Statutory Accounting Principles (E) Working Group
Meeting Agenda
March 15, 2021

A. Consideration of Maintenance Agenda – Pending List

1. Ref #2021-01: *ASU 2021-01, Reference Rate Reform*
2. Ref #2021-02: ASU 2020-08 – Premium Amortization on Callable Debt Securities
3. Ref #2021-03: SSAP No. 103R – Disclosures
4. Ref #2021-04: SSAP No. 97 – Valuation of Foreign Insurance SCAs
5. Ref #2021-05: Cryptocurrencies
6. Ref #2021-06EP: Editorial Updates
7. Ref #2021-07: ASU 2020-11 – Financial Services
8. Ref #2021-08: ASU 2021-02 – Franchisors Revenue from Contracts
9. Ref #2021-09: State ACA Reinsurance Programs

Ref #	Title	Attachment #
2021-01 **SSAP No. 86** **(Jim)**	***ASU 2021-01, Reference Rate Reform***	**A - Agenda** **B – INT 20-01**

Summary:
In March 2020, the Financial Accounting Standards Board (FASB) issued *ASU 2020-04, Reference Rate Reform (Topic 848) Facilitation of the Effects of Reference Rate Reform on Financial Reporting* to ensure the financial reporting of hedging relationships would reflect a continuation of the original contract and hedging relationship during the period of the market-wide transition to alternative reference rates. ASU 2020-04, which was adopted by the Working Group through interpretation 20-01, provides temporary, optional, and expedient relief in that a qualifying modification (because of reference rate reform) should not be considered an event that requires contract remeasurement at the modification date or reassessment of a previous accounting determination.

However, since the issuance of ASU 2020-04, the derivatives market continues to undergo various other transitions due to reference rate reform initiatives, specifically changing the reference rates used for margining, discounting, or contract price alignment (this change is referred to as a "discounting transition"). While these changes are related to reference rate reform, they are not modifying an interest rate that is expected to be discontinued (e.g., LIBOR).

Accordingly, in January 2021, FASB issued *ASU 2021-01, Reference Rate Reform* to clarify that all derivative instruments affected by changes to the interest rates used for discounting, margining or contract price alignment (regardless of whether they reference LIBOR or another rate that is expected to be discontinued as a result of reference rate reform) are in afforded the contract modification relief provided in ASU 2020-04. In short summary, ASU 2021-01 expands the scope of ASU 2020-04 by allowing an entity to apply the optional expedients, by stating that a change to the interest rate used for margining, discounting or contract price alignment for a derivative is not considered to be a change to the critical terms of the hedging relationship that requires dedesignation.

Recommendation:
NAIC staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose temporary (optional) expedient and exception interpretative guidance, with an expiration date of December 31, 2022. These optional expedients would expand the current exception guidance provided by *INT 20-01: ASU 2020-04 - Reference Rate Reform*. With this guidance, derivative instruments affected by changes to the interest rates used for discounting, margining or contract price

alignment (regardless of whether they reference LIBOR or another rate that is expected to be discontinued as a result of reference rate reform) would be in scope of INT 20-01. This exception would allow for continuation of the existing hedge relationship and thus not requiring hedge dedesignation.

Ref #	Title	Attachment #
2021-02 SSAP No. 26R (Jim)	**ASU 2020-08 – Premium Amortization on Callable Debt Securities**	**C**

Summary:
In October 2020, the Financial Accounting Standards Board (FASB) issued *ASU 2020-08, Codification Improvements to Subtopic 310-20, Receivables – Nonrefundable Fees and Other Costs* to clarify the amortization of premium associated with callable debt securities. In summary, ASU 2020-08 requires that to the extent the amortized cost basis of a callable debt security exceeds the amount repayable by the issuer, any associated premium (above the call price) is to be amortized to the next effective call price/date. For example, if a reporting entity held a bond at $104 in which could be called at $102 in a year, the $2 excess premium would be amortized over that particular year. Once amortized to $102, the reporting entity would then reassess for any excess premium to the next effective call price/date. If there is no remaining premium or further call dates, the effective yield is reset using the payment terms of the debt security.

