract. https://www.legis.iowa.gov/docs/iac/chapter/09-26-2018.191.97.pdf

    - *Bulletin 06-01: Accounting for Derivative Instruments Used to Hedge the Growth in Interest Credited for Index Products*. This bulletin permits insurance entities to recognize changes in the fair value of derivatives in the summary of operations consistently with how changes in indexed product reserves are recorded. (Under this bulletin, derivatives continue to be reported at fair value.) https://iid.iowa.gov/documents/commissioners-bulletin/accounting-for-derivative-instruments-used-to-hedge-the-growth-in

- It is anticipated that other states may also have issued legislation or bulletins addressing derivatives hedging FIA/IUL products, and NAIC staff will review those provisions throughout the discussion process.

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

Convergence with International Financial Reporting Standards (IFRS): Pursuant to ASU 2017-12, although the language used to describe hedge accounting guidance in the ASU and *IFRS 9, Financial Instruments*, differs, there are several areas of alignment between the two standards, and it is expected that many common hedge accounting strategies will have similar outcomes related to hedging components of financial instruments and nonfinancial terms and in the measurement of hedged items in fair value hedges of interest rate risk. However, differences remain between the two standards in the criteria for qualifying for hedge accounting. Additionally, IFRS 9 retained the separate measurement and reporting of hedge ineffectiveness and does not have broad guidance on presentation.

Staff 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 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.

Staff Review Completed by:
Julie Gann - NAIC Staff
October 2020

Status:
On November 12, 2020, the Statutory Accounting Principles (E) Working Group moved this item to the active listing, categorized as substantive, and exposed 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 products. In addition to the two general options presented in the agenda item, the Working Group is open for additional commentary and suggestions, and directs NAIC staff to work with industry throughout the process similar to the collaborative efforts that occurred when developing the guidance in *SSAP No. 108—Derivatives Hedging Variable Annuity Guarantees*. With this exposure, notification to the Life Actuarial (E) Task Force will occur.

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

Issue: Related Parties, Disclaimers of Affiliation and Variable Interest Entities

Check (applicable entity):

	P/C	Life	Health
Modification of existing SSAP	☒	☒	☒
New Issue or SSAP	☐	☐	☐
Interpretation	☐	☐	☐

Description of Issue:
The intent of this agenda item is 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.

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. generally accepted accounting principles (GAAP) or Securities Exchange Commission (SEC) reporting requirements would be considered a related party under statutory accounting principles (SAP).

- 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.

NAIC staff noted that the requirements for the SEC filings do not allow for a disclaimer of affiliation, as is allowed in the *Insurance Holding Company System Regulatory Act* (#440) and the *Insurance Holding Company System Model Regulation* (#450) and included in Appendix A-440. As a result, the statutory financial statements do not provide the full picture of some complicated business structures, which can be common among insurance companies. This agenda item intends to propose revisions to have the related party and affiliate reporting more closely match that of SEC filings. This will be done by adding language from SEC laws and regulation and clarifying the disclaimer of affiliation or control from a statutory reporting standpoint.

Additionally, this agenda item addresses the FASB Accounting Standards Updates (ASU) related to Variable Interest Entities (VIE) and Consolidation (Topic 810).

FASB defines a VIE as an entity (the investee) in which the investor holds a controlling interest that is not based on the majority of voting rights. This agenda item discusses several ASUs that established the initial guidance for VIEs and all subsequent ASUs to update and clarify this guidance. As a fundamental issue, the concept of consolidation has been rejected for statutory accounting. As such, the main concepts included in the ASUs that are discussed in this agenda item are proposed to be rejected for statutory accounting. While this agenda item is not intended to change the concept of consolidation for statutory accounting, NAIC staff believe that there is a need and justification for enhanced disclosures to supplement the reporting process of related parties and affiliates within a company structure. The proposed additions will ensure state insurance regulators have a full picture of the companies that they are regulating.

A brief description of the ASUs that are addressed in this agenda item are included below:

- *ASU 2009-17, Consolidations (Topic 810)—Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities* clarifies and establishes the basis of U.S. GAAP accounting for consolidation and VIEs. This ASU is a result of *FASB Statement No. 167, Amendments to FASB Interpretation No. 46(R)*.
- *ASU 2010-02, Consolidation (Topic 810)—Accounting and Reporting for Decreases in Ownership of a Subsidiary—a Scope Clarification* addresses implementation issues related to the changes in ownership provisions in Subtopic 810-10, originally issued as *FASB Statement No. 160, Noncontrolling Interests in Consolidated Financial Statements*, which establishes the accounting and reporting guidance for noncontrolling interests and changes in ownership interests of a subsidiary.
- *ASU 2010-10, Consolidations (Topic 810)—Amendments for Certain Investment Funds* defers consolidation requirements for a reporting entity's interest in an entity that has all the attributes of an investment company or for which it is industry practice to apply measurement principles for financial reporting purposes that are consistent with those followed by investment companies.
- *ASU 2014-07, Consolidation (Topic 810)—Applying Variable Interest Entities Guidance to Common Control Leasing Arrangements* permits a private company lessee (the reporting entity) to elect an alternative not to apply VIE guidance to a lessor entity in certain situations.
- *ASU 2015-02, Consolidation (Topic 810)—Amendments to the Consolidation Analysis* includes updates to limited partnerships and similar legal entities, evaluating fees paid to a decision maker or a service provider as a variable interest, the effect of fee arrangements on the primary beneficiary determination, the effect of related parties on the primary beneficiary determination, and certain investment funds.
- *ASU 2016-17, Consolidation (Topic 810)—Interests Held through Related Parties That Are under Common Control* provides that if a reporting entity satisfies the first characteristic of a primary beneficiary (such that it is the single decision maker of a VIE), these amendments require that reporting entity, in determining whether it satisfies the second characteristic of a primary beneficiary, to include all of its direct variable interests in a VIE and, on a proportionate basis, its indirect variable interests in a VIE held through related parties, including related parties that are under common control with the reporting entity.
- *ASU 2018-17, Consolidation (Topic 810)—Targeted Improvements to Related Party Guidance for Variable Interest Entities* includes updated VIE guidance for private companies and considers if indirect interests held through related parties under common control for determining whether fees paid to decision makers and service providers are variable interests.

Existing Authoritative Literature: Statutory accounting guidance is in *SSAP No. 25—Affiliates and Other Related Parties,* model law and regulation provisions are included in *Insurance Holding Company System Regulatory Act* (#440) and the *Insurance Holding Company System Model Regulation* (#450).

From Model #440

Section 4. Registration of Insurers

K. Disclaimer. Any person may file with the commissioner a disclaimer of affiliation with any authorized insurer or a disclaimer may be filed by the insurer or any member of an insurance holding company system. The disclaimer shall fully disclose all material relationships and bases for affiliation between the person and the insurer as well as the

> basis for disclaiming the affiliation. A disclaimer of affiliation shall be deemed to have been granted unless the commissioner, within thirty (30) days following receipt of a complete disclaimer, notifies the filing party the disclaimer is disallowed. In the event of disallowance, the disclaiming party may request an administrative hearing, which shall be granted. The disclaiming party shall be relieved of its duty to register under this section if approval of the disclaimer has been granted by the commissioner, or if the disclaimer is deemed to have been approved.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): In 2010, in response to the issuance of *FAS 166, Accounting for Transfers of Financial Assets—an amendment of FASB Statement No. 140* and *FAS 167,* Amendments to FASB Interpretation No. 46(R), the SAPWG formed the "SAPWG FAS 166/167 Subgroup. FAS 167 was issued in June 2009 and revised the scope of the FASB consolidation guidance to ensure that entities previously considered qualifying special purpose entities were included within the GAAP consolidation. Additionally, FAS 167 requires consolidation for entities (variable interest entities) in which the reporting entity has the "controlling financial interest". Those situations are specific to when the entity is not controlled by contract, but the reporting entity has: (1) the power to direct the activities of the entity that most significantly impact the entity's economic performance; and (2) the obligation to absorb losses or receive benefits of the entity that could be potentially significant to the entity. Although the concept of consolidation was not supported for SAP, the Subgroup discussion was focused on considering new disclosures for variable interest entities. The discussion of this Subgroup was deferred as Agenda Item 2011-16, Definition of a Related Party in SSAP No. 25 was considering changes to clarify the relationships that should be considered related parties. Discussion on this agenda item was halted in 2012 and 2015 as FASB issued new ASUs pertaining to VIEs. With the issuance of this new agenda item (2019-34), it is recommended that the 2011 agenda item be disposed.

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

Convergence with International Financial Reporting Standards (IFRS): None.

Staff Recommendation:
NAIC Staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to *SSAP No. 25—Affiliates and Other Related Parties*, to clarify the types of entities or persons that are included as related parties, to clarify that a non-controlling ownership interest greater than 10% is a related party and is subject to the related party disclosures, to clarify the guidance for disclaimers of affiliation and control for statutory accounting, to clarify that the reporting entity must disclose if they knowingly engaged in any non-arms-length transactions with any entity, individual or company that has not been previously identified as a related party and to reject the seven FASB *Accounting Standards Updates* listed in the agenda item as not applicable for statutory accounting in SSAP No. 25.

Staff Review Completed by:
Jake Stultz, NAIC Staff – November 2019

Status:
On December 7, 2019, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to *SSAP No. 25—Affiliates and Other Related Parties*, to clarify the following:

- The types of entities or persons that are included as related parties;
- That a non-controlling ownership interest greater than 10% is a related party and is subject to the related party disclosures; and

- The guidance for disclaimers of affiliation and control for statutory accounting.

This agenda item also rejects seven FASB Accounting Standards Updates, listed above, for statutory accounting. With exposure, an intent is included to dispose of agenda item 2011-16: Definition of Related Party, which is a historical item drafted to consider the SSAP No. 25 definition. The Working Group also directed notice of the exposure to be sent to the Group Solvency Issues (E) Working Group.

On March 18, 2020, the Statutory Accounting Principles (E) Working Group deferred discussion of this item for a subsequent call or meeting.

Summer 2020:
Pursuant to the direction received Dec. 7, 2019, NAIC staff has drafted nonsubstantive revisions to SSAP No. 25. The current version is shown as tracked changes to SSAP No. 25 is attached as an exhibit to this agenda item. The updated draft revisions to SSAP No. 25 are discussed below.

- Based on the comments from the Group Solvency Issues (E) Working Group, NAIC staff have added a new disclosure that provides information on minority ownership interests, as well as significant relationships between minority owners and other U.S. domestic insurers/groups. This new disclosure is not intended to include passive fund owners, such as ETFs and mutual funds. This is in paragraph 22 in the exhibit to this agenda item.
- NAIC staff have removed the direct references to U.S. GAAP and SEC guidance that was included in the initial draft revisions. It was not intended to incorporate by reference the guidance from these sources but was instead intended to show that the revisions were going to be more consistent with the U.S. GAAP and SEC guidance. The language that was added to the description of related parties in paragraph 4 in the original expose draft are all language from either U.S. GAAP or from laws and regulations related to the SEC.
- With the proposed rejection of the U.S. GAAP VIE guidance for statutory accounting, our intention is to rely on SSAP No. 25, including the proposed revisions, to capture related parties for reporting. These updates are not intended to change reporting in Schedule BA or Schedule D for any investments.

On July 30, 2020, the Statutory Accounting Principles (E) Working Group exposed this agenda item, with revisions as detailed above under "Summer 2020."

On November 12, 2020, the Statutory Accounting Principles (E) Working Group exposed this agenda item, with detailed revisions to SSAP No. 25, as detailed below under "November 12, 2020."

November 12, 2020:
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.

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Statement of Statutory Accounting Principles No. 25

Affiliates and Other Related Parties

STATUS

Type of Issue	Common Area
Issued	Initial Draft, November 12, 2020 exposure draft
Effective Date	January 1, 2001
Affects	Supersedes SSAP No. 96 with guidance incorporated August 2011; Nullifies and incorporates INT 03-16
Affected by	No other pronouncements
Interpreted by	No other pronouncements
Relevant Appendix A Guidance	A-440

SCOPE OF STATEMENT

1. Related party transactions are subject to abuse because reporting entities may be induced to enter transactions that may not reflect economic realities or may not be fair and reasonable to the reporting entity or its policyholders. As such, related party transactions require specialized accounting rules and increased regulatory scrutiny. This statement establishes statutory accounting principles and disclosure requirements for related party transactions.

2. This statement shall be followed for all related party transactions, including transactions with parties that own 10% or more of the reporting entity, -even if the transaction is also governed by other statutory accounting principles. Furthermore, this statement shall be followed in all transactions which involve unrelated parties as intermediaries between related parties. In determining whether a transaction is a related party transaction, consideration shall be given to the substance of the agreement and the parties whose actions or performance materially impact the insurance reporting entity under the transaction. For example, an investment acquired from a non-related intermediary in which the investment return is predominantly contingent on the performance of a related party shall be considered a related party investment. As a general principle, it is erroneous to conclude that the mere inclusion of a non-related intermediary eliminates the requirement to assess and properly identify the related party transaction in accordance with the provisions of this statement. It is also erroneous to conclude that the presence of non-related assets in a structure predominantly comprised of related party investments eliminates the requirement to assess and identify the investment transaction as a related party arrangement.

3. If a company receives the stock of an affiliated company as a capital contribution rather than through a purchase, the transaction shall be accounted for according to *SSAP No. 25—Affiliates and Other Related Parties*, *SSAP No. 95—Nonmonetary Transactions*, or *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*, based on the details of each transaction. The statutory purchase method within *SSAP No. 68—Business Combinations* is not applicable for stock received as a capital contribution.

SUMMARY CONCLUSION

4. Related parties are defined as entities that have common interests as a result of ownership, control, affiliation or by contract. Related parties shall include but are not limited to the following:

a. Affiliates of the reporting entity, as defined in paragraph 5;

b. Trusts for the benefit of employees, such as pension and profit-sharing trusts and Employee Stock Ownership Plans that are managed by or under the trusteeship of management of the reporting entity, its parent or affiliates;

c. The principal owners, directors, officers of the reporting entity;

d. Any immediate family member of a principal owner, director or executive officer of the reporting entity, which means any child, stepchild, parent, stepparent, spouse, sibling, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law, or individual related by blood or marriage whose close association is equivalent to a family relationship of such director, executive officer or nominee for director, or any person (other than a tenant or employee) sharing the household of such director, executive officer or nominee for director;

e. Companies and entities which share common control, such as principal owners, directors, or officers, including situations where a principal owners, directors, or officers have a controlling stake in another reporting entity;

~~c.~~f. Any direct or indirect ownership greater than 10% of the reporting entity results in a related party classification regardless of any disclaimer of control or disclaimer of affiliation.

~~d.~~g. The management of the reporting entity, its parent or affiliates (including directors);

~~e.~~h. Members of the immediate families of principal owners and management of the reporting entity, its parent or affiliates and their management;

~~f.~~i. Parties with which the reporting entity may deal if either party directly or indirectly controls or can significantly influence the management or operating policies of the other to an extent that one of the transacting parties might be prevented from fully pursuing its own separate interest;

~~g.~~j. A party which can, directly or indirectly, significantly influence the management or operating policies of the reporting entity, which may include a provider who is contracting with the reporting entity. This is not intended to suggest that all provider contracts create related party relationships;

~~h.~~k. A party which has an ownership interest in one of the transacting parties and can significantly influence the other to an extent that one or more of the transacting parties might be prevented from fully pursuing its own separate interests;

~~i.~~l. Attorney-in-fact of a reciprocal reporting entity or any affiliate of the attorney-in-fact; and

~~j.~~m. A U.S. manager of a U.S. Branch or any affiliate of the U.S. manager of a U.S. Branch.

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

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

7. Control as defined in paragraph 6 shall be measured at the holding company level. For example, if one member of an affiliated group has a 5% interest in an entity and a second member of the group has an 8% interest in the same entity, the total interest is 13%, and therefore, each member of the affiliated group shall be presumed to have control. This presumption will stand until rebutted by an evaluation of all the facts and circumstances relating to the investment based on the criteria in *FASB Interpretation No. 35, Criteria for Applying the Equity Method of Accounting for Investments in Common Stock, an Interpretation of APB Opinion No. 18*. The corollary is required to demonstrate control when a reporting entity owns less than 10% of the voting securities of an investee. The insurer shall maintain documents substantiating its determination for review by the domiciliary commissioner. Examples of situations where the presumption of control may be in doubt include the following:

a. Any limited partner investment in a limited partnership, unless the limited partner is affiliated with the general partner.

b. An entity where the insurer owns less than 50% of an entity and there is an unaffiliated individual or group of investors who own a controlling interest.

c. An entity where the insurer has given up participation rights[1] as a shareholder to the investee.

d. Agreements where direct or indirect non-controlling ownership interest is less than 10% where the parties have structured the arrangement in this structure to avoid the 10% threshold in paragraph 4.f. and paragraph 8.

8. Any direct or indirect ownership interest of the reporting entity greater than 10% results in a related party classification regardless of any disclaimer of control or disclaimer of affiliation. The *Insurance Holding Company System Regulatory Act* (#440) and the *Insurance Holding Company System Model Regulation* (#450) include a provision that allows for the disclaimer of affiliation and/or the disclaimer of control for members of an insurance holding company system. The disclaimer must be filed with the state insurance commissioner. Entities whose relationship is subject to a disclaimer of affiliation or a disclaimer of control are related parties and are subject to the related party disclosures within this statement. Such a disclaimer does not eliminate a "related party" distinction or disclosure requirements for material transactions pursuant to SSAP No. 25.

~~8.~~9. Transactions between related parties must be in the form of a written agreement. The written agreement must provide for timely settlement of amounts owed, with a specified due date. Amounts owed to the reporting entity over ninety days from the written agreement due date shall be nonadmitted, except to the extent this is specifically addressed by other statements of statutory accounting principles (SSAPs). If the due date is not addressed by the written agreement, any uncollected receivable is nonadmitted.