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 reject ASU 2020-08 for statutory accounting. While ASU 2020-08 closely mimics existing guidance in SSAP No. 26R (amortizing applicable debt premium to the next effective call price), it does preclude statutory accounting's yield-to-worst concept, which requires amortizing premiums to the call or the maturity value/date in which produces the lowest asset value. There may be scenarios, for statutory accounting, in which premiums amortized to the maturity value/date will yield a lower asset value than simply amortizing applicable premium to the next effective call date (as is required in ASU 2020-08).

Ref #	Title	Attachment #
Ref #2021-03 SSAP No. 103R (Jim)	**SSAP No. 103R – Disclosures**	**D**

Summary:
This agenda item has been drafted to propose additional disclosures and to data-capture certain existing disclosure elements in *SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities.* The additional disclosures proposed herein are in response to the Working Group's continued deliberation of agenda item 2019-21: SSAP No. 43R – Equity Instruments. Agenda item 2019-21 is a substantive project to consider what investments fall within scope of *SSAP No. 43R—Loan-Backed and Structured Securities* and on Oct. 13, 2020, this project was expanded to include a review of the investments eligible for reporting on Schedule D-1: Long Term Bonds. During the continued work on this project, regulators expressed a desire to identify situations in which a reporting entity has entered into a securitization, asset-backed financing or similar transfer transaction where a significant economic interest in the transferred assets is retained by the reporting entity, its related parties or another member within the holding company group.

Recommendation:
NAIC staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive to 1) expose new disclosure elements and 2) propose data-capture templates for existing disclosures in *SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. A blanks proposal exposure is anticipated to occur concurrently with the Working Group's exposure. With inclusion of the data templates, narrative (pdf) reporting shall still occur to provide additional information regarding transfers accounted for as a sale when the transferor maintains continuing involvement in the transferred financial assets. The purpose of the data-capture templates is so regulators can perform system inquiries to identify which reporting entities have such transactions, at which time further analysis of the narrative disclosures can be performed.

Ref #	Title	Attachment #
Ref #2021-04 SSAP No. 97 (Fatima)	**SSAP No. 97 – Valuation of Foreign Insurance SCAs**	**E**

Summary:
In March 2020, agenda item 2018-26 – SCA Loss Tracking – Accounting Guidance adopted guidance in *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities* to state that reported equity method losses of an investment in a subsidiary controlled or affiliated entity (SCA) would not create a negative value in a SCA investment, thus equity method losses would stop at zero. However, the agenda item also clarified that to the extent there was a financial guarantee or commitment, it would require appropriate recognition under *SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets.* In November 2020, the Working Group adopted agenda item 2020-18 - SSAP No. 97 Update and removed a lingering, superseded reference regarding negative equity method loss valuations.

However guidance in SSAP No. 97 also requires specific adjustments to 8.b.ii (insurance related SCA) and 8.b.iv (foreign insurance SCA) entities. These long-standing adjustments require the non-admission of certain assets to achieve a limited statutory basis of accounting. The adjustments have typically been viewed as necessary in order to prevent assets being held by SCA receiving more favorable treatment than had the assets been held directly by the insurer. (e.g., requiring the nonadmittance of certain assets per *SSAP No. 20—Nonadmitted Assets*). Per SSAP No. 97, an equity method of accounting for 8.b.ii and 8.b.iv entities would be a beginning point which would then be adjusted by the provisions of SSAP No. 97, paragraph 9 (see "authoritative literature section"). It is important to note the outcome of these adjustments can result in a negative equity valuation of the investment. Again, this is so assets held by an SCA aren't reported at a higher value than had they been held directly by the insurer.

During the discussion of agenda item 2020-18, industry comments requested consideration of whether 8.b.iv entities should be subject to the provisions of SSAP No. 97, specifically that paragraph 9 adjustments may result in a negative equity valuation. While stating many positions, industry's primary response that foreign insurance operations are subject to foreign jurisdiction and should be allowed to stand independently of a domestic insurer – thus in the absence of a guarantee or commitment, equity valuation should not go negative and thus stop at zero. Comments were received from industry noted that the circumstances that would cause a foreign insurance reporting entity to record negative equity is not prevalent, however indicated the potential to arise in the future.

At the direction of the Working Group, NAIC staff have drafted this agenda item to determine if further edits to SSAP No. 97 are required, specifically if the required statutory adjustments to 8.b.iv entities should no longer be able to result in a negative equity valuation. In response to this direction, **NAIC staff reviewed all SCA filings for the last 3 years, noting that less than 7% of all SCA filings were 8.b.iv entities. It was further noted that there was not a single instance of an 8.b.iv in a negative equity situation.**

Recommendation:
Staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose the intent to move this item to the disposal listing without statutory edits. Per staff's review of SCA Sub 2 filings filed with an 8b(iv) valuation method, there were no noted instances of negative value SCAs, therefore we do not recommend revisions to the existing guidance. This exposure will allow industry to determine if they are aware of any prevalent examples of a negative equity valuation in a foreign insurance SCA (8.b.iv) and provide detailed information to NAIC staff for assessment.

NAIC staff highlights that if such an event (negative equity due to nonadmitted assets) were to actually occur at some point, and the company was to question whether the negative equity in the SCA should be reported, that this should be addressed directly with the state of domicile. With this approach, the domiciliary state would be able to assess the limited statutory edits that were performed, the extent to which assets are held in the SCA that would be nonadmitted if held directly by the insurer, and how the SCA obtained those assets.

Ref #	Title	Attachment #
Ref #2021-05 SSAP No. 2R (Jake)	**Cryptocurrencies**	**F - Agenda G - INT 21-01**

Summary:
NAIC staff have received several inquiries related to the statutory accounting treatment for cryptocurrencies, which are defined as a digital currency in which transactions are verified and records maintained by a decentralized system using cryptography, rather than by a centralized authority, such as the Federal Reserve System. These questions generally inquiry whether Bitcoin is permitted to be admitted, but a recent inquiry asked whether Bitcoin is captured in the cash definition within *SSAP No. 2R—Cash, Cash Equivalents, Drafts, and Short-Term Investments.*

For statutory accounting, cash is defined in SSAP No. 2R as a "medium of exchange that a bank or other similar financial institution will accept for deposit and allow an immediate credit to the depositor's account." **Cryptocurrencies do not meet this definition because these assets are not able to be deposited or exchanged with most U.S. banks and financial institutions**. NAIC staff are aware that this treatment is evolving and that in the future banks may accept cryptocurrencies in the same manner as true government-backed currencies, which could then meet the statutory accounting definition of cash. However, at this time, NAIC staff note that cryptocurrencies currently do not meet the definitions of cash equivalents, drafts, or short-term investments as they are defined in SSAP No. 2R.

Recommendation:
NAIC staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose the interpretative guidance provided by *INT 21-01T: Statutory Accounting Treatment for Cryptocurrencies*. This guidance clarifies that cryptocurrencies do not meet the definition of cash in *SSAP No. 2R—Cash, Cash Equivalents, Drafts, and Short-Term Investments* and are nonadmitted assets for statutory accounting.