Related Party Loans

~~9.~~10. Loans or advances (including debt, public or private) made by a reporting entity to its parent or principal owner shall be admitted if approval for the transaction has been obtained from the domiciliary commissioner and the loan or advance is determined to be collectible based on the parent or principal owner's independent payment ability. An affiliate's ability to pay shall be determined after consideration of the liquid assets or revenues available from external sources (i.e., determination shall not include dividend paying ability of the subsidiary making the loan or advance) which are available to repay the balance and/or maintain its account on a current basis. Evaluation of the collectibility of loans or advances shall be made periodically. If, in accordance with *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets*, it is probable the balance is uncollectible, any uncollectible receivable shall be written off and charged to income in the period the determination is made. Pursuant to *SSAP No. 72—Surplus and Quasi-Reorganization*, forgiveness by a reporting entity of any debt, surplus note or other obligation of its parent or other stockholder shall be accounted for as a dividend.

~~10.~~11. Loans or advances by a reporting entity to all other related parties shall be evaluated by management and nonadmitted if they do not constitute arm's-length transactions as defined in paragraph 14~~13~~. Loans or advances made by a reporting entity to related parties (other than its parent or principal owner) that are economic transactions as defined in paragraph 14~~13~~ shall be admitted. This includes financing arrangements with providers of health care services with whom the reporting entity contracts with from time to time. Such arrangements can include both loans and advances to these providers. Evaluation of the collectibility of loans or advances shall be made periodically. If, in accordance with SSAP No. 5R,

[1] The term "participating rights" refers to the type of rights that allows an investor to effectively participate in significant decisions related to an investee's ordinary course of business and is distinguished from the more limited type of rights referred to as "protective rights". Refer to the sections entitled: "Protective Rights" and "Substantive Participating Rights" in EITF 96-16, *Investor's Accounting for an Investee When the Investor Owns a Majority of the Voting Stock but the Minority Shareholder or Shareholders Have Certain Approval or Veto Rights*. The term "participating rights" shall be used consistent with the discussion of substantive participating rights in this EITF.

it is probable the balance is uncollectible, any uncollectible receivable shall be written off and charged to income in the period the determination is made.

~~11.~~12. Any advances under capitation arrangements made directly to providers, or to intermediaries that represent providers, that exceed one month's payment shall be nonadmitted assets.

~~12.~~13. Indirect loans are loans or extensions of credit to any person who is not an affiliate, where the reporting entity makes loans or extensions of credit with the agreement or understanding that the proceeds of the transactions, in whole or in substantial part, are to be used to make loans or extensions of credit to, to purchase assets of, or to make investments in, any affiliate of the reporting entity making the loans or extensions of credit. The admissibility of indirect loans made by a reporting entity for the benefit of its parent or principal owner shall be determined in accordance with the guidelines in paragraph 10~~9~~. Indirect loans or advances made for the benefit of all other related parties shall be evaluated and accounted for consistent with loans or advances to related parties as described in paragraph 11~~10~~ and paragraph 12~~11~~.

Transactions Involving the Exchange of Assets or Liabilities

~~13.~~14. An arm's-length transaction is defined as a transaction in which willing parties, each being reasonably aware of all relevant facts and neither under compulsion to buy, sell, or loan, would be willing to participate. A transaction between related parties involving the exchange of assets or liabilities shall be designated as either an economic transaction or non-economic transaction. An economic transaction is defined as an arm's-length transaction which results in the transfer of the risks and rewards of ownership and represents a consummated act thereof, i.e., "permanence." The appearance of permanence is also an important criterion in assessing the economic substance of a transaction. In order for a transaction to have economic substance and thus warrant revenue (loss) recognition, it must appear unlikely to be reversed. If subsequent events or transactions reverse the effect of an earlier transaction prior to the issuance of the financial statements, the reversal shall be considered in determining whether economic substance existed in the case of the original transaction. Subsequent events are addressed in *SSAP No. 9—Subsequent Events*. An economic transaction must represent a bonafide business purpose demonstrable in measurable terms. A transaction which results in the mere inflation of surplus without any other demonstrable and measurable betterment is not an economic transaction. The statutory accounting shall follow the substance, not the form of the transaction.

~~14.~~15. In determining whether there has been a transfer of the risks and rewards of ownership in the transfer of assets or liabilities between related parties, the following—and any other relevant facts and circumstances related to the transaction—shall be considered:

a. Whether the seller has a continuing involvement in the transaction or in the financial interest transferred, such as through the exercise of managerial authority to a degree usually associated with ownership;

b. Whether there is an absence of significant financial investment by the buyer in the financial interest transferred, as evidenced, for example, by a token down payment or by a concurrent loan to the buyer;

c. Whether repayment of debt that constitutes the principal consideration in the transaction is dependent on the generation of sufficient funds from the asset transferred;

d. Whether limitations or restrictions exist on the buyer's use of the financial interest transferred or on the profits arising from it;

e. Whether there is retention of effective control of the financial interest by the seller.

~~15.~~16. A transaction between related parties may meet the criteria for treatment as an economic transaction at one level of financial reporting, but may not meet such criteria at another level of financial reporting. An example of such a transaction is a reporting entity purchasing securities at fair value from an affiliated reporting entity that carried the securities at amortized cost. This transaction meets the criteria of an economic transaction at this level of financial reporting, and therefore, the selling reporting entity would record a gain and the acquiring reporting entity would record the securities at their cost (fair value on the transaction date). At the common parent level of reporting, this transaction has resulted in the mere inflation of surplus, and therefore, is a non-economic transaction. The parent reporting entity shall defer the net effects of any gain or increase in surplus resulting from such transactions by recording a deferred gain and an unrealized loss. The deferred gain shall not be recognized by the parent reporting entity unless and until arms-length transaction(s) with independent third parties give rise to appropriate recognition of the gain.

~~16.~~17. A non-economic transaction is defined as any transaction that does not meet the criteria of an economic transaction. Similar to the situation described in paragraph 16~~15~~, transfers of assets from a parent reporting entity to a subsidiary, controlled or affiliated entity shall be treated as non-economic transactions at the parent reporting level because the parent has continuing indirect involvement in the assets.

~~17.~~18. When accounting for a specific transaction, reporting entities shall use the following valuation methods:

a. Economic transactions between related parties shall be recorded at fair value at the date of the transaction. To the extent that the related parties are affiliates under common control, the controlling reporting entity shall defer the effects of such transactions that result in gains or increases in surplus (see paragraph 16~~15~~);

b. Non-economic transactions between reporting entities, which meet the definition of related parties above, shall be recorded at the lower of existing book values or fair values at the date of the transaction;

c. Non-economic transactions between a reporting entity and an entity that has no significant ongoing operations other than to hold assets that are primarily for the direct or indirect benefit or use of the reporting entity or ~~it's~~its affiliates, shall be recorded at the fair value at the date of the transaction; however, to the extent that the transaction results in a gain, that gain shall be deferred until such time as permanence can be verified;

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

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

Transactions Involving Services

~~18.~~19. Transactions involving services between related parties can take a variety of different forms. One of the significant factors as to whether these transactions will be deemed to be arm's length is the amount charged for such services. In general, amounts charged for services are based either on current market rates or on allocations of costs. Determining market rates for services is difficult because the circumstances surrounding each transaction are unique. Unlike transactions involving the exchange of assets and liabilities between related parties, transactions for services create income on one party's books and expense on the second party's books, and therefore, do not lend themselves to the mere inflation of surplus. These arrangements are generally subject to regulatory approval.

~~19.~~20. Transactions involving services provided between related parties shall be recorded at the amount charged[2]. Regulatory scrutiny of related party transactions where amounts charged for services do not meet the fair and reasonable standard established by Appendix A-440, may result in (a) amounts charged being recharacterized as dividends or capital contributions, (b) transactions being reversed, (c) receivable balances being nonadmitted, or (d) other regulatory action. Expenses that result from cost allocations shall be allocated subject to the same fair and reasonable standards, and the books and records of each party shall disclose clearly and accurately the precise nature and details of the transaction. See *SSAP No 70—Allocation of Expenses* for additional discussion regarding the allocation of expenses.

Disclosures

~~20.~~21. The financial statements shall include disclosures of all material related party transactions, including transactions with the ownership interests identified in paragraph 22. In some cases, aggregation of similar transactions may be appropriate. Sometimes, the effect of the relationship between the parties may be so pervasive that disclosure of the relationship alone will be sufficient. If necessary to the understanding of the relationship, the name of the related party should be disclosed. Transactions shall not be purported to be arm's-length transactions unless there is demonstrable evidence to support such statement. The disclosures shall include:

a. The nature of the relationships involved;

b. A description of the transactions for each of the periods for which financial statements are presented, and such other information considered necessary to obtain an understanding of the effects of the transactions on the financial statements. Exclude reinsurance transactions, any non-insurance transactions which involve less than ½ of 1% of the total admitted assets of the reporting entity, and cost allocation transactions. The following information shall be provided if applicable:

    i. Date of transaction;

    ii. Explanation of transaction;

    iii. Name of reporting entity;

    iv. Name of affiliate;

    v. Description of assets received by reporting entity;

    vi. Statement value of assets received by reporting entity;

    vii. Description of assets transferred by reporting entity; and

    viii. Statement value of assets transferred by reporting entity.

[2] The amount charged shall be reviewed when there are any modifications or waivers subsequent to the establishment of the contract terms. If waivers or modifications to amounts charged occur, the related party transaction shall be reassessed to determine whether the contract continues to reflect fair and reasonable standards. If the transaction was with a parent or other stockholder and the charge for services has been fully waived, then the guidance in SSAP No. 72 for recognition as contributed capital (forgiveness of reporting entity obligation) or as a dividend (forgiveness of amount owed to the reporting entity) shall apply.

c. The dollar amounts of transactions for each of the periods for which financial statements are presented and the effects of any change in the method of establishing the terms from that used in the preceding period;

d. Amounts due from or to related parties as of the date of each balance sheet presented and, if not otherwise apparent, the terms and manner of settlement;

e. Any guarantees or undertakings, written or otherwise, shall be disclosed in accordance with the requirements of SSAP No. 5R. In addition, the nature of the relationship to the beneficiary of the guarantee or undertaking (affiliated or unaffiliated) shall also be disclosed;

f. A description of material management or service contracts and cost-sharing arrangements involving the reporting entity and any related party. This shall include, but is not limited to, sale lease-back arrangements, computer or fixed asset leasing arrangements, and agency contracts, which remove assets otherwise recordable (and potentially nonadmitted) on the reporting entity's financial statements;

g. The nature of the control relationship whereby the reporting entity and one or more other enterprises are under common ownership or control and the existence of that control could result in operating results or financial position of the reporting entity significantly different from those that would have been obtained if the enterprises were autonomous. The relationship shall be disclosed even though there are no transactions between the enterprises; and

h. The amount deducted from the value of an upstream intermediate entity or ultimate parent owned, either directly or indirectly, via a downstream subsidiary, controlled, or affiliated entity, in accordance with the *Purposes and Procedure Manual of the NAIC Investment Analysis Office*, "Procedures for Valuing Common Stocks and Stock Warrants."

22. The disclosures of ownership interests in the reporting entity shall be provided outside of the financial statements (Schedule Y). The intent of this disclosure is to capture information related to active ownership and is not intended for passive fund owners to be reported.

a. Disclosure is required for all owners with greater than 10% ownership of the reporting entity.

b. Reporting entity must disclose each owner's ultimate controlling party and must provide a listing of other U.S. insurance groups or entities under that ultimate controlling party's control.

~~21.~~23. Refer to the Preamble for further discussion regarding disclosure requirements.

Relevant Literature

~~22.~~24. This statement adopts *FASB Statement No. 57, Related Party Disclosures* with a modification to paragraph 4 to require disclosure of compensation arrangements, expense allowances, and other similar items in the ordinary course of business.

~~23.~~25. This statement rejects *ASU 2009-17, Consolidations (Topic 810)—Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities, ASU 2010-02, Consolidation (Topic 810)—Accounting and Reporting for Decreases in Ownership of a Subsidiary—a Scope Clarification, ASU*

2010-10, Consolidations (Topic 810)—Amendments for Certain Investment Funds, ASU 2013-06, Not-For-Profit Entities, Services Received from Personnel of an Affiliate, ASU 2014-07, Consolidation (Topic 810)—Applying Variable Interest Entities Guidance to Common Control Leasing Arrangements, ASU 2015-02, Consolidation (Topic 810)—Amendments to the Consolidation Analysis, ASU 2016-17, Consolidation (Topic 810)—Interests Held through Related Parties That Are under Common Control, ASU 2018-17, Consolidation (Topic 810)—Targeted Improvements to Related Party Guidance for Variable Interest Entities and AICPA *Accounting Interpretations, Business Combinations: Accounting Interpretations of APB Opinion No. 16, No. 39*, "Transfers and Exchanges between Companies under Common Control."

~~24.~~26. Guidance in paragraph 9~~8~~ was incorporated from SSAP No. 96 as discussed in *Issue Paper No. 128—Settlement Requirements for Intercompany Transactions, An Amendment to SSAP No. 25—Accounting for and Disclosures about Transactions with Affiliates and Other Related Parties*. SSAP No. 96 was nullified in 2011 with the guidance from that SSAP retained within this SSAP.

Effective Date and Transition

~~25.~~27. This statement is effective for years beginning January 1, 2001. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*.

~~26.~~28. Guidance reflected in paragraph 9~~8~~, incorporated from SSAP No. 96, is effective for reporting periods ending December 31, 2007. Early adoption is permitted. A change resulting from the application of this paragraph shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*. Guidance reflected in paragraph 3, incorporated from *INT 03-16: Contribution of Stock*, was originally effective December 7, 2003.

REFERENCES

Other

- *Purposes and Procedures Manual of the NAIC Investment Analysis Office*

Relevant Issue Papers

- *Issue Paper No. 25—Accounting for and Disclosures about Transactions with Affiliates and Other Related Parties*
- *Issue Paper No. 128—Settlement Requirements for Intercompany Transactions, An Amendment to SSAP No. 25—Accounting for and Disclosures about Transactions with Affiliates and Other Related Parties*

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

Issue: Levelized and Persistency Commission

Check (applicable entity):

	P/C	Life	Health
Modification of existing SSAP	☒	☒	☒
New Issue or SSAP	☐	☐	☐
Interpretation	☐	☐	☐

Description of Issue:
NAIC staff has received regulator inquiries on the application of the levelized commissions guidance in *SSAP No. 71—Policy Acquisition Costs and Commissions.* This agenda item is to recommend clarifications to the existing levelized commissions guidance and provide additional guidance regarding commission that is based on policy persistency. SSAP No. 71 describes that levelized commissions occur in situations in which a third party pays agents non-levelized commissions and the reporting entity pays a third party by levelized payments. The statement notes that it is intended, but not necessarily guaranteed, that the amounts paid to the agents by the third party would ultimately be repaid to the third party from the reporting entity. SSAP No. 71 identifies such arrangements as funding agreements between the reporting entity and the third party. SSAP No. 71 then identifies that the use of a commission arrangement where commission payments are not linked to traditional elements (such as premium payments and policy persistency) requires the establishment of a liability for the full amount of the unpaid principal and accrued interest which is payable to a third party related to levelized commissions is required.

The questions received by NAIC staff relate to the use of levelized commission arrangements and when the liability for commission based on annual persistency is required to be recorded as a liability in accordance with *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets*.

Levelized Commission

For the example in question, a third party is paying agent commissions and receiving periodic payments. Consistent with the guidance in SSAP No. 71, paragraph 4, the third party (funding agent) is paying the agents on behalf of the reporting entity and receiving levelized payments from the reporting entity which include additional fees or interest in excess of the commissions. The agreement between the reporting entity and the funding agent specifies that the funding agent will not be reimbursed by the reporting entity if the policies that generate the commission are cancelled prior to the policy anniversary date. The regulator noted that the reporting entity was not accruing the liability to the third-party funding agent, asserting that the payments to the funding agent were theoretically avoidable until the policy had passed the anniversary year-end date.

The accounting issue is whether levelized commission arrangements that are linked to traditional elements (such as premium payments and policy persistency) requires the establishment of a liability for the full amount of the unpaid principal and accrued interest which is payable to a third party related to levelized commissions.

Persistency Commission

Also, in the noted example, the reporting entity was also asserting that the levelized commission obligations related to policy persistency commission were not required to be accrued until the policy anniversary year end had been passed. The reporting entity asserts that the liability is not required until the persistency commission was fully earned by the agent and therefore unavoidable.

The accounting issue is if the persistency commission expense should be accrued proportionately over the policy period to which the commission relates, or if it is accrued only when fully earned and unavoidable.

Existing Authoritative Literature:

Preamble provides the following (**bolding added for emphasis**):

37. Liabilities require recognition as they are incurred. Certain statutorily mandated liabilities may also be required to arrive at conservative estimates of liabilities and probable loss contingencies (e.g., interest maintenance reserves, asset valuation reserves, and others).

38. Revenue should be recognized only as the earnings process of the underlying underwriting or investment business is completed. **Accounting treatments which tend to defer expense recognition do not generally represent acceptable SAP treatment.**

SSAP No. 5 – Revised—Liabilities, Contingencies and Impairments of Assets

Liabilities

2. A liability is defined as certain or probable1 future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or to provide services to other entities in the future as a result of a past transaction(s) or event(s).

3. A liability has three essential characteristics: (a) it embodies a present duty or responsibility to one or more other entities that entails settlement by probable1 future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand, (b) the duty or responsibility obligates a particular entity, leaving it little or no discretion to avoid the future sacrifice, and (c) the transaction or other event obligating the entity has already happened. This includes, but is not limited to, liabilities arising from policyholder obligations (e.g., policyholder benefits, reported claims and reserves for incurred but not reported claims). Liabilities shall be recorded on a reporting entity's financial statements when incurred.

4. Estimates (e.g., loss reserves) are required in financial statements for many ongoing and recurring activities of a reporting entity. The mere fact that an estimate is involved does not of itself constitute a loss contingency. For example, estimates of losses utilizing appropriate actuarial methodologies meet the definition of liabilities as outlined above and are not loss contingencies.

Loss Contingencies or Impairments of Assets

6. For purposes of implementing the statutory accounting principles of loss contingency or impairment of an asset described below, the following additional definitions shall apply:

a. Probable—The future event or events are likely to occur;
b. Reasonably Possible—The chance of the future event or events occurring is more than remote but less than probable;
c. Remote—The chance of the future event or events occurring is slight.

7. A loss contingency or impairment of an asset is defined as an existing condition, situation, or set of circumstances involving uncertainty as to possible loss to an enterprise that will ultimately be resolved when one or more future event(s) occur or fail to occur (e.g., collection of receivables).