With this exposure, the Working Group requests input from Interested Parties and the insurance company trade groups that follow the Working Group to gather information from their members on current ownership of cryptocurrencies. The Working Group requests information on:

1. Extent to which companies currently hold cryptocurrencies,
2. How the acquisition in cryptocurrency is held (held directly by the insurer or indirectly through an SCA),
3. Which cryptocurrencies they are acquiring in (Bitcoin, Ethereum, Litecoin, etc.), and

4. General level of interest for future acquisition by both companies that currently do and do not own cryptocurrencies.

Ref #	Title	Attachment #
Ref #2021-06EP Multiple (Jake)	**Editorial Updates**	**H**

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

- *SSAP No. 53—Property Casualty Contracts – Premiums* retitle to *SSAP No. 53—Property and Casualty Contracts – Premiums*.
- *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities* - corrects grammatical errors in paragraph 54.
- SSAP Glossary - Removes the footnote noted in title and replaces it as an opening paragraph with updated verbiage.

Recommendation:
NAIC staff recommends that the Working Group move this agenda item to the active listing, categorized as nonsubstantive, and expose the editorial revisions to SSAP No. 53, SSAP No. 97 and the SSAP Glossary.

Ref #	Title	Attachment #
Ref #2021-07 Appendix D (Jake)	***ASU 2020-11, Financial Services—Insurance: Effective Date and Early Application***	**I**

Summary:
FASB issued *ASU 2020-11, Financial Services—Insurance: Effective Date and Early Application*, which updates guidance on the effective date of the amendments in *ASU 2019-09, Financial Services – Insurance* and *ASU 2018-12, Targeted Improvements to the Accounting for Long-Duration Contracts* because of COVID-19. Both ASU 2019-09 and 2018-12 have previously been rejected for statutory accounting.

Recommendation:
NAIC staff recommends 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 2020-11, Financial Services—Insurance: Effective Date and Early Application* as not applicable for statutory accounting. This ASU was issued to only address the effective dates of ASU 2019-09 and ASU 2018-12, which were both previously rejected by the Working Group.

Ref #	Title	Attachment #
Ref #2021-08 SSAP No. 47 (Jake)	***ASU 2021-02, Franchisors—Revenue from Contracts with Customers***	**J**

Summary:
In January 2021, the Financial Accounting Standards Board (FASB) issued *ASU 2021-02, Franchisors—Revenue from Contracts with Customers (Subtopic 952-606)*, slightly amending the guidance which was issued in *ASU 2014-09, Revenue from Contracts with Customers*, as it relates to franchisors.

In 2018, the Working Group rejected the guidance in ASU 2014-09 and several other ASUs related to Revenue Recognition in *SSAP No. 47—Uninsured Plans*. Since 2018, all additional ASUs related to revenue recognition have been reviewed by NAIC staff and have been rejected for statutory accounting.

Recommendation:
NAIC staff recommends the Working Group move this agenda item to the active listing, categorized as nonsubstantive and expose revisions to reject ASU 2021-02 in *SSAP No. 47—Uninsured Plans*. This recommendation is consistent with how the prior ASUs related to Topic 606 have been treated.

Ref #	Title	Attachment #
Ref #2021-09 SSAP No. 107 (Robin)	**State ACA Reinsurance Programs**	**K**

Summary:
SSAP No. 107—Risk-Sharing Provisions of the Affordable Care Act provides guidance regarding the three Affordable Care Act (ACA) risk sharing programs known as risk adjustment, the transitional reinsurance program and risk corridors. All three programs were to assist with rate stabilization in the individual market. Risk adjustment was originally the only permanent program and the other two were temporary. Although the 2014-2016 transitional reinsurance program has ended, several states have received approval from the Department of Health and Human Services (HHS) to run similar state ACA reinsurance programs under what are known as Section 1332 waivers.

This agenda item is to provide accounting and reporting guidance regarding State ACA reinsurance programs being run under Section 1332 waivers. Note that states can seek Section 1332 waivers to address a variety of issues such as:

- Individual and employer mandates;
- Essential health benefits (EHBs);
- Limits on cost sharing for covered benefits;
- Metal tiers of coverage;
- Standards for health insurance marketplaces, including requirements to establish a website, a call center, and a navigator program; and
- Premium tax credits and cost-sharing reductions.