8. An estimated loss from a loss contingency or the impairment of an asset shall be recorded by a charge to operations if both of the following conditions are met:

a. Information available prior to issuance of the statutory financial statements indicates that **it is probable that an asset has been impaired or a liability has been incurred** at the date of the statutory financial statements. It is implicit in this condition that it is probable that one or more future events will occur confirming the fact of the loss or incurrence of a liability; and

b. The amount of loss can be reasonably estimated.

SSAP No. 71—Policy Acquisition Costs and Commissions provides the following (**bolding added for emphasis**):

SUMMARY CONCLUSION

2. Acquisition costs are those costs that are incurred in the acquisition of new and renewal insurance contracts and include those costs that vary with and are primarily related to the acquisition of insurance contracts (e.g., agent and broker commissions, certain underwriting and policy issue costs, and medical and inspection fees). **Acquisition costs and commissions shall be expensed as incurred. Determination of when acquisition costs and commissions have been incurred shall be made in accordance with SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets.**

3. Contingent commission liabilities shall be determined in accordance with the terms of each individual commission agreement. Commission liabilities determined on the basis of a formula that relates to loss experience shall be established for the earned portion. **Assumptions used to calculate the contingent commission liability shall be consistent with the terms of the policy contract and with the assumptions made in recording other assets and liabilities necessary to reflect underwriting results of the reporting entity such as retrospective premium adjustments and loss reserves, including incurred but not reported.**

4. **Levelized commissions occur in situations where agents receive normal (non-level) commissions with payments made by a third party.** It is intended, but not necessarily guaranteed, that the amounts paid to the agents by the third party would ultimately be repaid (with interest explicit or implied) to the third party by levelized payments (which are less than the normal first year commissions but exceed the normal renewal commissions) from the reporting entity. These transactions are, in fact, funding agreements between a reporting entity and a third party. **The continuance of the stream of payments specified in the levelized commission contract is a mechanism to bypass recognition of those expenses which are ordinarily charged to expense in the first year of the contract. Consequently, the normal link between the persistency of the policy, the continuance of the premium payment or the maintenance of the agent's license with the reporting entity is not maintained with respect to the payment stream.**

5. **The use of an arrangement where commission payments are not linked to traditional elements such as premium payments and policy persistency, but rather are linked to the repayment of an advance amount requires the establishment of a liability for the full amount of the unpaid principal and accrued interest which is payable to a third party related to levelized commissions**.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): None

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

Convergence with International Financial Reporting Standards (IFRS): Not applicable

Staff Review Completed by:
Robin Marcotte, NAIC Staff – July 2019

Staff Recommendation:
NAIC Staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to SSAP No. 71 as illustrated below. NAIC Staff recommends that revisions to the guidance clarify the following:

1. A levelized commission arrangement (whether linked to traditional or nontraditional elements) require the establishment of a liability for the full amount of the unpaid principal and accrued interest payable to a third party at the time the policy is issued.

2. The persistency commission is accrued proportionately over the policy period in which the commission relates to and is not deferred until fully earned.

These recommendations are consistent with the original intent of SSAP No. 71 as well as the Statutory Statement of Concepts focusing on Recognition (excerpts from Preamble, paragraphs 37 and 38):

- Liabilities require recognition as they are incurred.

- Accounting treatments which tend to defer expense recognition do not generally represent acceptable SAP treatment.

July 2019 Proposed Revisions to SSAP No. 71:

SUMMARY CONCLUSION

2. Acquisition costs are those costs that are incurred in the acquisition of new and renewal insurance contracts and include those costs that vary with and are primarily related to the acquisition of insurance contracts (e.g., agent and broker commissions, certain underwriting and policy issue costs, and medical and inspection fees). Acquisition costs and commissions shall be expensed as incurred. Determination of when acquisition costs and commissions have been incurred shall be made in accordance with SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets. The recognition of commission expense for new and renewal insurance contracts meets the definition of a liability under SSAP No. 5R when the policy is issued or renewed. The issuance of the policy is the obligating event under SSAP No. 5R.

3. Contingent commission liabilities shall be determined in accordance with the terms of each individual commission agreement. Commission liabilities determined on the basis of a formula that relates to loss experience shall be established for the earned portion. Assumptions used to calculate the contingent commission liability shall be consistent with the terms of the policy contract and with the assumptions made in recording other assets and liabilities necessary to reflect underwriting results of the reporting entity such as retrospective premium adjustments and loss reserves, including incurred but not reported. Commission contracts that include persistency (or other such components) shall not use these clauses to defer recognition of commission expense. If a commission is based on annual policy persistency (or similar components), the commission is accrued based on experience to date for the policy period (it is inappropriate to wait until the amount is fully earned and/or unavoidable). Actual policy cancellation would reverse the accrual of the related persistency commission.

4. Levelized commissions occur in situations where agents receive normal (non-level) commissions with payments made by a third party. It is intended, but not necessarily guaranteed, that the amounts paid to the agents by the third party would ultimately be repaid (with interest explicit or implied) to the third

party by levelized payments (which are less than the normal first year commissions but exceed the normal renewal commissions) from the reporting entity. These transactions are, in fact, funding agreements between a reporting entity and a third party. The continuance of the stream of payments specified in the levelized commission contract is a mechanism to bypass recognition of those expenses which are ordinarily charged to expense in the first year of the contract. Consequently, the normal link between the persistency of the policy, the continuance of the premium payment or the maintenance of the agent's license with the reporting entity is not maintained with respect to the payment stream.

5. The use of an arrangement where commission payments are not linked to traditional elements such as premium payments and policy persistency, but rather are linked to the repayment of an advance amount requires the establishment of a liability for the full amount of the unpaid principal and accrued interest which is payable to a third party related to levelized commissions[FN].

New Footnote – The guidance in this paragraph does not imply that levelized commissions that are linked to traditional elements do not require establishment of a liability. Rather, such levelized commissions are captured in paragraphs 3-4.

Status:
On August 3, 2019, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to *SSAP No. 71—Policy Acquisition Costs and Commissions*, as illustrated above, to clarify levelized commissions guidance and provide additional direction regarding commissions that are based on policy persistency. The revisions also clarify that the recognition of commission expense is based on experience to date.

For Fall 2019 Discussion NAIC staff has proposed updates for exposure.

Paragraph 2 - Removed previously exposed revisions as unneeded.
Paragraph 3 - Added clarifying phrases regarding persistency commission accrual. The concept is that normal persistency commission is accrued for the period it relates to unless the policy is cancelled.
Paragraph 4 - Added two clarifying phrases to assist with identifying levelized commission funding agreements.
Paragraph 5 - Added clarifying phrases regarding funding agreements.
Footnote 1 - Redrafted to remove double negative wording.

Fall 2019 Proposed Revisions to SSAP No. 71:

SUMMARY CONCLUSION

2. Acquisition costs are those costs that are incurred in the acquisition of new and renewal insurance contracts and include those costs that vary with and are primarily related to the acquisition of insurance contracts (e.g., agent and broker commissions, certain underwriting and policy issue costs, and medical and inspection fees). Acquisition costs and commissions shall be expensed as incurred. Determination of when acquisition costs and commissions have been incurred shall be made in accordance with SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets.

3. Contingent commission liabilities shall be determined in accordance with the terms of each individual commission agreement. Commission liabilities determined on the basis of a formula that relates to loss experience shall be established for the earned portion. Assumptions used to calculate the contingent commission liability shall be consistent with the terms of the policy contract and with the assumptions made in recording other assets and liabilities necessary to reflect underwriting results of the reporting entity such as retrospective premium adjustments and loss reserves, including incurred but not reported. Commission contracts that include persistency (or other such components) shall not use these clauses to defer recognition of commission expense. If a commission is based on annual policy persistency (or other similar components), the commission shall be accrued based on experience to date

for the policy period that the commission relates. In regard to persistency commission, it is inappropriate to wait until the amount is fully earned and/or unavoidable to accrue experience to date commission expenses. Actual policy cancellation would reverse the accrual of the related persistency commission.

4. Levelized commissions occur in situations where agents receive normal (non-level) commissions with payments made by a third party. It is intended, but not necessarily guaranteed, that the amounts paid to the agents by the third party would ultimately be repaid (with interest explicit or implied) to the third party by levelized payments (which are less than the normal first year commissions but exceed the normal renewal commissions) from the reporting entity. (Note: levelized repayments made by the reporting entity extend the repayment period but might not be a straight-line repayment.) These transactions are, in fact, funding agreements between a reporting entity and a third party, regardless of how the payment to the third party is characterized. The continuance of the stream of payments specified in the levelized commission contract is a mechanism to bypass recognition of those expenses which are ordinarily charged to expense in the first year of the contract. Consequently, the normal link between the persistency of the policy, the continuance of the premium payment or the maintenance of the agent's license with the reporting entity is not maintained with respect to the payment stream.

5. The use of an arrangement such as a levelized commission arrangement where commission payments are not linked to traditional elements such as premium payments and policy persistency, but rather are linked to the repayment of an advance amount paid by a third party to the agents requires the establishment of a liability by the reporting entity for the full amount of the unpaid principal and accrued interest which is payable to a third party related to levelized commissions[FN].

New Footnote – The guidance in this paragraph notes that levelized commissions which use a third party to pay agents that are linked to traditional elements require establishment of a liability for the amounts that have been paid to the agents and any interest accumulated to date.

On December 7, 2019, the Statutory Accounting Principles (E) Working Group exposed revisions to *SSAP No. 71—Policy Acquisition Costs and Commissions*, as illustrated above, to include additional NAIC staff modifications regarding persistency commission and levelized commission arrangements to address certain comments received and to allow for further discussion. With this exposure, the Working Group directed a notification of the exposure to be sent to the Life Actuarial (A) Task Force.

On March 18, 2020, the Statutory Accounting Principles (E) Working Group deferred discussion of this item for a subsequent call or meeting.

On July 30, 2020, the Statutory Accounting Principles (E) Working Group exposed revisions to *SSAP No. 71—Policy Acquisition Costs and Commissions*, as illustrated below. Exposed revisions clarify existing levelized commissions guidance which requires full recognition of the funding liabilities incurred to date for commission expenses prepaid on behalf of an insurer. The exposed revisions are consistent with the 2019 Fall National Meeting exposure, with the inclusion of guidance to clarify that reporting entities that have not complied with the original intent shall reflect the change as a correction of an error, in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*, in the year-end 2020 financial statements.

July 30, 2020 Exposed Revisions to SSAP No. 71:

SUMMARY CONCLUSION

2. Acquisition costs are those costs that are incurred in the acquisition of new and renewal insurance contracts and include those costs that vary with and are primarily related to the acquisition of insurance contracts (e.g., agent and broker commissions, certain underwriting and policy issue costs, and medical and inspection fees). Acquisition costs and commissions shall be expensed as incurred.

Determination of when acquisition costs and commissions have been incurred shall be made in accordance with SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets.

3. Contingent commission liabilities shall be determined in accordance with the terms of each individual commission agreement. Commission liabilities determined on the basis of a formula that relates to loss experience shall be established for the earned portion. Assumptions used to calculate the contingent commission liability shall be consistent with the terms of the policy contract and with the assumptions made in recording other assets and liabilities necessary to reflect underwriting results of the reporting entity such as retrospective premium adjustments and loss reserves, including incurred but not reported. Commission contracts that include persistency (or other such components) shall not use these clauses to defer recognition of commission expense. If a commission is based on annual policy persistency (or other similar components), the commission shall be accrued based on experience to date for the policy period that the commission relates. In regard to persistency commission, it is inappropriate to wait until the amount is fully earned and/or unavoidable to accrue experience to date commission expenses. Actual policy cancellation would reverse the accrual of the related persistency commission.

4. Levelized commissions occur in situations where agents receive normal (non-level) commissions with payments made by a third party. It is intended, but not necessarily guaranteed, that the amounts paid to the agents by the third party would ultimately be repaid (with interest explicit or implied) to the third party by levelized payments (which are less than the normal first year commissions but exceed the normal renewal commissions) from the reporting entity. (Note: levelized repayments made by the reporting entity extend the repayment period but might not be a straight-line repayment.) These transactions are, in fact, funding agreements between a reporting entity and a third party, regardless of how the payment to the third party is characterized. The continuance of the stream of payments specified in the levelized commission contract is a mechanism to bypass recognition of those expenses which are ordinarily charged to expense in the first year of the contract. Consequently, the normal link between the persistency of the policy, the continuance of the premium payment or the maintenance of the agent's license with the reporting entity is not maintained with respect to the payment stream.

5. The use of an arrangement such as a levelized commission arrangement where commission payments are not linked to traditional elements such as premium payments and policy persistency, but rather are linked to the repayment of an advance amount paid by a third party to the agents requires the establishment of a liability by the reporting entity for the full amount of the unpaid principal and accrued interest which is payable to a third party related to levelized commissions [FN].

New Footnote – The guidance in this paragraph notes that levelized commissions which use a third party to pay agents that are linked to traditional elements require establishment of a liability for the amounts that have been paid to the agents and any interest accumulated to date.

Effective Date and Transition

7. This statement is effective for years beginning January 1, 2001. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*. The nonsubstantive revisions adopted ________ regarding levelized commission intend to clarify the original intent of this statement. Reporting entities that have not complied with the original intent of the statement shall reflect the change as a correction of an error (as a mistake in the application of an accounting principle) pursuant to SSAP No. 3 in the December 31, 2020 financial statements. In accordance with SSAP No. 3, correction of all accounting errors in previously issued financial statements, for which an amended financial statement was not filed, shall be reported as an adjustment to unassigned funds (surplus) in the period in which the error was detected. Disclosure shall also occur in accordance with SSAP No. 3.

On October 15, 2020, the Statutory Accounting Principles (E) Working Group held a hearing to receive comments, resulting in updated exposed revisions to *SSAP No. 71—Policy Acquisition Costs and Commissions*, as illustrated below. The updated exposed revisions clarify existing levelized commissions guidance, which requires full recognition of funding agreement liabilities incurred for commission expenses obligated when an insurance policy is written. (This guidance clarifies that writing the insurance policy is the obligating event for initial sales commission.) The exposed revisions have the following key changes from the prior exposure:

1. Improved description of the funding agreements in paragraphs 4 and 5.
2. Deletes the previously proposed revisions in paragraph 3 regarding other types of commission to address the comments received regarding unintended impacts on traditional renewal commission.
3. Modifies the revisions in paragraph 7 to remove the language on correction of an error.
4. Proposes the nonsubstantive revisions apply to contracts in effect on Jan. 1, 2021.

For ease of review the following pages illustrate the October 15, 2020 exposed revisions in two formats:

1. **Exposure reflecting tracked revisions to Existing SSAP No. 71**
2. **October 2020 (new) Shaded Revisions to prior July exposure**

Oct. 2020 Exposure of Tracked Revisions to Existing SSAP No. 71

2. Acquisition costs are those costs that are incurred in the acquisition of new and renewal insurance contracts and include those costs that vary with and are primarily related to the acquisition of insurance contracts (e.g., agent and broker commissions, certain underwriting and policy issue costs, and medical and inspection fees). Acquisition costs and commissions shall be expensed as incurred. Determination of when acquisition costs and commissions have been incurred shall be made in accordance with SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets.

3. Contingent commission liabilities shall be determined in accordance with the terms of each individual commission agreement. Commission liabilities determined on the basis of a formula that relates to loss experience shall be established for the earned portion. Assumptions used to calculate the contingent commission liability shall be consistent with the terms of the policy contract and with the assumptions made in recording other assets and liabilities necessary to reflect underwriting results of the reporting entity such as retrospective premium adjustments and loss reserves, including incurred but not reported.

4. Levelized commissions occur in situations where agents receive normal (non-level) commissions with payments made by a third party. It is intended, but not necessarily guaranteed, that the amounts paid to the agents by the third party would ultimately be repaid (with interest explicit or implied) to the third party by levelized payments (which are less than the normal first year commissions but exceed the normal renewal commissions) from the reporting entity. (Note: levelized repayments made by the reporting entity extend the repayment period but might not be a straight-line repayment.) These transactions are, in fact, funding agreements between a reporting entity and a third party, regardless of how the payment to the third party is characterized. The continuance of the stream of payments specified in the levelized commission contract is a mechanism which attempts to bypass recognition of those expenses which are ordinarily charged to expense in the first year of the contract. Consequently, the normal link between the persistency of the policy, the continuance of the premium payment or the maintenance of the agent's license with the reporting entity is not maintained with respect to the payment stream.

5. The use of an arrangement such as a levelized commission arrangement where commission payments are not linked to traditional elements such as premium payments and policy persistency, but rather are linked to the repayment of an advance amount paid by a third party to the direct selling agents requires the establishment of a liability by the reporting entity for the full amount of the unpaid principal and accrued interest which is payable to a third party related to levelized commissions ~~FN~~. Arrangements that use a third party to pay agents who write policies for the reporting entity and the insured can be an attempt to de-link the relationship between the insurer

and those agents and defer or levelize the acquisition commissions. The insurance reporting entity is required to recognize the full amount of earned commission costs to the direct policy writing agents even if those costs are paid indirectly to the agents by a third party through the use of levelized commission, or similar arrangement, which is in substance a funding arrangement. Having a third party pay commission costs to the selling agent is strong evidence of a potential funding arrangement which shall be recognized as a liability because the substance of the arrangement indicates that repayment is reasonable and probable, even if a contingency has been incorporated into the funding arrangement, unless the underlying policy has been cancelled. A third-party structure cannot recharacterize (e.g. by referencing policy persistency) and delay recognition of liabilities for initial sales commission owed from the writing of policies regardless of how a third-party arrangement is structured with regards to the timing of payment from the insurer. The amount owed for full initial sales commission shall be recognized immediately as the writing of an insurance contract is the event that obligates the insurer, and such action shall occur consistently among insurers. As such, this recognition is required regardless if the insurer owes a selling agent directly or if a third-party has been contracted to provide payment to the selling agent.

Effective Date and Transition

7. This statement is effective for years beginning January 1, 2001. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*. The nonsubstantive revisions adopted ________ regarding levelized commission are to clarify the original intent of this statement and are effective January 1, 2021.

October 2020 (new) Shaded Revisions to prior July exposure

2. Acquisition costs are those costs that are incurred in the acquisition of new and renewal insurance contracts and include those costs that vary with and are primarily related to the acquisition of insurance contracts (e.g., agent and broker commissions, certain underwriting and policy issue costs, and medical and inspection fees). Acquisition costs and commissions shall be expensed as incurred. Determination of when acquisition costs and commissions have been incurred shall be made in accordance with SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets.

3. Contingent commission liabilities shall be determined in accordance with the terms of each individual commission agreement. Commission liabilities determined on the basis of a formula that relates to loss experience shall be established for the earned portion. Assumptions used to calculate the contingent commission liability shall be consistent with the terms of the policy contract and with the assumptions made in recording other assets and liabilities necessary to reflect underwriting results of the reporting entity such as retrospective premium adjustments and loss reserves, including incurred but not reported. ~~Commission contracts that include persistency (or other such components) shall not use these clauses to defer recognition of commission expense. If a commission is based on annual policy persistency (or other similar components), the commission shall be accrued based on experience to date for the policy period that the commission relates. In regard to persistency commission, it is inappropriate to wait until the amount is fully earned and/or unavoidable to accrue experience to date commission expenses. Actual policy cancellation would reverse the accrual of the related persistency commission.~~

4. Levelized commissions occur in situations where agents receive normal (non-level) commissions with payments made by a third party. It is intended, but not necessarily guaranteed, that the amounts paid to the agents by the third party would ultimately be repaid (with interest explicit or implied) to the third party by levelized payments (which are less than the normal first year commissions but exceed the normal renewal commissions) from the reporting entity. (Note: levelized repayments made by the reporting entity extend the repayment period but might not be a straight-line repayment.) These transactions are, in fact, funding agreements between a reporting entity and a third party, regardless of how the payment to the third party is characterized. The continuance of the stream of payments specified in the levelized commission contract is a mechanism which attempts to bypass recognition of those expenses which are ordinarily charged to expense in the first year of the contract. Consequently, the normal link between the persistency of the policy, the continuance of the premium payment or the maintenance of the agent's license with the reporting entity is not maintained with respect to the payment stream.

5. The use of an arrangement such as a levelized commission arrangement where commission payments are not linked to traditional elements such as premium payments and policy persistency, but rather are linked to the repayment of an advance amount paid by a third party to the direct selling agents requires the establishment of a liability by the reporting entity for the full amount of the unpaid principal and accrued interest which is payable to a third party related to levelized commissions ~~FN~~. Arrangements that use a third party to pay agents who write policies for the reporting entity and the insured can be an attempt to de-link the relationship between the insurer and those agents and defer or levelize the acquisition commissions. The insurance reporting entity is required to recognize the full amount of earned commission costs to the direct policy writing agents even if those costs are paid indirectly to the agents by a third party through the use of levelized commission, or similar arrangement, which is in substance a funding arrangement. Having a third party pay commission costs to the selling agent is strong evidence of a potential funding arrangement which shall be recognized as a liability because the substance of the arrangement indicates that repayment is reasonable and probable, even if a contingency has been incorporated into the funding arrangement, unless the underlying policy has been cancelled. A third-party structure cannot recharacterize (e.g. by referencing policy persistency) and delay recognition of liabilities for initial sales commission owed from the writing of policies regardless of how a third-party arrangement is structured with regards to the timing of payment from the insurer. The amount owed for full initial sales commission shall be recognized immediately as the writing of an insurance contract is the event that obligates the insurer, and such action shall occur consistently among insurers. As such, this recognition is required regardless if the insurer owes a selling agent directly or if a third-party has been contracted to provide payment to the selling agent.

~~**New Footnote – The guidance in this paragraph notes that levelized commissions which use a third party to pay agents that are linked to traditional elements require establishment of a liability for the amounts that have been paid to the agents and any interest accumulated to date.**~~

Effective Date and Transition

7. This statement is effective for years beginning January 1, 2001. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*. The nonsubstantive revisions adopted ________ regarding levelized commission ~~intend~~are to clarify the original intent of this statement and are effective January 1, 2021. ~~Reporting entities that have not complied with the original intent of the statement shall reflect the change as a correction of an error (as a mistake in the application of an accounting principle) pursuant to SSAP No. 3 in the December 31, 2020 financial statements. In accordance with SSAP No. 3, correction of all accounting errors in previously issued financial statements, for which an amended financial statement was not filed, shall be reported as an adjustment to unassigned funds (surplus) in the period in which the error was detected. Disclosure shall also occur in accordance with SSAP No. 3.~~

On November 12, 2020, the Statutory Accounting Principles (E) Working Group **held a hearing to receive comments. The Working Group took the following actions:**

- **Re-exposed** the prior version of SSAP #71 with shaded edits reflected below. – (1) the proposed effective date of Jan.1, 2021 was changed to be effective upon adoption, and (2) the revised text made explicit that the proposed revisions will apply to contracts in effect as of the date of adoption. Comments due by Jan. 11, 2021.

- Determined that the revisions to SSAP #71 had met the due process for **either a substantive or a non-substantive revision but concluded to keep the revision classified as nonsubstantive**. The Working Group reiterated that it is not the impact of a change on an individual entity that determines whether a change is substantive or non-substantive, but whether the revision is in line with the original intent of the SSAP. The Working group noted that this is a clarification of existing guidance consistent with original intent. Commissioner Donelon noted an objection to the classification as non-substantive.

- **Directed NAIC Staff to draft an Issue Paper** to document the discussion on this topic for historical purposes. The issue paper will be exposed for comment before considered for adoption by the Working Group.

Nov. 12, 2020 Exposed shaded SSAP No. 71 revisions are new from prior exposure.

2. Acquisition costs are those costs that are incurred in the acquisition of new and renewal insurance contracts and include those costs that vary with and are primarily related to the acquisition of insurance contracts (e.g., agent and broker commissions, certain underwriting and policy issue costs, and medical and inspection fees). Acquisition costs and commissions shall be expensed as incurred. Determination of when acquisition costs and commissions have been incurred shall be made in accordance with SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets.

3. Contingent commission liabilities shall be determined in accordance with the terms of each individual commission agreement. Commission liabilities determined on the basis of a formula that relates to loss experience shall be established for the earned portion. Assumptions used to calculate the contingent commission liability shall be consistent with the terms of the policy contract and with the assumptions made in recording other assets and liabilities necessary to reflect underwriting results of the reporting entity such as retrospective premium adjustments and loss reserves, including incurred but not reported.

4. Levelized commissions occur in situations where agents receive normal (non-level) commissions with payments made by a third party. It is intended, but not necessarily guaranteed, that the amounts paid to the agents by the third party would ultimately be repaid (with interest explicit or implied) to the third party by levelized payments (which are less than the normal first year commissions but exceed the normal renewal commissions) from the reporting entity. (Note: levelized repayments made by the reporting entity extend the repayment period but might not be a straight-line repayment.) These transactions are, in fact, funding agreements between a reporting entity and a third party, regardless of how the payment to the third party is characterized. The continuance of the stream of payments specified in the levelized commission contract is a mechanism which attempts to bypass recognition of those expenses which are ordinarily charged to expense in the first year of the contract. Consequently, the normal link between the persistency of the policy, the continuance of the premium payment or the maintenance of the agent's license with the reporting entity is not maintained with respect to the payment stream.

5. The use of an arrangement such as a levelized commission arrangement where commission payments are not linked to traditional elements such as premium payments and policy persistency, but rather are linked to the repayment of an advance amount paid by a third party to the direct selling agents requires the establishment of a liability by the reporting entity for the full amount of the unpaid principal and accrued interest which is payable to a third party related to levelized commissions ~~FN~~. Arrangements that use a third party to pay agents who write policies for the reporting entity and the insured can be an attempt to de-link the relationship between the insurer and those agents and defer or levelize the acquisition commissions. The insurance reporting entity is required to recognize the full amount of earned commission costs to the direct policy writing agents even if those costs are paid indirectly to the agents by a third party through the use of levelized commission, or similar arrangement, which is in substance a funding arrangement. Having a third party pay commission costs to the selling agent is strong evidence of a potential funding arrangement which shall be recognized as a liability because the substance of the arrangement indicates that repayment is reasonable and probable, even if a contingency has been incorporated into the funding arrangement, until ~~unless~~the underlying policy has been cancelled. A third-party structure cannot recharacterize (e.g. by referencing policy persistency) and delay recognition of liabilities for initial sales commission owed from the writing of policies regardless of how a third-party arrangement is structured with regards to the timing of payment from the insurer. The amount owed for full initial sales commission shall be recognized immediately as the writing of an insurance contract is the event that obligates the insurer, and such action shall occur consistently among insurers. As such, this recognition is required regardless if the insurer owes a selling agent directly or if a third-party has been contracted to provide payment to the selling agent.

Effective Date and Transition

7. This statement is effective for years beginning January 1, 2001. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*. The nonsubstantive revisions adopted TBD date regarding levelized commission are to clarify the original intent of this statement and apply to existing contracts ~~are effective~~ in effect on the date of adoption of the revisions ~~January 1, 2021~~.

For Spring 2021 discussion, NAIC staff recommends that the Working Group take the following actions:

1. **Expose the issue paper to document the historical discussion**.

2. **Adopt the exposed revisions to SSAP No. 71 after discussion regarding whether to incorporate the revisions to paragraph 7 regarding the effective date** which is illustrated as shaded text below. The November 2020 exposure was for the revisions to be effective on adoption. This is because some members noted a preference for an early as possible effective date in 2021. Guggenheim and IPs comments requested an effective date no sooner than December 31, 2021 to allow time to work with regulators, auditors etc.

   In the event that the Working Group wants to consider the industry request, NAIC staff has provided language for a December 31, 2021 effective date as illustrated below. As the issue paper is to document the historical discussion there is not a need to delay the effective date for an issue paper that is not authoritative. A December 31, 2021 effective date would allow the issue paper to be adopted prior to the implementation of the revisions. Note that under SSAP No. 3, the impacts are still calculated using Jan. 1 numbers, but would not be initially reported until the year-end 2021 financial statements.

   Effective Date and Transition (shaded revisions to paragraph 7 are for discussion).

   7. This statement is effective for years beginning January 1, 2001. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*. The nonsubstantive revisions adopted TBD date regarding levelized commission are to clarify the original intent of this statement and apply to existing contracts in effect as of December 31, 2021 and new contracts thereafter ~~on the date of adoption of the~~.

3. **Note – It is recommended that the Working Group expose a blanks proposal (2021-04BWG, see attachment 20.1) to incorporate a new general interrogatory to assist with identifying the use of funding agreements** as a concurrent exposure with the Blanks (E) Working Group. This general interrogatory will require the identification of circumstances of when an insurer utilizes third parties to pay agent commissions in which the advances paid by the 3rd party are not settled in full within 90 days. The 90-day threshold for reporting was selected to not require reporting when an insurer a third-party for traditional payment processing. This proposal is attached at 20.1 and was developed with Working Group member input. (*Staff Note: Input from interested parties is requested to ensure that this GI is written to capture the desired information on companies using financing arrangements to pay commissions.)*

SSAP No. 71 Nov. 12, 2020 exposure with shaded revisions to paragraph 7 for Spring 2021 discussion

2. Acquisition costs are those costs that are incurred in the acquisition of new and renewal insurance contracts and include those costs that vary with and are primarily related to the acquisition of insurance contracts (e.g., agent and broker commissions, certain underwriting and policy issue costs, and medical and inspection fees). Acquisition costs and commissions shall be expensed as incurred. Determination of when acquisition costs and commissions have been incurred shall be made in accordance with SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets.

3. Contingent commission liabilities shall be determined in accordance with the terms of each individual commission agreement. Commission liabilities determined on the basis of a formula that relates to loss

experience shall be established for the earned portion. Assumptions used to calculate the contingent commission liability shall be consistent with the terms of the policy contract and with the assumptions made in recording other assets and liabilities necessary to reflect underwriting results of the reporting entity such as retrospective premium adjustments and loss reserves, including incurred but not reported.

4. Levelized commissions occur in situations where agents receive normal (non-level) commissions with payments made by a third party. It is intended, but not necessarily guaranteed, that the amounts paid to the agents by the third party would ultimately be repaid (with interest explicit or implied) to the third party by levelized payments (which are less than the normal first year commissions but exceed the normal renewal commissions) from the reporting entity. (Note: levelized repayments made by the reporting entity extend the repayment period but might not be a straight-line repayment.) These transactions are, in fact, funding agreements between a reporting entity and a third party, regardless of how the payment to the third party is characterized. The continuance of the stream of payments specified in the levelized commission contract is a mechanism which attempts to bypass recognition of those expenses which are ordinarily charged to expense in the first year of the contract. Consequently, the normal link between the persistency of the policy, the continuance of the premium payment or the maintenance of the agent's license with the reporting entity is not maintained with respect to the payment stream.

5. The use of an arrangement such as a levelized commission arrangement where commission payments are not linked to traditional elements such as premium payments and policy persistency, but rather are linked to the repayment of an advance amount paid by a third party to the direct selling agents requires the establishment of a liability by the reporting entity for the full amount of the unpaid principal and accrued interest which is payable to a third party related to levelized commissions ~~FN~~. Arrangements that use a third party to pay agents who write policies for the reporting entity and the insured can be an attempt to de-link the relationship between the insurer and those agents and defer or levelize the acquisition commissions. The insurance reporting entity is required to recognize the full amount of earned commission costs to the direct policy writing agents even if those costs are paid indirectly to the agents by a third party through the use of levelized commission, or similar arrangement, which is in substance a funding arrangement. Having a third party pay commission costs to the selling agent is strong evidence of a potential funding arrangement which shall be recognized as a liability because the substance of the arrangement indicates that repayment is reasonable and probable, even if a contingency has been incorporated into the funding arrangement, until the underlying policy has been cancelled. A third-party structure cannot recharacterize (e.g. by referencing policy persistency) and delay recognition of liabilities for initial sales commission owed from the writing of policies regardless of how a third-party arrangement is structured with regards to the timing of payment from the insurer. The amount owed for full initial sales commission shall be recognized immediately as the writing of an insurance contract is the event that obligates the insurer, and such action shall occur consistently among insurers. As such, this recognition is required regardless of if the insurer owes a selling agent directly or if a third-party has been contracted to provide payment to the selling agent.

Effective Date and Transition

7. This statement is effective for years beginning January 1, 2001. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*. The nonsubstantive revisions adopted TBD date regarding levelized commission are to clarify the original intent of this statement and apply to existing contracts in effect as of December 31, 2021 and new contracts thereafter. ~~on the date of adoption of the~~

NAIC BLANKS (E) WORKING GROUP

Blanks Agenda Item Submission Form

DATE: 02/25/2021	**FOR NAIC USE ONLY**
CONTACT PERSON:	Agenda Item # 2021-04BWG
TELEPHONE:	Year 2021
EMAIL ADDRESS:	Changes to Existing Reporting [X]
ON BEHALF OF:	New Reporting Requirement [ ]
NAME: Dale Bruggeman	**REVIEWED FOR ACCOUNTING PRACTICES AND PROCEDURES IMPACT**
TITLE: Chair SAPWG	No Impact [X]
AFFILIATION: Ohio Department of Insurance	Modifies Required Disclosure [ ]
ADDRESS: 50W. Town St., 3rd Fl., Ste. 300	**DISPOSITION**
Columbus, OH 43215	[ ] Rejected For Public Comment
	[ ] Referred To Another NAIC Group
	[ ] Received For Public Comment
	[ ] Adopted Date
	[ ] Rejected Date
	[ ] Deferred Date
	[ ] Other (Specify)

BLANK(S) TO WHICH PROPOSAL APPLIES

[X] **ANNUAL STATEMENT** [ ] **INSTRUCTIONS** [ ] **CROSSCHECKS**
[ ] **QUARTERLY STATEMENT** [X] **BLANK**

[X] Life, Accident & Health/Fraternal [ ] Separate Accounts [X] Title
[X] Property/Casualty [ ] Protected Cell [ ] Other
[X] Health [ ] Health (Life Supplement)

Anticipated Effective Date: Annual 2021

IDENTIFICATION OF ITEM(S) TO CHANGE

Add interrogatory questions 24.1 and 24.2 to the General Interrogatories, Part 1 and renumber those below them. Renumber the questions and question references in the General Interrogatories, Part 1 to match the renumbering on the blank page.

REASON, JUSTIFICATION FOR AND/OR BENEFIT OF CHANGE**

During the Statutory Accounting Principles (E) Working Group's ongoing discussion of agenda item #2019-24: Levelized and Persistency Commissions, regulators expressed the desire for a GI to identify certain scenarios in which an insurer utilizes third parties to pay commission expenses.

NAIC STAFF COMMENTS

Comment on Effective Reporting Date:

Other Comments:

**** This section must be completed on all forms.** **Revised 7/18/2018**

ANNUAL STATEMENT BLANK – LIFE\FRATERNAL, HEALTH, PROPERTY AND TITLE

GENERAL INTERROGATORIES

Detail Eliminated to Conserve Space

FINANCIAL

Detail Eliminated to Conserve Space

23.1 Does the reporting entity report any amounts due from parent, subsidiaries or affiliates on Page 2 of this statement? Yes [ ] No [ ]

23.2 If yes, indicate any amounts receivable from parent included in the Page 2 amount: $ ____________________

24.1 Does the insurer utilize third parties to pay agent commissions in which the amounts advanced by the third parties are not settled in full within 90 days? Yes [ ] No [ ]

24.2 If the response to 24.1 is yes, identify the third-party that pays the agents and whether they are a related party.

Name of Third-Party	Is the Third-Party Agent a Related Party (Y/N)

INVESTMENT

~~24~~25.01 Were all the stocks, bonds and other securities owned December 31 of current year, over which the reporting entity has exclusive control, in the actual possession of the reporting entity on said date? (other than securities lending programs addressed in ~~24~~25.03) Yes [ ] No [ ]

~~24~~25.02 If no, give full and complete information, relating thereto ....

~~24~~25.03 For securities lending programs, provide a description of the program including value for collateral and amount of loaned securities, and whether collateral is carried on or off-balance sheet. (an alternative is to reference Note 17 where this information is also provided)

....