To date, most of the states that have sought 1332 waivers did so to implement state ACA reinsurance programs which have the goal of using the reinsurance programs to lower individual health insurance premium in the jurisdiction. As these programs seek to operate to cover higher individual health claims in a manner similar to the

transitional reinsurance program, the initial recommendation is to provide guidance that such state programs should follow the guidance in SSAP No. 107 to the extent the state program has similar terms.

The original transitional reinsurance program and the subsequent state ACA reinsurance programs are not reinsurance in the true sense. They typically rely on group products to help fund the program, but do not typically allow the group products to receive reinsurance distributions. Therefore the group products help fund the program but are not true participants. Because of this, a hybrid approach was incorporated into the SSAP No. 107 accounting guidance. A similar hybrid approach is recommended for state ACA reinsurance programs. At a high level this approach divides products into 3 broad categories. This includes:

1. Subject individual products (typically individual plans) that may pay an insurance contribution and are eligible to receive reinsurance distributions. These programs report like an involuntary reinsurance pool as is described in *SSAP No. 63—Underwriting Pools*.

2. Other insured health products (typically group plans) that are not eligible for reinsurance distributions under the terms of the state ACA reinsurance program. These products treat the amounts as assessments reported in taxes, licenses and fees similar to treatment under *SSAP No. 35R—Guaranty Funds and Other Assessments*.

3. Self-insured plans where the reporting entity is acting as an administrator, and will exclude the payments made on behalf of the self-insured plan from the reporting entity's operations, consistent with the guidance in *SSAP No. 47—Uninsured Plans*.

Recommendation:
NAIC Staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to SSAP No. 107 as illustrated below. These revisions would include State ACA reinsurance programs which are using Section 1332 waivers in the scope of *SSAP No. 107—Risk-Sharing Provisions of the Affordable Care Act*. The intent of the proposed accounting revisions is to continue to follow the SSAP No. 107 hybrid accounting approach for the state ACA programs as they operate in a similar manner.

In general, state ACA reinsurance programs provide funding to issuers in the individual market that incur high claims costs for enrollees. The programs often require assessments from issuers typically on behalf of group health plans. At a high level this hybrid accounting approach divides products into 3 broad categories. This includes:

a. Subject individual products (typically individual plans) that may pay a reinsurance funding contribution and are eligible to receive reinsurance distributions shall report similar to an involuntary reinsurance pool as described in *SSAP No. 63—Underwriting Pools*.

b. Other insured Health products (typically group plans) that are not eligible for reinsurance distributions under the terms of the state ACA reinsurance program shall treat the amounts as assessments reported in taxes, licenses and fees similar to treatment under *SSAP No. 35R—Guaranty Funds and Other Assessments*.

c. Self-insured plans where the reporting entity is acting as an administrator, and will exclude the payments made on behalf of the self-insured plan from the reporting entity's operations, shall report consistent with the guidance in *SSAP No. 47—Uninsured Plans*.

ANY OTHER MATTERS

a. Ref #2019-21: SSAP No. 43R – (Julie and Carrie Mears / Kevin Clark (IA))

Since Dec. 1, 2020, a small group of industry reps, Iowa and NAIC staff have been working to develop a definition of what should be captured as a "bond" in Schedule D-1: Long-Term Bonds. This initiative was directed after considering the comments received on the IA proposed definition and the prior discussion of SSAP No. 43R project. (As detailed within the comments received, the investments that cause concern are not necessarily limited to SSAP No. 43R but can be captured in scope of SSAP No. 26R. As such, addressing this issue solely within SSAP No. 43R would not eliminate the potential for such investments to be reported as bonds.) The small group has made significant progress and is nearing the time in which the proposed Schedule D-1 definition will be exposed publicly to allow for broader comments and discussion. As a few items to highlight with regards to the current proposal and next steps:

- The Schedule D-1 definitions focuses on investments that reflects issuer credit obligations and asset backed securities. The current approach is to first identify what should be captured in scope of Schedule D-1. Once that project is concluded, the concepts will then drive revisions to both SSAP No. 26R and SSAP No. 43R.