~~24~~25.04 For the reporting entity's securities lending program, report amount of collateral for conforming programs as outlined in the Risk-Based Capital Instructions. $ ____________________

~~24~~25.05 For the reporting entity's securities lending program, report amount of collateral for other programs. $ ____________________

~~24~~25.06 Does your securities lending program require 102% (domestic securities) and 105% (foreign securities) from the counterparty at the outset of the contract? Yes [ ] No [ ] N/A [ ]

~~24~~25.07 Does the reporting entity non-admit when the collateral received from the counterparty falls below 100%? Yes [ ] No [ ] N/A [ ]

~~24~~25.08 Does the reporting entity or the reporting entity's securities lending agent utilize the Master Securities Lending Agreement (MSLA) to conduct securities lending? Yes [ ] No [ ] N/A [ ]

GENERAL INTERROGATORIES

~~24~~25.09 For the reporting entity's securities lending program, state the amount of the following as of December 31 of the current year:

~~24~~25.091 Total fair value of reinvested collateral assets reported on Schedule DL, Parts 1 and 2 $ ________________

~~24~~25.092 Total book adjusted/carrying value of reinvested collateral assets reported on Schedule DL, Parts 1 and 2 $ ________________

~~24~~25.093 Total payable for securities lending reported on the liability page $ ________________

~~25~~26.1 Were any of the stocks, bonds or other assets of the reporting entity owned at December 31 of the current year not exclusively under the control of the reporting entity or has the reporting entity sold or transferred any assets subject to a put option contract that is currently in force? (Exclude securities subject to Interrogatory ~~21~~22.1 and ~~24~~25.03). Yes [ ] No [ ]

~~25~~26.2 If yes, state the amount thereof at December 31 of the current year:

~~25~~26.21 Subject to repurchase agreements $ ________________
~~25~~26.22 Subject to reverse repurchase agreements $ ________________
~~25~~26.23 Subject to dollar repurchase agreements $ ________________
~~25~~26.24 Subject to reverse dollar repurchase agreements $ ________________
~~25~~26.25 Placed under option agreements $ ________________
~~25~~26.26 Letter stock or securities restricted as to sale – excluding FHLB Capital Stock $ ________________
~~25~~265.27 FHLB Capital Stock $ ________________
~~25~~26.28 On deposit with states $ ________________
~~25~~26.29 On deposit with other regulatory bodies $ ________________
~~25~~26.30 Pledged as collateral – excluding collateral pledged to an FHLB $ ________________
~~25~~26.31 Pledged as collateral to FHLB – including assets backing funding agreements $ ________________
~~25~~26.32 Other $ ________________

~~25~~26.3 For category (~~25~~26.26) provide the following:

1 Nature of Restriction	2 Description	3 Amount

~~26~~27.1 Does the reporting entity have any hedging transactions reported on Schedule DB? Yes [ ] No [ ]

~~26~~27.2 If yes, has a comprehensive description of the hedging program been made available to the domiciliary state? Yes [ ] No [ ] N/A [ ]
If no, attach a description with this statement.

LINES ~~26~~27.3 through ~~26~~27.5: FOR LIFE/FRATERNAL REPORTING ENTITIES ONLY:

~~26~~27.3 Does the reporting entity utilize derivatives to hedge variable annuity guarantees subject to fluctuations as a result of interest rate Yes [ ] No [ ]

~~26~~27.4 If the response to ~~26~~27.3 is YES, does the reporting entity utilize:

~~26~~27.41 Special accounting provision of SSAP No. 108 Yes [ ] No [ ]
~~26~~27.42 Permitted accounting practice Yes [ ] No [ ]
~~26~~27.43 Other accounting guidance Yes [ ] No [ ]

~~26~~274.5 By responding YES to ~~26~~27.41 regarding utilizing the special accounting provisions of SSAP No. 108, the reporting entity attests to the following: Yes [ ] No [ ]

- ....
he reporting entity has obtained explicit approval from the domiciliary state.
- ....
edging strategy subject to the special accounting provisions is consistent with the requirements of VM-21.
- ....
ctuarial certification has been obtained which indicates that the hedging strategy is incorporated within the establishment of VM-21 reserves and provides the impact of the hedging strategy within the Actuarial Guideline Conditional Tail Expectation Amount.
- ....
inancial Officer Certification has been obtained which indicates that the hedging strategy meets the definition of a Clearly Defined Hedging Strategy within VM-21 and that the Clearly Defined Hedging Strategy is the hedging strategy being used by the company in its actual day-to-day risk mitigation efforts.

~~27~~28.1 Were any preferred stocks or bonds owned as of December 31 of the current year mandatorily convertible into equity, or, at the option of the issuer, convertible into equity? Yes [ ] No [ ]

~~27~~28.2 If yes, state the amount thereof at December 31 of the current year. $ ____________________

~~28~~29. Excluding items in Schedule E– Part 3 – Special Deposits, real estate, mortgage loans and investments held physically in the reporting entity's offices, vaults or safety deposit boxes, were all stocks, bonds and other securities, owned throughout the current year held pursuant to a custodial agreement with a qualified bank or trust company in accordance with Section 1, III – General Examination Considerations, F. Outsourcing of Critical Functions, Custodial or Safekeeping Agreements of the NAIC *Financial Condition Examiners Handbook*? Yes [ ] No [ ]

~~28~~29.01 For agreements that comply with the requirements of the NAIC *Financial Condition Examiners Handbook*, complete the following:

1 Name of Custodian(s)	2 Custodian's Address

GENERAL INTERROGATORIES

~~28~~29.02 For all agreements that do not comply with the requirements of the NAIC *Financial Condition Examiners Handbook*, provide the name, location and a complete explanation:

1 Name(s)	2 Location(s)	3 Complete Explanation(s)

~~28~~29.03 Have there been any changes, including name changes, in the custodian(s) identified in ~~28~~29.01 during the current year? Yes [ ] No [ ]

~~28~~29.04 If yes, give full and complete information relating thereto:

1 Old Custodian	2 New Custodian	3 Date of Change	4 Reason

~~28~~29.05 Investment management – Identify all investment advisors, investment managers, broker/dealers, including individuals that have the authority to make investment decisions on behalf of the reporting entity. For assets that are managed internally by employees of the reporting entity, note as such. [“…that have access to the investment accounts”; “…handle securities”]

1 Name of Firm or Individual	2 Affiliation

~~28~~29.0597 For those firms/individuals listed in the table for Question ~~28~~29.05, do any firms/individuals unaffiliated with the reporting entity (i.e., designated with a “U”) manage more than 10% of the reporting entity’s invested assets? Yes [ ] No [ ]

~~28~~29.0598 For firms/individuals unaffiliated with the reporting entity (i.e., designated with a “U”) listed in the table for Question ~~28~~29.05, does the total assets under management aggregate to more than 50% of the reporting entity’s invested assets? Yes [ ] No [ ]

~~28~~29.06 For those firms or individuals listed in the table for ~~28~~29.05 with an affiliation code of “A” (affiliated) or “U” (unaffiliated), provide the information for the table below.

1 Central Registration Depository Number	2 Name of Firm or Individual	3 Legal Entity Identifier (LEI)	4 Registered With	5 Investment Management Agreement (IMA) Filed

~~29~~30.1 Does the reporting entity have any diversified mutual funds reported in Schedule D – Part 2 (diversified according to the Securities and Exchange Commission (SEC) in the Investment Company Act of 1940 [Section 5 (b) (1)])? Yes [ ] No [ ]

~~29~~330.2 If yes, complete the following schedule:

1 CUSIP #	2 Name of Mutual Fund	3 Book/Adjusted Carrying Value
~~29~~30.2999 TOTAL		

~~29~~30.3 For each mutual fund listed in the table above, complete the following schedule:

1 Name of Mutual Fund (from above table)	2 Name of Significant Holding of the Mutual Fund	3 Amount of Mutual Fund’s Book/Adjusted Carrying Value Attributable to the Holding	4 Date of Valuation

GENERAL INTERROGATORIES

~~30~~31. Provide the following information for all short-term and long-term bonds and all preferred stocks. Do not substitute amortized value or statement value for fair value.

	1 Statement (Admitted) Value	2 Fair Value	3 Excess of Statement over Fair Value (–), or Fair Value over Statement (+)
~~30~~31.1 Bonds			
~~30~~31.2 Preferred Stocks			
~~30~~31.3 Totals			

~~30~~31.4 Describe the sources or methods utilized in determining the fair values:..
....
....
....

~~31~~32.1 Was the rate used to calculate fair value determined by a broker or custodian for any of the securities in Schedule D? Yes [ ] No [ ]

~~31~~32.2 If the answer to ~~31~~32.1 is yes, does the reporting entity have a copy of the broker's or custodian's pricing policy (hard copy or electronic copy) for all brokers or custodians used as a pricing source? Yes [ ] No [ ]

~~31~~32.3 If the answer to ~~31~~32.2 is no, describe the reporting entity's process for determining a reliable pricing source for purposes of disclosure of fair value for Schedule D:
....
....

~~32~~33.1 Have all the filing requirements of the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* been followed? Yes [ ] No [ ]

~~32~~33.2 If no, list exceptions:..
....

~~33~~34. By self-designating 5GI securities, the reporting entity is certifying the following elements of each self-designated 5GI security:

a. Documentation necessary to permit a full credit analysis of the security does not exist or an NAIC CRP credit rating for an FE or PL security is not available.
b. Issuer or obligor is current on all contracted interest and principal payments.
c. The insurer has an actual expectation of ultimate payment of all contracted interest and principal.

Has the reporting entity self-designated 5GI securities? Yes [ ] No [ ]

~~34~~35. By self-designating PLGI securities, the reporting entity is certifying the following elements of each self-designated PLGI security:

a. The security was purchased prior to January 1, 2018.
b. The reporting entity is holding capital commensurate with the NAIC Designation reported for the security.
c. The NAIC Designation was derived from the credit rating assigned by an NAIC CRP in its legal capacity as an NRSRO which is shown on a current private letter rating held by the insurer and available for examination by state insurance regulators.
d. The reporting entity is not permitted to share this credit rating of the PL security with the SVO.

Has the reporting entity self-designated PLGI securities? Yes [ ] No [ ]

~~35~~36. By assigning FE to a Schedule BA non-registered private fund, the reporting entity is certifying the following elements of each self-designated FE fund:

a. The shares were purchased prior to January 1, 2019.
b. The reporting entity is holding capital commensurate with the NAIC Designation reported for the security.
c. The security had a public credit rating(s) with annual surveillance assigned by an NAIC CRP in its legal capacity as an NRSRO prior to January 1, 2019.
d. The fund only or predominantly holds bonds in its portfolio.
e. The current reported NAIC Designation was derived from the public credit rating(s) with annual surveillance assigned by an NAIC CRP in its legal capacity as an NRSRO.
f. The public credit rating(s) with annual surveillance assigned by an NAIC CRP has not lapsed.

Has the reporting entity assigned FE to Schedule BA non-registered private funds that complied with the above criteria? Yes [ ] No [ ]

~~36~~37. By rolling/renewing short-term or cash equivalent investments with continued reporting on Schedule DA, Part 1 or Schedule E Part 2 (identified through a code (%) in those investment schedules), the reporting entity is certifying to the following:

a. The investment is a liquid asset that can be terminated by the reporting entity on the current maturity date.
b. If the investment is with a nonrelated party or nonaffiliate, then it reflects an arms-length transaction with renewal completed at the discretion of all involved parties.
c. If the investment is with a related party or affiliate, then the reporting entity has completed robust re-underwriting of the transaction for which documentation is available for regulator review.
d. Short-term and cash equivalent investments that have been renewed/rolled from the prior period that do not meet the criteria in ~~36~~37.a -~~36~~37.c are reported as long-term investments.

Has the reporting entity rolled/renewed short-term or cash equivalent investments in accordance with these criteria? Yes [ ] No [ ] N/A [ ]

GENERAL INTERROGATORIES

OTHER

~~37~~38.1 Amount of payments to trade associations, service organizations and statistical or rating bureaus, if any? $ ____________________

~~37~~38.2 List the name of the organization and the amount paid if any such payment represented 25% or more of the total payments to trade associations, service organizations, and statistical or rating bureaus during the period covered by this statement.

1 Name	2 Amount Paid
	$
	$
	$
	$

~~38~~39.1 Amount of payments for legal expenses, if any? $ ____________________

~~38~~39.2 List the name of the firm and the amount paid if any such payment represented 25% or more of the total payments for legal expenses during the period covered by this statement.

1 Name	2 Amount Paid
	$
	$
	$
	$

~~39~~40.1 Amount of payments for expenditures in connection with matters before legislative bodies, officers, or departments of government, if any? $ ____________________

~~39~~40.2 List the name of the firm and the amount paid if any such payment represented 25% or more of the total payment expenditures in connection with matters before legislative bodies, officers, or departments of government during the period covered by this statement.

1 Name	2 Amount Paid
	$
	$
	$
	$

GENERAL INTERROGATORIES

PART 1 – COMMON INTERROGATORIES

Detail Eliminated to Conserve Space

FINANCIAL

Detail Eliminated to Conserve Space

INVESTMENT

~~24~~25. For the purposes of this interrogatory, "exclusive control" means that the company has the exclusive right to dispose of the investment at will, without the necessity of making a substitution thereof. For purposes of this interrogatory, securities in transit and awaiting collection, held by a custodian pursuant to a custody arrangement or securities issued subject to a book entry system are considered to be in actual possession of the company.

If bonds, stocks and other securities owned December 31 of the current year, over which the company has exclusive control are: (1) securities purchased for delayed settlement, or (2) loaned to others, the company should respond "NO" to ~~24~~25.01 and "YES" to ~~25~~26.1.

~~24~~25.03 Describe the company's securities lending program, including value for collateral and amount of loaned securities, and whether the collateral is held on- or off-balance sheet. Note 17 of Notes to Financial Statement provides a full description of the program.

~~24~~25.04 Report amount of collateral for conforming programs as outlined in the Risk-Based Capital Instructions.

~~24~~25.05 Report amount of collateral for other programs.

~~24~~25.091 The fair value amount reported should equal the grand total of Schedule DL, Part 1, Column 5 plus Schedule DL, Part 2, Column 5.

The fair value amount reported amount should also equal the fair value amount reported in Note 5E(5)a1(m).

~~24~~25.092 The book adjusted/carrying value amount reported should equal the grand total of Schedule DL, Part 1, Column 6 plus Schedule DL, Part 2, Column 6.

~~24~~25.093 The payable for securities lending amount reported should equal current year column for payable for securities lending line on the liability page.

~~25~~26. Disclose the statement value of investments that are not under the exclusive control of the reporting entity within the categories listed in ~~25~~26.2.

~~27~~28. The purpose for this General Interrogatory is to capture the statement value for securities reported in Schedule D, Part 1, Bonds or Schedule D, Part 2, Section 1, Preferred Stock that are mandatorily convertible into equity, or at the option of the issuer, are convertible into equity. This disclosure will facilitate the application of the equity factors to the statement value of such securities for purposes of RBC.

~~28~~29. The question, regarding whether items are held in accordance with the *Financial Condition Examiners Handbook*, must be answered.

~~28~~29.01 If the answer to ~~28~~ 29 is "YES," then list all of the agreements in ~~28~~29.01. If the answer is "NO," but one or more of the agreements do comply with the *Financial Condition Examiners Handbook*, then list the agreements that do comply in ~~28~~29.01.

~~28~~29.02 If the answer to ~~28~~ 29 is "NO," then list all agreements that do not comply with the *Financial Condition Examiners Handbook*. Provide a complete explanation of why each custodial agreement does not include the characteristics outlined in the *Financial Condition Examiners Handbook* (Section 1 (III) (F), Outsourcing of Critical Functions, Custodial or Safekeeping Agreements), available at the NAIC website:

www.naic.org/documents/committees_e_examover_fehtg_Custodial_or_Safekeeping_Agreements.doc

~~28~~29.03 This question, regarding changes in custodian, must be answered.

~~28~~29.04 If the answer to ~~28~~29.03 is "YES," list the change(s).

~~28~~29.05 Identify all investment advisors, investment managers and broker/dealers, including individuals who have the authority to make investment decisions on behalf of the reporting entity. For assets that are managed internally by employees of the reporting entity, note as such.

Name of Firm or Individual:

Should be name of firm or individual that is party to the Investment Management Agreement

Affiliation:

Note if firm or individual is affiliated, unaffiliated or an employee by using the following codes:

A Investment management is handled by firms/individuals affiliated with the reporting entity.

U Investment management is handled by firms/individuals unaffiliated with the reporting entity.

I Investment management is handled internally by individuals that are employees of the reporting entity.

~~28~~29.0597 If the total assets under management of any the firms/individuals unaffiliated with the reporting entity (i.e., designated with a "U") listed in the table for Question ~~28~~29.05 are greater than 10% of the reporting entity's invested assets (Line 12 of the Asset page), answer "YES" to Question ~~28~~29.0597.

~~28~~29.0598 If the total assets under management of all the firms/individuals unaffiliated with the reporting entity (i.e., designated with a "U") listed in the table for Question ~~28~~29.05 are greater than 50% of the reporting entity's invested assets (Line 12 of the Asset page), answer "YES" to Question ~~28~~29.0598. When determining the aggregate total of assets under management, include all firms/individuals unaffiliated with the reporting entity not just those who manage more than 10% of the reporting entity's assets.

~~28~~29.06 For assets managed by an affiliated or unaffiliated firm or individual, provide for each firm or individual the Central Registration Depository Number, Legal Entity Identifier (LEI), who they are registered with and if an Investment Management Agreement has been filed for each firm or individual.

Name of Firm or Individual:

Should be name of firm or individual provided for ~~28~~29.05

Central Registration Depository Number

The Central Registration Depository (CRD) number is a number issued by the Financial Industry Regulatory Authority (FINRA) to brokers, dealers or individuals when licensed, and can be verified against their database *www.finra.org*. These brokers, dealers or individuals would be those contracted to manage some of the reporting entity's investments or funds and invest them for the reporting entity. The brokers, dealers or individuals can be affiliated or unaffiliated with the reporting entity. The reporting entity must list all brokers, dealers or individuals who have the authority to make investments on behalf of the reporting entity.

Legal Entity Identifier (LEI)

Provide the 20-character Legal Entity Identifier (LEI) for issuer as assigned by a designated Local Operating Unit. If no LEI number has been assigned, leave blank.