- If there are investments that no longer qualify for Schedule D-1, at this time, it is anticipated that these investments will likely be captured on Schedule BA. With this project, it is anticipated that NAIC staff and regulators will be working with the Capital Adequacy (E) Task Force to ensure that these investments are assessed for appropriate accounting, reporting and RBC.

Industry is invited to provide additional comments on this project.

b. INT 19-02: Freddie Mac Single Security Initiative – (Julie)

The SAPWG support staff periodically review INTs currently in effect for possible movement to *Appendix H – Superseded SSAPs and Nullified Interpretations.* For public information, the Freddie Mac Single Security Initiative remains an ongoing program and does not appear to be subject to termination in the foreseeable future. Accordingly, INT 19-02 remain in full effect.

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

This issue is to address a referral from the Committee on Property and Liability Financial Reporting (COPLFR) of the American Academy of Actuaries which noted diversity in reporting for companies applying the retroactive reinsurance exception which allows certain contracts to be reported prospectively.

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

d. Paycheck Protection Program (PPP) – SAP Guidance - (Robin)

NAIC staff has received inquiries regarding the reporting and extinguishment of loans received from the PPP. While we are aware that the AICPA has issued some technical guidance regarding treatment of the PPP loans, NAIC staff note that for statutory accounting, the authoritative guidance is *SSAP No.15—Debt and Holding Company Obligations.* SSAP No. 15, paragraph 11 provides that debt is recognized until extinguished including formally being forgiven. NAIC staff notes that the SSAP No. 15 guidance is consistent with one of the two options provided in the AICPA issuance. As the other option cites guidance previously rejected for SAP, and as SSAP No. 15 is already adopted for statutory accounting, entities shall follow the guidance in SSAP No. 15. It is also noted that the AICPA guidance provides optionality, which is generally not supported

under the SAP guidance pursuant to the Consistency Concept.

The PPP program requires applying for loan forgiveness after meeting certain criteria. Therefore, PPP loans should be reflected as debt until legally released. Once legally released, the debt forgiveness is reported as a capital gain pursuant to SSAP No 15, paragraph 25.

> 11. A reporting entity shall derecognize a liability if, and only if, it has been extinguished. A liability has been extinguished if either of the following conditions is met:
>
> a. The reporting entity pays the creditor and is relieved of its obligation for the liability. Paying the creditor includes delivery of cash, other financial assets, goods or services, or reacquisition by the debtor of its outstanding debt securities; or
>
> **b. <u>The reporting entity is legally released from being the primary obligor under the liability, either judicially or by the creditor.</u>**
>
> 25. This statement adopts *Accounting Principles Board Opinion No. 26, Early Extinguishment of Debt* with modification to **<u>require that gains and losses from extinguishment of debt be reported as capital gains or losses and charged to operations</u>** unless the extinguishment reflects the forgiveness of a reporting entity's obligation to its parent or other stockholders. Forgiveness of a reporting entity's obligation to its parent or other stockholder shall be accounted for as contributed surplus under SSAP No. 72.

e. VOSTF Referral Regarding WCFI is Pending (Robin)

The Valuation of Securities (E) Task Force is discussing revisions to the *Purposes and Procedures Manual of the Investment Analysis Office* (P&P Manual) as coordination regarding the revisions to *SSAP No. 105R—Working Capital Finance Investment* adopted by the Working Group in May 2020 (agenda item 2019-25). At the November 18, 2020 meeting, the Task Force directed a referral to the Working Group which is still pending. The NAIC staff anticipates addressing this referral when received in the interim.

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

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

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

<u>Comment Deadline Exposure is Friday, April 30, 2021.</u> This date has been selected so items can be reviewed and considered in advance of the Blanks (E) Working Group public call anticipated in May.