Registered With:

If a Registered Investment Advisor, specify if registered with Securities Exchange Commission or state securities authority. Note if not a Registered Investment Advisor.

Investment Management Agreement (IMA) Filed:

Indicate if a current Investment Management Agreement (IMA) has been filed with the state of domicile or the insurance department in another state(s). Use one of the codes below to indicate if the IMA has been filed and with whom it was filed.

DS If the current IMA has been filed with the state of domicile regardless if it was also filed with another state.

OS If the current IMA has been filed with a state(s) other than the state of domicile but not the state of domicile

NO If the current IMA has not been filed with any state

~~29~~30. This interrogatory is applicable to Property/Casualty and Health entities only.

~~29~~30.2 The diversified mutual funds (diversified according to the U.S. Securities and Exchange Commission (SEC) in the Investment Company Act of 1940 [Section 5(b)(1)]) that are excluded from the Asset Concentration Factor section of the risk-based capital filing are to be disclosed in this interrogatory.

~~29~~30.3 "Significant Holding" means the top five largest holdings of the mutual fund. For each diversified mutual fund disclosed in Interrogatory ~~29~~30.2, the top largest holdings of the mutual fund must be disclosed in this interrogatory.

The "Amount of Mutual Fund's Book/Adjusted Carrying Value Attributable to the Holding" should be based upon the fund's latest available valuation as of year-end (e.g., fiscal year-end or latest periodic valuation available prior to year-end).

The "Date of Valuation" should be the date of the valuation amount provided in the Amount of Mutual Fund's Book/Adjusted Carrying Value Attributable to the Holding column.

~~30~~31. Include bonds reported as cash equivalents in Schedule E, Part 2.

~~32~~33. This interrogatory applies to any investment required to be filed with the SVO (or that would have been required if not exempted in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office*), whether in the general account or separate accounts.

The existence of Z securities does not mean that a reporting entity is not complying with the procedures. As long as the entity has filed its Z securities with the SVO within 120 days of purchase, compliance with the procedures has been met. If an entity wishes to provide the counts of Z securities, include those counts in the explanation lines. An explanation is only expected if the answer to the compliance question is NO.

OTHER

~~37~~38. The purpose of this General Interrogatory is to capture information about payments to any trade association, service organization, and statistical or rating bureau. A "service organization" is defined as every person, partnership, association or corporation that formulates rules, establishes standards, or assists in the making of rates or standards for the information or benefit of insurers or rating organizations.

~~38~~39. The purpose of this General Interrogatory is to capture information about legal expenses paid during the year. These expenses include all fees or retainers for legal services or expenses, including those in connection with matters before administrative or legislative bodies. It excludes salaries and expenses of company personnel, legal expenses in connection with investigation, litigation and settlement of policy claims, and legal fees associated with real estate transactions, including mortgage loans on real estate. Do not include amounts reported in General Interrogatories No. ~~37~~ 38 and No. ~~39~~40.

~~39~~40. The purpose of this General Interrogatory is to capture information about expenditures in connection with matters before legislative bodies, officers or departments of government paid during the year. These expenses are related to general legislative lobbying and direct lobbying of pending and proposed statutes or regulations before legislative bodies and/or officers or departments of government. Do not include amounts reported in General Interrogatories No. ~~37~~ 38 and No. ~~38~~39.

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Attachment 21 is pending Working Group direction.

Attachment 22

Statutory Accounting Principles (E) Working Group
March 15 Interim Meeting
Comment Letters Received

TABLE OF CONTENTS

COMMISSIONER OF SECURITIES & INSURANCE

MATTHEW M. ROSENDALE, SR.
COMMISSIONER

OFFICE OF THE
MONTANA STATE AUDITOR

Scott,

December 4, 2020

cc: Statutory Accounting Principles Working Group

This is one of my final letters as the Montana Insurance Commissioner as my fellow Montanans have honored me with the privilege of representing them in the United States House of Representatives. I will continue to champion our state-based system of insurance regulation while I am a member of Congress.

With that noted, I do have a concern as I close out my term as Insurance Commissioner: the proposed changes to the SSAP 71. There is no reason to change the current SSAP 71 accounting principle. There has been no policyholder peril, fraud, or company financial impairment by using SSAP 71 as currently allowed since 1998.

I believe the changes being proposed constitute a significant change in application of this statutory accounting principle and therefore should be deemed a substantive change under the SSAP guidelines. The Statutory Accounting Principles Working Group (SAPWG) continues to conclude that the proposed changes simply clarify the intent of the working group, but the proposed changes would significantly change the way some companies report certain commission arrangements. These companies have been reporting these arrangements the same way for decades without, as far as I have been informed, any harm to policyholders.

Efforts to fix something that isn't broken often have negative consequences, whether intentional or not. As a former state legislator and as an incoming federal legislator, I have always been a strong proponent for closely following appropriate processes and not taking shortcuts.

I encourage the SAPWG to take the necessary steps to study this issue further and give proposed substantive changes the appropriate attention they deserve.

Sincerely,

Matt Rosendale

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January 22, 2021

Mr. Dale Bruggeman, Chairman
Statutory Accounting Principles Working Group
National Association of Insurance Commissioners
1100 Walnut Street, Suite 1500
Kansas City, MO 64106-2197

RE: Items Exposed for Comment by the Statutory Accounting Principles Working Group on November 12, 2020 with Comments due January 22, 2021

Dear Mr. Bruggeman:

Interested parties appreciate the opportunity to comment on the exposure drafts released for comment by the NAIC Statutory Accounting Principles (E) Working Group (the Working Group). We offer the following comments:

INT 20-03: Troubled Debt Restructuring Due to COVID-19

This interpretation was effective for the specific purpose to address loan modifications in response to COVID-19. Consistent with the CARES act, this interpretation was only applicable for the term of the loan modification, but solely with respect to any modification, including a forbearance arrangement, interest rate modification, a repayment plan and other similar arrangement that defer or delays the payment of principal or interest for a loan that was not more than 30 days past due as of December 31, 2019. As determined in the CARES Act, this interpretation was originally only applicable for the period beginning on March 1, 2020 and ending on the earlier of December 31, 2020, or the date that was 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.

On December 27, 2020, President Trump signed into law the *Consolidated Appropriations Act, 2021,* which slightly modified and extended the original CARES Act. These modifications included extending the provisions for temporary relief from troubled debt restructurings. Accordingly, on January 6, 2021, the provisions in this INT were tentatively extended to be applicable through the earlier of January 1, 2022 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 terminates. With this extension, this INT's effective date corresponds with the current effective dates of the CARES Act. Unless the outbreak under the National Emergencies Act terminates, this INT will automatically expire on January 2, 2022 (to include year-end 2021 financial statements reporting).

Interested parties support the continued consistency with the Cares Act.

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

This interpretation was originally effective for the specific purpose to provide practical expedients in assessing whether modifications in response to COVID-19 are insignificant under SSAP No. 36 and in assessing whether a change is substantive under SSAP No. 103R. This interpretation 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. For clarity, this effective timeframe specifies when modifications in response to COVID-19 can be incorporated using the provisions of this interpretation. Once incorporated, the provisions of this interpretation will continue for the duration of the modification.

On December 27, 2020, President Trump signed into law the *Consolidated Appropriations Act, 2021,* which slightly modified and extended the original CARES Act. These modifications included extending the provisions for temporary relief from troubled debt restructurings. Accordingly, on January 6, 2021, the provisions in this INT were tentatively extended to be applicable through the earlier of January 1, 2022 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 terminates. With this extension, this INT's effective date corresponds with the current effective dates of the CARES Act. Unless the outbreak under the National Emergencies Act terminates, this INT will automatically expire on January 2, 2022 (to include year-end 2021 financial statements reporting).

Interested parties support the continued consistency with the Cares Act.

Ref #2019-24: Levelized and Persistency Commission

On November 12, 2020, the Working Group held a hearing to receive comments and based on those comments, took the following actions:

- Re-exposed the prior version of SSAP #71 with certain edits: – (1) the proposed effective date of Jan.1, 2021 was changed to be <u>effective upon adoption</u>, and (2) the revised text made explicit that the proposed revisions will apply to contracts in effect as of the date of adoption.

- Determined that the revisions to SSAP #71 met the due process for either a substantive or a non-substantive revision but concluded to keep the revision classified as nonsubstantive. The Working Group reiterated that it is not the impact of a change on an individual entity that determines whether a change is substantive or non-substantive, but whether the revision is in line with the original intent of the SSAP. The Working group noted that this is a clarification of existing guidance consistent with original intent. (Commissioner Donelon noted an objection to the classification as non-substantive.)

- Directed NAIC Staff to draft an Issue Paper to document the discussion on this topic for historical purposes.

Interested parties would like to again thank the Working Group for the opportunity to continue to comment on the most recent revisions to exposure Ref #2019-24 – Levelized and Persistency Commission (SSAP No. 71, Policy Acquisition Costs and Commissions) discussed on November 12, 2020 (the "Exposure").

These comments begin with industry comments regarding the Working Group's most recent revisions to the Exposure:

Paragraph #5 new comments pertain to the sentence below:
Having a third party pay commission costs to the selling agent is strong evidence of a potential funding arrangement which shall be recognized as a liability because the substance of the arrangement indicates that repayment is reasonable and probable, even if a contingency has been incorporated into the funding arrangement, until ~~unless~~the underlying policy has been cancelled.

The Working Group has made a change to the last phrase of this sentence that still does not provide clarity as to its meaning and to the sentence as a whole. Assuming that the phrase refers to the contingency noted in the previous phrase within the sentence, industry disagrees with wording that creates a blanket statement across all third-party agreements with regard to recognizing a liability similar to a funding agreement. During the entire exposure/revision process, interested parties has consistently stated that agreements which include traditional elements such as persistency as part of a legally binding commission contract should be excluded from the funding agreement treatment as was provided in the original (current) SSAP No. 71 wording. If the last phrase "until the underlying policy has been cancelled" pertains to the recognition of the liability, it seems that the wording does not contemplate even a partial repayment of the liability during the period when the policy is active.

Paragraph #7 new comments pertain to the following:
The nonsubstantive revisions adopted TBD date regarding levelized commission are to clarify the original intent of this statement and apply to existing contracts ~~are effective~~ in effect on the date of adoption of the revisions ~~January 1, 2021~~.

Industry has consistently maintained that there has been a long-standing industry practice to link third party contracts to insurance elements such as persistency, including commission arrangements, reinsurance contracts, etc. Removing this link as has been indicated in the

Working Group revisions is a substantive change. As such, we do not agree with the language in paragraph #7 that calls the revisions nonsubstantive and we disagree that such changes should be put in effect immediately upon adoption since they are substantive in nature and require further evaluation.

Certain of the third-party contracts noted above are complex and not quite as simple as the description of levelized commissions in the most recent draft of the Exposure. The Exposure depicts a simple arrangement whereby the insurer repays a third party over time, with interest, for making upfront heaped commissions to agents. This does not consider, for example, certain third-party contracts for which the insurer pays the third-party trail commissions based upon account value in-force in exchange for performing many contractual agency services other than simply funding and making upfront payments to selling agents. Such complex contracts require sufficient time to allow insurers to work with their state of domicile to determine the correct application of the revised guidance with respect to contracts which the regulator has already approved. Then, if establishment of a liability is indeed required, additional time would be necessary to calculate such an accrual and review with external auditors prior to reporting the change on a quarterly or annual statement. For these reasons, and as you suggested, Chairman Bruggeman, we propose that the revisions within the Exposure be adopted with an effective date no sooner than 12/31/21.

Comments previously made on existing revisions included for purposes of documentation:

Paragraph #4, most recent exposure:

4. Levelized commissions occur in situations where agents receive normal (non-level) commissions with payments made by a third party. It is intended, but not necessarily guaranteed, that the amounts paid to the agents by the third party would ultimately be repaid (with interest explicit or implied) to the third party by levelized payments (which are less than the normal first year commissions but exceed the normal renewal commissions) from the reporting entity. (Note: levelized repayments made by the reporting entity extend the repayment period but might not be a straight-line repayment.) These transactions are, in fact, funding agreements between a reporting entity and a third party, regardless of how the payment to the third party is characterized. The continuance of the stream of payments specified in the levelized commission contract is a mechanism which attempts to bypass recognition of those expenses which are ordinarily charged to expense in the first year of the contract. Consequently, the normal link between the persistency of the policy, the continuance of the premium payment or the maintenance of the agent's license with the reporting entity is not maintained with respect to the payment stream.

Paragraph #4, most recent exposure with highlighted edits:

4. Levelized commissions occur in situations where agents receive normal (non-level) commissions with
payments made by a third party. It is intended, but not necessarily guaranteed, that the amounts paid to the agents by the third party would ultimately be repaid (with interest explicit or implied) to the third party by levelized payments (which are less than the normal first year commissions but exceed the normal renewal commissions) from the reporting entity over time. (Note: levelized repayments made by the reporting entity ~~extend the repayment period~~ but might not be

a straight-line repayment.) In instances where the levelized commission is not tied to, or contingent upon, traditional elements such as policy persistency or premium payments, these transactions are, in fact, funding agreements between a reporting entity and a third party, ~~regardless of how the payment to the third party is characterized~~ when the contract between the reporting entity and the third party has no substance but to defer commission payments by the reporting entity. The continuance of the stream of payments specified in the levelized commission contract in these situations is a mechanism ~~which attempts~~ to bypass recognition of those expenses which are ordinarily charged to expense in the first year of the contract. Consequently, the normal link between the persistency of the policy, the continuance of the premium payment or the maintenance of the agent's license with the reporting entity is not maintained with respect to the payment stream.

Industry proposes to replace a large section of paragraph #5, including the Working Group recent revisions, with more concise language that expresses the need to establish a liability when an arrangement is in substance a funding agreement. The current revisions are lengthy and somewhat redundant. Industry continues to disagree with the current revisions which too broadly state that all third-party arrangements, even those with traditional insurance elements, are considered funding arrangements. Industry retained the concept of the link between the accrual of commissions and traditional elements such as policy persistency.

Excerpt from paragraph #5, most recent exposure requested to be deleted:
~~Arrangements that use a third party to pay agents who write policies for the reporting entity and the insured can be an attempt to de-link the relationship between the insurer and those agents and defer or levelize the acquisition commissions. The insurance reporting entity is required to recognize the full amount of earned commission costs to the direct policy writing agents even if those costs are paid indirectly to the agents by a third party through the use of levelized commission, or similar arrangement, which is in substance a funding arrangement. Having a third party pay commission costs to the selling agent is strong evidence of a potential funding arrangement which shall be recognized as a liability because the substance of the arrangement indicates that repayment is reasonable and probable, even if a contingency has been incorporated into the funding arrangement, until the underlying policy has been cancelled. A third-party structure cannot recharacterize (e.g. by referencing policy persistency) and delay recognition of liabilities for initial sales commission owed from the writing of policies regardless of how a third-party arrangement is structured with regards to the timing of payment from the insurer. The amount owed for full initial sales commission shall be recognized immediately as the writing of an insurance contract is the event that obligates the insurer, and such action shall occur consistently among insurers. As such, this recognition is required regardless if the insurer owes a selling agent directly or if a third-party has been contracted to provide payment to the selling agent.~~

Interested parties highlighted wording to replace the above excerpt from paragraph #5:
The reporting entity is required to recognize the full repayment amount of earned commission costs by the direct policy writing agents even if those costs are paid indirectly by a third party through the use of levelized commission, or similar arrangement, which is in substance a funding arrangement. Recognition of those commission costs and recording a liability is required in such arrangements that are not linked to or contingent upon traditional elements. Such treatment shall

occur consistently among insurers.

Summary:

Since its initial exposure in August 2019, industry has had concerns with the substantive nature of the proposed revisions and has consistently expressed these concerns.

- The last paragraph of the current SSAP No. 71 states: “The use of an arrangement where commission payments are not linked to traditional elements such as premium payments and policy persistency, but rather are linked to the repayment of an advance amount requires the establishment of a liability for the full amount of the unpaid principal and accrued interest which is payable to a third party related to levelized commissions.” This wording was revised to instead explicitly include arrangements linked to traditional elements with those that have no substance other than to link to the repayment of an advance amount. This is clearly a substantive change and not clarifying the original intent. It is a change to the intent.

- The current revisions require the accrual of a liability in situations that are inconsistent with the guidance SSAP No. 5R. Under a levelized commission program a third party has the obligation for the full initial sales commission. The insurer’s obligation under a levelized commission program that incorporates persistency should be accrued to the extent of legally contracted amounts owed. We do not believe the original intent of the SSAP required accruing for amounts that are not yet due and that may never be due. We strongly feel that the recognition of an obligation based on persistency is in accordance with the principles of SSAP 5R.

- The interpretation of SSAP No.71 that persistency is the obligating event for accrual of the levelized/persistency commissions is long standing industry practice that has been subject to both independent audits and state insurance department examinations without this interpretation being raised as an issue nor requiring adjustments to the companies’ financial statements.

- The current proposed language does not address the many varying product/distribution compensation arrangements in the industry and interested parties continue to believe this will cause unintended consequences.

- The existing SSAP No. 71 guidance is consistent in the application of persistency being part of the transfer of the risk(liability) to another party. If the lapse risk(persistency) is transferred to another party, the liability that the insurance company may have is also transferred to that party and the insurance company has no liability. Removing persistency as a factor in the accrual of commissions is a dangerous precedent. The differentiation between commissions based on real insurance risks versus payments based solely upon the passage of time in SSAP No. 71 goes directly to the risk transfer issue of one type of level commissions versus another. The proposed additional language eliminates this differentiation.

<u>Conclusion</u>:

Industry continues to maintain that the revisions exposed have changed the original intent of SSAP No. 71 and do not believe that they are nonsubstantive. Removing insurance elements from the determination of obligating events of third-party commission contracts may set a precedent that will have significant unintended consequences. As such, interested parties request that the Working Group consider these comments and proposed revisions. In addition, we request that this exposure be categorized as substantive, and given due process and an effective date.

Ref #2019-34: Related Parties, Disclaimers of Affiliation and Variable Interest Entities

The Working Group exposed this agenda item, with detailed revisions to SSAP No. 25, as detailed in a draft labeled with the date of November 12, 2020.

That draft contained proposed revisions intended 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.

On December 10, 2020, some members of interested parties and NAIC staff had a conference call to discuss the November 12th draft and possible edits to address concerns that the draft unintentionally impacted passive investments held by insurers in addition to investment in insurers. Staff amended the draft to address these concerns and is taking the updated draft back to the Working Group for its consideration.

Interested parties thank the staff for meeting with industry and in working to address our concerns.

Ref #2020-22: Accounting for Perpetual Bonds

The Working Group exposed revisions to *SSAP No. 26R—Bonds* to clarify that perpetual bonds are within scope as a "bond," and shall apply the yield-to-worst concept. Additionally, perpetual bonds that do not possess or no longer possess a call feature shall follow fair value reporting.

Interested parties appreciated the opportunity to work directly with NAIC staff on this topic. After reviewing the modified proposal, we have one remaining comment, which has already been discussed with NAIC Staff. In paragraph 9, the proposal reads as follows:

> "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."

We recommend the language be "fine-tuned" as it implies those with a remaining premium would be amortized to the next effective call date. The language regarding amortization should be aligned with other bonds and reference the use of the yield to worst method, not the next effective call date. We suggest the following wording:

> "New footnote: For perpetual bonds with an effective call option, any applicable premium shall be amortized utilizing the yield-to-worst method."

Ref #2020-32: SSAP No. 26R - Disclosure Update

The Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to *SSAP No. 26R—Bonds* to expand the called bond disclosures to also include bonds terminated early through a tender offer.

Interested parties have no comments on this item.

Ref #2020-33: SSAP No. 32R – Publicly Traded Preferred Stock Warrants

The Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to *SSAP No. 32R—Preferred Stock* and *SSAP No. 86—Derivatives* to scope publicly traded preferred stock warrants into SSAP No. 32R with accounting at fair value.

Interested parties have no comments on this item.

Ref #2020-34: SSAP No. 43R – Government-Sponsored Enterprises – Credit Risk Transfer Transactions

The Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to *SSAP No. 43R—Loan-Backed and Structures Securities* to incorporate 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 of SSAP No. 43R when a REMIC structure is used in the STACR program or CAS program.

Interested parties have no comments on this item.

Ref #2020-35: SSAP No. 97 – Audit Opinions

The Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed this agenda item with a request for comments on the extent in which situations exist that hinder admittance of 8.b.iii. entities due to the inability to quantify a departure from U.S. GAAP.

Interested parties is not aware of any situations 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 #2020-37: Separate Account – Product Identifiers

The Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed 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 in the separate account. Particularly, this is requesting feedback on how to obtain increased product identifier reporting granularity in question 1.01 (product mix) of the separate account general interrogatories (GI 1.01). Additionally, feedback is requested regarding if a threshold should be established for when aggregate reporting would be permitted.

In response to the solicitation of feedback on additional product identifiers specifically for PRT and RILA transactions in the Separate Account General Interrogatories, the ACLI suggests adding a PRT and RILA product identifier. See example identifiers in bold:

1	Not Registered with SEC		
Product Identifier	2 Private Placement Variable Annuity	3 Private Placement Life Insurance	4 Other (Not PPVA or PPLI)
Pension Risk Transfer Group Annuities			
All Other Group Annuities			
Registered Index Linked Annuities Individual Annuities			
All Other Individual Annuities			
Life Insurance			
Totals			

The addition of these identifiers would bifurcate out PRT and RILA transactions. Further, the use of these additional identifiers would show in General Interrogatory 1.01 if there were guarantees associated with these different products.

Ref #2020-38: Pension Risk Transfer – Separate Account Disclosure

The Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed the agenda item to solicit comments from state insurance regulators and industry regarding possible modifications to *SSAP No. 56—Separate Accounts* specific to pension risk transfer (PRT) products. 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.

Pension risk transfer transactions differ from other separate account transactions in that PRT products are group products, not individual products. The American Council of Life Insurers believes that these differences are adequately addressed in the current disclosure requirements of SSAP No. 56 – Separate Accounts. Specifically, paragraphs 31c and 33a include disclosure requirements for products with guarantees, which may include PRT transactions. Further, these disclosure requirements extend to the General Account Annual Statement Note 35B. Additionally, the proposal above on Ref# 2020-37 will provide additional detail for PRT products in the General Interrogatories.

We believe that the current disclosures sufficiently capture PRT transactions however, we defer to the Working Group and regulators if these groups voice concern that they are not able to discern something specific.

Ref #2020-39: Interpretation Policy Statement Updates

The Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to *NAIC Policy Statement on Maintenance of Statutory Accounting Principles* in *Appendix F—Policy Statements* regarding the issuance and adoption of accounting interpretations.

Based upon interested parties' discussion with NAIC staff and our understanding of the objective of the changes to *NAIC Policy Statement on Maintenance of Statutory Accounting Principles* in *Appendix F—Policy Statements* (Appendix F), we've marked up Appendix F with edits that clarify the policy for issuing interpretations which amend, supersede, or conflict with existing SSAPs (please see attached). Specifically, the interested parties' proposed revisions clarify that such interpretations are temporary and restricted to circumstances requiring immediate, temporary guidance such as catastrophes or other emergencies. We believe the marked Appendix F is consistent with the intent to use interpretations in limited circumstances. Our proposed revisions explicitly establish that interpretations are not intended as a shortcut to bypass the deliberative process for amending existing statutory accounting guidance or developing new guidance.

Ref #2020-40: Clarification of Prescribed Practices

The Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed 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 audit requirements.

Interested parties are concerned that the discussion of prescribed and permitted practices in this proposal are likely to cause confusion. An insurer's annual and quarterly statutory statements that are filed with the state of domicile and all states the insurer is licensed are prepared in accordance with the accounting practices prescribed or permitted by the state of domicile. However, in addition to the financial statements required by the domiciliary state, a non-domiciliary state in which the company is licensed may require an insurer to file supplemental financial information that require or allow the use of different accounting practices in the supplementary filing than provided in the AP&P manual. We believe the proposal should be amended to clarify that 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) in such **supplemental financial information** that is different from NAIC SAP, that practice(s) is also considered a prescribed practice. We recommend changes to the proposed wording to clarify these points (please see attached).

Ref #2020-41: ASU 2020-06 - Convertible Instruments

The Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets*, *SSAP No. 72—Surplus and Quasi-Reorganizations* and *SSAP No. 86—Derivatives*, 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.

Interested parties have no comment on this item.

Ref #2020-42: *ASU 2020-07 - Presentation and Disclosures by Not-for-Profit Entities*

The Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed 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.

Interested parties have no comment on this item.

*   *   *

Thank you for considering interested parties' comments. If you have any questions in the interim, please do not hesitate to contact us.

Sincerely,

D. Keith Bell   Rose Albrizio

cc: NAIC staff
Interested parties

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

Issue: Interpretation Policy Statement Updates

Check (applicable entity):

	P/C	Life	Health
Modification of Existing SSAP	☒	☒	☒
New Issue or SSAP	☐	☐	☐
Interpretation	☐	☐	☐

Description of Issue: This agenda item proposes edits to Appendix F of the *NAIC Policy Statement on Maintenance of Statutory Accounting Principles*, clarifying the requirements regarding the issuance and adoption of accounting interpretations.

Existing Authoritative Literature:

NAIC Policy Statement on Maintenance of Statutory Accounting Principles (Appendix F) documents the requirements of interpretation issuances and adoptions.

Development of Interpretations to SSAPs and Referencing Interpretations Within SSAPs

9. Interpretations will be developed to address, but will not be limited to issues requiring timely application or clarification of existing SAP, which shall not amend, supersede or conflict with existing, effective SSAPs. Issues being considered as an interpretation must be discussed at no less than two open meetings. (Original introduction of the issue when the Working Group identifies the intent to address the issue as an "interpretation" during a public discussion is considered the first open meeting discussion.) The process must allow opportunity for interested parties to provide comments, but as interpretations are intended to provide timely responses to questions of application or interpretation and clarification of guidance, no minimum exposure timeframe is required.

10. The voting requirement to adopt an interpretation is a simple majority. As interpretations do not amend, supersede or conflict with existing SSAP guidance, the interpretation is effective upon Working Group adoption unless specifically stated otherwise. The Working Group shall report the adopted interpretation to the Task Force as part of its public report during the next NAIC national meeting (or earlier if applicable). Interpretations can be overturned, amended or deferred only by a two-thirds majority of the Task Force membership.

11. In rare circumstances, the Working Group may adopt an interpretation which creates new SAP or conflicts with existing SSAPs. Historically, these interpretations temporarily modified statutory accounting principles and/or specific disclosures were developed in response to nationally significant events (e.g., Hurricane Sandy, September 11, 2001). In order to adopt an interpretation that creates new SAP or conflicts with existing SSAPs, the Working Group must have 67% of its members voting (10 out of 15 members) with a super majority (7 out of 10, 8 out of 11 or 12, 9 out of 13, 10 out of 14, or 11 out of 15) supporting adoption. These interpretations can be adopted, overturned, amended or deferred only by a two-thirds majority of the Task Force membership.

12. As new SSAPs are developed, it is essential to review and, if necessary, update the status of interpretations related to SSAPs that are being replaced and/or new SSAPs being developed. The following options are available to the Working Group when a SSAP with existing interpretations is replaced:

a. **Interpretation of the new SSAP -** If the Working Group would like to maintain the interpretation, the new SSAP can be added to the list of statements interpreted by the interpretation. In addition, the status section of the new SSAP will list the interpretation number next to the heading "Interpreted by."

b. **Nullification** - When an interpretation is nullified by a subsequent SSAP or superseded by another interpretation, the interpretation is deemed no longer technically helpful, is shaded and moved to Appendix H (Superseded SSAPs and Nullified Interpretations), and the reason for the change is noted beneath the interpretation title. The status section of the SSAP describes the impact of the new guidance and the effect on the interpretation (for example, nullifies, incorporated in the new SSAP with paragraph reference, etc.).

c. **Incorporation** - When an interpretation is incorporated into a new SSAP, the Working Group can choose from the following two options:

i. If the interpretation only interprets one SSAP, then the interpretation is listed as being nullified under the "affects" section of the SSAP and is not referenced under the "interpreted by" section of the status page of the SSAP.

ii. If the interpretation references additional SSAPs, and the Working Group intends to maintain the guidance, the interpretation is unchanged (no nullification). The new SSAP (Summary of Issue section) reflects that the interpretation issue has been incorporated into the new statement.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): None

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

Convergence with International Financial Reporting Standards (IFRS): N/A

Staff 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.

Development of Interpretations to SSAPs and Referencing Interpretations Within SSAPs

Interpretations which DO NOT amend, supersede, or conflict with existing SSAPs

9. Interpretations ~~will~~ may be developed to address~~, but will not be limited to~~ issues requiring timely application or clarification of existing SAP, which shall not amend, supersede or conflict with~~ existing,~~ effective SSAPs. Issues being considered as an interpretation must be discussed at no less than two open meetings. (Original introduction of the issue when the Working Group identifies the intent to address the issue as an "interpretation" during a public discussion is considered the first open meeting discussion.) The process must allow opportunity for interested parties to provide comments, but as interpretations are intended to provide timely responses to questions of application or interpretation and clarification of guidance, no minimum exposure timeframe is required.

10. ~~The voting requirement to adopt an interpretation is a simple majority.~~ As these interpretations do not amend, supersede or conflict with existing SSAP guidance, the interpretation is effective upon Working Group adoption~~,~~ unless specifically stated otherwise. The voting requirement to adopt an interpretation of this type is a simple majority. The Working Group shall report the adopted interpretation to the Accounting Practice and Procedures (E) Task Force as part of its public report during the next NAIC national meeting (or earlier if applicable). Interpretations can be overturned, amended or deferred ~~only~~ by a two-thirds majority of the Task Force membership. For clarification, a two-thirds majority of the Task Force requires two-thirds of the entire Task Force membership, not just those electing to vote. Additionally, interpretations

can be overturned, amended, deferred, or referred to either the Task Force and/or the Working Group by a simple majority of the Financial Condition (E) Committee.

Interpretations which amend, supersede, or conflict with existing SSAPs

11. In ~~rare~~ certain circumstances such as catastrophes or emergencies requiring immediate, temporary statutory accounting guidance, the Working Group may adopt an interpretation which creates a new SAP or conflicts with existing SSAPs. Historically, these interpretations temporarily modified statutory accounting principles and/or specific disclosures were developed in response to nationally significant events (e.g., Hurricane Sandy, September 11, 2001). Interpretations that conflict with existing SSAPs shall be temporary guidance and restricted to circumstances arising from the need to issue guidance for circumstance requiring immediate, temporary guidance. In order to adopt an interpretation that creates new SAP or conflicts with existing SSAPs, the Working Group must have 67% of its members voting (10 out of 15 members) with a super majority (7 out of 10, 8 out of 11 or 12, 9 out of 13, 10 out of 14, or 11 out of 15) supporting adoption.

a. These interpretations are effective upon Working Group adoption, unless stated otherwise, and shall be reported to the Accounting Practice and Procedures (E) Task Force as part of its public report during the next NAIC national meeting (or earlier if applicable). In circumstance where the Working Group adopts an interpretation (which creates new SAP or conflicts with existing SSAPs) that is controversial in nature (i.e., due to regulator or industry feedback or could have a policy level impact), 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.

b. These interpretations can be ~~adopted~~ overturned, amended or deferred by a two-thirds majority of the Task Force membership. For clarification, a two-thirds majority of the Task Force requires two-thirds of entire Task Force membership, not just those electing to vote. Additionally, interpretations can be overturned, amended, deferred, or referred to either the Task Force and/or the Working Group by a simple majority of the Financial Condition (E) Committee.

Staff Review Completed by: Jim Pinegar, NAIC Staff – August 2020

Status:
On November 12, 2020, the Statutory Accounting Principles (E) Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to *NAIC Policy Statement on Maintenance of Statutory Accounting Principles* in *Appendix F—Policy Statements* regarding the issuance and adoption of accounting interpretations, as illustrated above.

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

Issue: Clarification of Prescribed Practices

Check (applicable entity):

	P/C	Life	Health
Modification of Existing SSAP	☒	☒	☒
New Issue or SSAP	☐	☐	☐
Interpretation	☐	☐	☐

Description of Issue:
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. The AP&P Manual is not intended to preempt states' legislative and regulatory authority.

- 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, in addition to the financial statements required by the domiciliary state, a non-domiciliary state in which the company is licensed may require an insurer to file supplemental financial information that require or allow the use of different accounting practices in the supplementary filing than provided in the AP&P manual. ~~Ideally, t~~To prevent reporting entities from having to file ~~different~~ financial statements or reports prepared on different basis of accounting with differen~~ting~~ states, the practices permitted or prescribed by a domiciliary state will be accepted in all states in which a company is licensed. However, as noted above, the provisions of the AP&P Manual are not intended to preempt states' legislative or regulatory authority. Accordingly, each state in which a company is licensed could require supplemental financial information that requires or allows statutory accounting practices that differ from the AP&P manual. 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) in such supplemental financial information that is different from NAIC SAP, that practice(s) is also considered a prescribed practice. If the company files supplemental financial information that reflect this practice(s), even if the supplemental financial information is filed only in the non-domiciliary state, then the prescribed practice disclosure of Note 1 shall apply.

Examples of two possible situations:

Scenario 1: Non-domiciliary State A issues a state statute / bulletin that requires the filing of supplemental financial information and which requires the use of a prescribed accounting practice for all companies that are licensed and doing business within State A. Domiciliary State B does not issue a comparable state statute / bulletin.

Scenario 1 Conclusion: The reporting entity shall file statutory financial statements with their domiciliary state and the NAIC in accordance with the statutory accounting practices permitted or prescribed by the domiciliary state (State B). (These financial statements would be subject to the independent audit requirements per Model 205.) The reporting entity also shall file separate supplemental financial information with State A in accordance with the accounting practice mandated by that non-domiciliary state but shall include the prescribed practice disclosure of Note 1 in the supplemental financial information.

<u>Scenario 2:</u> Non-domiciliary State A issues a state statute / bulletin that <u>allows</u> an accounting practice for all companies that are licensed and doing business within State A. Domiciliary State B does not issue a comparable state statute / bulletin.

<u>Scenario 2 Conclusion</u>: The reporting entity shall file statutory financial statements with their domiciliary state and the NAIC in accordance with the statutory accounting practices permitted or prescribed by the domiciliary state (State B). (These financial statements would be subject to the independent audit requirements per Model 205.) The reporting entity <u>then has the ability, but is not required,</u> to <u>file supplemental financial information</u> in State A that reflects the accounting practice prescribed by that non-domiciliary state and <u>shall include the prescribed practice disclosure of Note 1 in the supplemental financial information</u>.

Existing Authoritative Literature:

Preamble

12. Codification is not intended to preempt state legislative and regulatory authority. While Codification is expected to be the foundation of a state's statutory accounting practices<u>, it may be subject to modification by practices prescribed or permitted by a state's insurance commissioner.</u> Statutory financial statements will continue to be prepared on the basis of accounting practices prescribed or permitted by the states. As a result, in 1998 the AICPA's Insurance Companies Committee determined that it will not be necessary for the Auditing Standards Board to grant the Codification status as an OCBOA since it will not be the sole basis for preparing statutory financial statements. <u>Further, auditors will be permitted to continue to provide audit opinions on practices prescribed or permitted by the insurance department of the state of domicile.</u>

Preamble Questions and Answers
Permitted Practices Advance Notification Requirement – Implementation Questions and Answers

2. Q: What is the difference between a permitted accounting practice and a prescribed practice?

A: **Permitted** accounting practices include practices specifically requested by an insurer that depart from NAIC Statutory Accounting Principles (SAP) and state prescribed accounting practices, as described below, and have received approval from the insurer's domiciliary state regulatory authority.

<u>**Prescribed** accounting practices are those practices that are incorporated directly or by reference by state laws, regulations and general administrative rules applicable to all insurance enterprises domiciled in a particular state</u>. The NAIC AP&P Manual is not intended to preempt states' legislative and regulatory authority.

If a reporting entity requests an accounting practice that differs from state prescribed accounting practices, but is in accordance with NAIC SAP, advance notice of approval is not required.

The NAIC Model laws do not contain a definition of "prescribed practice," but references to prescribed practices are noted in the Model laws below. These are provided as reference. There are no revisions proposed to the Model Laws:

<u>Model 205 – Annual Financial Reporting Model Regulation</u>

Section 6 - Designation of Independent Certified Public Accountant

B. The insurer shall obtain a letter from the accountant, and file a copy with the commissioner stating that the accountant is aware of the provisions of the insurance code and the regulations of the Insurance <u>Department of the state of domicile that relate to accounting and financial matters</u>

and affirming that the accountant will express his or her opinion on the financial statements in terms of their conformity to the statutory accounting practices prescribed or otherwise permitted by that Insurance Department, specifying such exceptions as he or she may believe appropriate.

Model 450 – Insurance Holding Company System Model Regulation with Reporting Forms and Instructions

Item 12. Financial Statements and Exhibits

The annual financial statements of the applicant shall be accompanied by the certificate of an independent public accountant to the effect that such statements present fairly the financial position of the applicant and the results of its operations for the year then ended, in conformity with generally accepted accounting principles or with requirements of insurance or other accounting principles prescribed or permitted under law. If the applicant is an insurer which is actively engaged in the business of insurance, the financial statements need not be certified, provided they are based on the Annual Statement of the person filed with the insurance department of the person's domiciliary state and are in accordance with the requirements of insurance or other accounting principles prescribed or permitted under the law and regulations of the state.

Model 785 – Credit for Reinsurance Model Law

Section 4. Qualified U.S. Financial Institutions

4.c. Maintains at least $250 million in capital and surplus when determined in accordance with the NAIC Accounting Practices and Procedures Manual, including all amendments thereto adopted by the NAIC, excluding the impact of any permitted or prescribed practices; and is

Model 787 – Term and Universal Life Insurance Reserve Financing Model Regulation

Section 6. The Actuarial Method

B. Valuation used for Purposes of Calculations

For the purposes of both calculating the Required Level of Primary Security pursuant to the Actuarial Method and determining the amount of Primary Security and Other Security, as applicable, held by or on behalf of the ceding insurer, the following shall apply: (1) For assets, including any such assets held in trust, that would be admitted under the NAIC Accounting Practices and Procedures Manual if they were held by the ceding insurer, the valuations are to be determined according to statutory accounting procedures as if such assets were held in the ceding insurer's general account and without taking into consideration the effect of any prescribed or permitted practices; and

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): None

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

Convergence with International Financial Reporting Standards (IFRS): Not Applicable

Staff 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. (NAIC staff do not believe revisions are necessary to paragraph 12 of the Preamble as that guidance does not limit practices to the domiciliary state and already confirms that the domiciliary state practices shall be reflected in the financial statements subject to audit. For reference paragraph 12 is below.)

12. Codification is not intended to preempt state legislative and regulatory authority. While Codification is expected to be the foundation of a state's statutory accounting practices, it may be subject to modification by practices prescribed or permitted by a state's insurance commissioner. Statutory financial statements will continue to be prepared on the basis of accounting practices prescribed or permitted by the states. As a result, in 1998 the AICPA's Insurance Companies Committee determined that it will not be necessary for the Auditing Standards Board to grant the Codification status as an OCBOA since it will not be the sole basis for preparing statutory financial statements. **Further, auditors will be permitted to continue to provide audit opinions on practices prescribed or permitted by the insurance department of the state of domicile**.

Proposed Revisions to the Preamble Questions and Answers:

2. Q: What is the difference between a permitted accounting practice and a prescribed practice?

A: **Permitted** accounting practices include practices specifically requested by an insurer that depart from NAIC Statutory Accounting Principles (SAP) and state prescribed accounting practices, as described below, and have received approval from the insurer's domiciliary state regulatory authority.

Prescribed accounting practices are those practices that are incorporated directly or by reference by state laws, regulations and general administrative rules applicable to all insurance enterprises domiciled and/or licensed in a particular state. The NAIC AP&P Manual is not intended to preempt states' legislative and regulatory authority. Prescribed accounting practices of the domiciliary state shall be reflected in the statutory financial statements filed with the NAIC. Non-domiciliary states may additionally require insurance entities licensed in their state to file **supplementary financial information that requires** or allows **the use of** different accounting practices in the **supplementary filing than provided in the AP&P manual**.

If a reporting entity requests an accounting practice that differs from state prescribed accounting practices, but is in accordance with NAIC SAP, advance notice of approval is not required.

Staff Review Completed by:
Julie Gann - NAIC Staff
July 2020

Status:
On November 12, 2020, the Statutory Accounting Principles (E) Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed proposed revisions to the Preamble Implementation Questions and Answers to clarify prescribed practices, as illustrated above. 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 audit requirements.

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Statutory Accounting Principles (E) Working Group

We have reviewed the revised proposed changes to SSAP No. 71 – Policy Acquisition Costs and Commissions as outlined in Ref. #2019-24. We continue to question several elements of the proposal and strongly object to the revisions for the following reasons:

1. This continues to be a substantive change to existing policy, contrary to the characterization in the published exposure draft.
2. The proposal continues to alter the fundamental premise of statutory accounting by creating a situation in which certain historically period expenses, trail commission payments, are to be treated differently from other period expenses by way of an accrual methodology, which leads to:
    a. A hybrid of statutory, GAAP and tax accounting.
    b. Fundamentally and permanently different economics for products designed with trail commission payments, leading to the need for significant effort at primary writers to redesign and/or reprice such products, presumably at a cost to the consumer.
    c. Guaranteed renewable products, like Long Term Care Insurance, could be exposed to further rate increases if the fundamental profit dynamics of the products change as a result of the new reserving practices.
    d. New uncertainty within the statutory accounting framework as to which other period expenses should also be accrued or might be targeted for similar treatment.
    e. A situation whereby trail commission expenses have a greater impact on statutory capital than other, similar expenses.
    f. A disincentive for primary writers to align the interests of the writer, broker/agent and policyholder through trail commissions because of the unique treatment and resulting capital implications.
3. Should the proposed changes be adopted, primary writers will be exposed to new and substantial accounting and actuarial workload relating to the determination of accrual methodologies for each affected product and the related periodic 'true-up' required to adjust the new statutory reserves for actual performance.
4. There is no apparent benefit for the consumer, primary writer, investment community, or regulatory bodies. The additional costs involved are highly restrictive and will likely cause either a decline in product offering or result in a higher cost to the consumer, which will ultimately curb the ability for the average person to save some of their earnings for retirement, children's schooling or other reason.
5. Moreover, there will be a material adverse impact on the RBC ratios of carriers utilizing legitimate third-party distribution structures, which may in some cases be material enough to affect carrier capital solvency.

ACADIA | Capital Solutions

We understand some have expressed concerns that related party structures have been put in place to achieve a deferral of commission expense, and understand that in such circumstances existing accounting rules may appropriately require that a liability should be established - but we continue to be of the view that existing accounting standards provide both the necessary guidance and basis for enforcement. In cases – like Acadia's carrier contracts - where a third-party licensed agent is involved and applies a trail commission to in-force policies only, there is no obligation to pay commissions until the anniversary date of the policy and therefore no reason to recognise a liability. The proposed change ignores both of these material elements – the involvement of a third party, and fact that an obligation does not arise until the anniversary date – and sweeps up these materially different arrangements in the same basket as related-party structures.

It is manifestly contrary to the public interest to pursue a change where:

- there is no clear benefit or public interest in favour of it;
- there is ample clarity and scope under existing accounting rules;
- there is material adverse impact on carriers;
- there is resulting adverse impact on the public through higher prices, reduced access, or both.

We urge the NAIC to reject this poorly conceived and clearly material change which is rife with unintended consequences, and instead rely on the proven ample scope under the existing SSAP 71 which has been in effect for decades.

cc: Julie Gann (jgann@naic.org), Robin Marcotte (rmarcotte@naic.org), Jim Pinegar (jpinegar@naic.org), Fatima Sediqzad (fsediqzad@naic.org), Jake Stultz (jstultz@naic.org)

Wayne Goodwin
former NC Insurance Commissioner (2009-2016)
8306 Wycombe Lane, Raleigh NC 27615
Email gwaynegoodwin@gmail.com

To: **Dale Bruggeman, Chair**
Statutory Accounting Principles (E) Working Group
National Association of Insurance Commissioners (NAIC)

From: **Hon. Wayne Goodwin, former NC Insurance Commissioner**

Date: **January 19, 2021**

Re: **Comment Period / Revised Proposed Changes to SSAP No. 71 – Policy Acquisition Costs and Commissions**

It has come to my attention that the Statutory Accounting Principles (E) Working Group is accepting comments pertaining to the Revised Proposed Changes to SSAP No. 71 – Policy Acquisition Costs and Commissions.

Although I concluded my service as NC Insurance Commissioner four years ago, I served eight (8) years in that office and an additional four (4) years as Assistant Commissioner, for a total of 12 years as a state insurance regulator. During that time, I also served on the NAIC Executive Committee and as Vice Chair of the Southeast Zone. Further, I have experience both as a state legislator (8 years) and licensed attorney (28 years). To the best of my ability, I have remained aware of many contemporary issues, proposals, and agenda items before the NAIC and its various committees and working groups.

Before the comment period closes, I want to restate the compass points of my tenure as well as that of my predecessor, the late great Jim Long: (1) Consumer protection and (2) fair, stable, reasonable regulation of the insurance market. Paramount, first and foremost of course, is consumer protection.

Today I submit my comment *in opposition* to the revised proposed changes to SSAP No. 71 based on the following:

SSAP 71 has been in place approximately 30 years and, by most accounts of which I am familiar, it has worked well.

It is my understanding that during those three decades such levelized commission programs have gone through multiple official examinations by insurance regulators with few to no material issues having been noted.

To the best of my knowledge presently, there has been no policyholder peril, fraud, or company financial impairment by using the current version of SSAP 71. Accordingly, existing rules have apparently worked as intended.

The revised changes have been described as non-substantive but upon analysis by other current and past state insurance regulators whom I respect and trust, whose comments in opposition or expressing concern are incorporated by reference, and upon my own review, it is more evident that the proposal is, in fact, *substantive* – in part because the current proposal will apparently cause unnecessary financial damage to some carriers and their policyholders because rating agencies would consequently and unnecessarily downgrade any impacted company due to a retroactive drop in surplus/RBC numbers.

Among other consumer concerns is this: This proposed new reserving practice could cause further, unnecessary rate increases for guaranteed renewable products like Long Term Care insurance.

Respectfully, acknowledging the above and consumer protection most of all, it appears that a more detailed, comprehensive study is necessary before further consideration of the revised proposal. More feedback will be particularly enlightening and will provide the best counsel on what direction – if any -- to take on the proposal.

# # #

cc: Julie Gann (jgann@naic.org), Robin Marcotte (rmarcotte@naic.org), Jim Pinegar (jpinegar@naic.org), Fatima Sediqzad (fsediqzad@naic.org), Jake Stultz (jstultz@naic.org)

Page 2 of 2

GUGGENHEIM

GUGGENHEIM LIFE AND ANNUITY COMPANY
401 PENNSYLVANIA PARKWAY
SUITE 300
INDIANAPOLIS, IN 46280

January 22, 2021

Mr. Dale Bruggeman, Chairman
Statutory Accounting Principles Working Group
National Association of Insurance Commissioners
1100 Walnut Street, Suite 1500
Kansas City, MO 64106-2197

RE: Ref #2019-24 Levelized and Persistency Commission

Dear Mr. Bruggeman,

Guggenheim Life and Annuity Company is writing to express our concern with the proposed changes to SSAP No. 71 set forth in agenda item *#2019-24: Levelized and Persistency Commission* ("2019-24"). There have been serious flaws in the exposure process, including the designation of the proposed change as "nonsubstantive", inconsistency regarding how to characterize the proposed changes, and a changing effective date.

Companies potentially impacted by 2019-24, in their attempt to provide input, have been aiming at a constantly moving target. 2019-24 has gone through several rounds of exposure, with significant variations to foundational aspects of the proposal, including how reporting entities should classify the proposed changes and the effective date of the proposed changes. The proposal has varied on the fundamental point of whether the change is a correction of error or change in accounting principle. Similarly, the effective date of the proposal has changed 3 times (from no effective date, to a January 1, 2021 effective date, to an "effective upon adoption" date).

We believe that a change to an accounting principle dating back to 1998 should be deemed a substantive change. The Statutory Accounting Principles Working Group has determined the process around 2019-24 has met the due process requirements of a substantive revision; however, we believe additional scrutiny and process should be given to this issue for several reasons. First, the proposed changes constitute a change to accounting principles that could have a significant impact on certain reporting entities. Second, decades of examinations and audits did not result in any objection to reporting entities' reporting of the commission arrangements at issue.[1] Third, companies have not harmed policyholders nor put themselves in financial impairment by reporting the way they have for decades. To us, this change in accounting principle seems like a punitive measure against a small number of companies that have been reporting these commissions a certain way for decades.

We appreciate the opportunity to comment on 2019-24 and believe regulators should continue to explore this issue and come to a reasonable solution.

Sincerely,

Ellyn M. Nettleton

Ellyn M. Nettleton
Chief Accounting Officer

cc: NAIC Staff

[1] Note also that a 2010 SEC complaint against a carrier explained that levelized commissions were a common practice in the insurance industry. There is no evidence in the complaint that the statutory accounting treatment was ever determined not to be in accordance with statutory accounting principles.

Atlantic Corporate Center
2317 Route 34, Suite 2B
Manasquan, NJ 08726
732-201-4133
CHIEF EXECUTIVE OFFICER: Thomas B. Considine

December 7, 2020

Dale Bruggeman
Chair
NAIC Statutory Accounting Principles (E) Working Group

Re: SSAP No. 71 - Policy Acquisition Costs and Commissions

Dear Chair Bruggeman & Members of the Working Group:

I write to you today on behalf and at the request of the elected leadership of the National Council of Insurance Legislators ("NCOIL")[1] regarding the NAIC's Statutory Accounting Principles Working Group's (WG) efforts to update SSAP No. 71 titled "Policy Acquisition Costs and Commissions." Without delving deeply into the specifics of the principle itself, with which you are well-versed, NCOIL has significant concerns about it. We note that SSAP No. 71 has been in effect since 1998, and inquire why, after 22 years, there needs to be a rush to implementation of this proposal for year-end?

Additionally, our members have heard differing opinions as to whether the proposed changes are substantive or non-substantive. Candidly, when NCOIL's legislators start to hear of substantive changes being made via a handbook or manual, it creates tension because it brings to mind the debate surrounding incorporation by reference (IBR) for substantive matters. Beyond this impairment of the legislative prerogative, I must note that there is a constitutional provision in California stating that no law shall be enacted except by statute and no statute except by bill.

Regardless of the determination on substantive vs non-substantive here though, there seems to be little debate that these changes could have a material and perhaps significant impact on insurers

[1] *NCOIL is a national legislative organization with the nation's 50 states as members, represented principally by legislators serving on their states' insurance and financial institutions committees. NCOIL writes Model Laws in insurance and financial services, works to preserve the State jurisdiction over insurance as established by the McCarran-Ferguson Act seventy-five years ago, and to serve as an educational forum for public policymakers and interested parties. Founded in 1969, NCOIL works to assert the prerogative of legislators in making State policy when it comes to insurance and educate State legislators on current and longstanding insurance issues.*

if adopted. If the impact is as large as some have told us, and we have heard of impacts as high as 30% of risk-based capital (RBC), it strikes NCOIL as quite bad timing to implement such changes as the entire global economy is suffering during this global pandemic. A number of companies from several states have advised us that the impact on their capital will be so great that these now-healthy companies would fall below the RBC regulatory action level if this change were to be implemented.

One of our most senior leaders has asked us, and we in turn ask you, if a solvent & healthy insurance carrier has been accounting for commissions in error due to a misunderstanding of SSAP No. 71, and the proposed change to SSAP No. 71 threatens to render that insurer insolvent, then is the proposed change really meeting its intent? It certainly would seem to fly in the face of the number one priority of the state regulatory system.

Accordingly, NCOIL requests and recommends that the WG delay implementation of the proposal until such time that staff completes the issue paper it is charged with drafting on the classification of the proposal. Moreover, NCOIL requests and recommends that in any case or at any point if the WG determines to move forward with the proposal, it be subject to a five year phase-in period in order to allow companies to maintain their health, soundness and solvency as the capital impact of the "clarification" to SSAP No. 71 takes effect.

On behalf of our member legislators, I thank you for your consideration of this matter.

Very truly yours,

Thomas B. Considine
Chief Executive Officer
NCOIL

cc:

The Honorable Matt Lehman
Indiana Representative
NCOIL President

The Honorable Ken Cooley
California Assemblyman
NCOIL Vice President

The Honorable Kevin Cahill
New York Assemblyman
NCOIL Treasurer

The Honorable Joe Fischer
Kentucky Representative
NCOIL Secretary

The Honorable Jason Rapert
Arkansas Senator
NCOIL Immediate Past President

The Honorable Travis Holdman
Indiana Senator
NCOIL Immediate Past President

The Honorable Ray Farmer
NAIC President
Director
South Carolina Department of Insurance

The Honorable David Altmaier
NAIC President-Elect
Commissioner
Florida Office of Insurance Regulation

The Honorable Dean Cameron
NAIC Vice President
Director
Idaho Department of Insurance

The Honorable Chlora Lindley-Myers
NAIC Secretary-Treasurer
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February 24, 2021

Mr. Dale Bruggeman, Chairman
Statutory Accounting Principles Working Group
National Association of Insurance Commissioners
1100 Walnut Street, Suite 1500
Kansas City, MO 64106-2197

RE: Ref #2020-36, Derivatives Hedging Fixed Indexed Products

Dear Mr. Bruggeman:

Interested parties would like to thank the Statutory Accounting Principles Working Group (SAPWG) for the opportunity to comment on the exposed 2020-36, Derivatives Hedging Fixed Indexed Products

The interested parties' response will be brief at this time as we continue our work reviewing the exposure, assessing the proposal and working on potential variances to the exposure.

Interested parties are committed to working with NAIC staff and SAPWG on this very complicated and important topic.

* * * * *

If you have any questions in the interim, please do not hesitate to contact us

Sincerely,

D. Keith Bell   Rose Albrizio

cc: Interested parties