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

Issue: ***ASU 2021-01, Reference Rate Reform***

Check (applicable entity):

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

Description of Issue:
In March 2020, the Financial Accounting Standards Board (FASB) issued *ASU 2020-04, Reference Rate Reform (Topic 848) Facilitation of the Effects of Reference Rate Reform on Financial Reporting* to ensure the financial reporting of hedging relationships would reflect a continuation of the original contract and hedging relationship during the period of the market-wide transition to alternative reference rates – commonly referred to as "reference rate reform." Reference rate reform typically refers to the transition away from referencing the London Interbank Offered Rate (LIBOR), and other interbank offered rates (IBORs), and moving toward alternative reference rates that are more observable or transaction based. In July 2017, the governing body responsible for regulating LIBOR announced it would no longer require banks to continue rate submissions after 2021 – thus, likely sunsetting both the use and publication of LIBOR.

As is often the case with hedge accounting, a change to the critical terms (including reference rate modifications) typically requires remeasurement of the contract, or in the case of a hedging relationship, a dedesignation of the transaction. However, ASU 2020-04 provides temporary, optional, and expedient relief in that a qualifying modification (because of reference rate reform) should not be considered an event that requires contract remeasurement at the modification date or reassessment of a previous accounting determination. In essence, when a modification (because of reference rate reform) is made to a hedge's critical terms, a reporting entity can continue hedge accounting rather than dedesignate the hedging relationship. For fair value hedges, a reporting entity may change the hedged risk to another permitted benchmark interest rate without dedesignating the relationship; that is if the hedge is expected to remain highly effective in offsetting changes in fair value attributed to the revised hedged risk. For cash flow hedges, a reporting entity may change to another permitted benchmark interest rate without dedesignating the relationship if the forecasted hedge transaction remains probable of occurring.

The derivatives market continues to undergo various other transitions due to reference rate reform initiatives, specifically changing the reference rates used for margining, discounting, or contract price alignment (this change is referred to as a "discounting transition"). While these changes are related to reference rate reform, they are not modifying an interest rate that is expected to be discontinued (e.g., LIBOR). The most prevalent example of a discounting transition occurred in October of 2020 with Central Clearing Parties (CCP). In October of 2020, the CME Group switched to using the Secured Overnight Financing Rate (SOFR) from the Effective Federal Funds Rate (EFFR) to discount, margin and price align most U.S. Dollar based derivative products. A change in the discount rate results in an immediate increase or decrease in a derivative's fair value, which can affect required variation margin payments. In addition, using SOFR instead of EFFR impacts the amount of interest an entity will pay or receive in the related cumulative variation margin. Questions arose in that if a change in these terms would require hedge dedesignation, or if these situations should be afforded the relief offered in ASU 2020-04.

In January 2021, FASB issued *ASU 2021-01, Reference Rate Reform* to clarify that all derivative instruments affected by changes to the interest rates used for discounting, margining or contract price alignment (regardless of whether they reference LIBOR or another rate that is expected to be discontinued as a result of reference rate reform) are in scope of Topic 848. In short summary, for all derivatives affected by the discounting transition, entities may apply the optional expedients and the continuation of contract exceptions allowed in ASU 2020-04.

ASU 2021-01 expands the scope of ASU 2020-04 by allowing an entity to apply the optional expedients, by stating that a change to the interest rate used for margining, discounting or contract price alignment for a derivative is not considered to be a change to the critical terms of the hedging relationship that requires dedesignation. The entity may apply the contract modification relief provided in ASU 2020-04 and continue to account for the derivative in the same manner that existed prior to the changes resulting from reference rate reform or the discounting transition.

Other Items:
The discounting transition previously discussed was primarily driven by CCPs. In October of 2020, CCPs converted open derivative end-of-day valuation calculations from EFFR to SOFR. The process entailed CCPs conducting a standard end-of day valuation cycle based on EFFR. Then, CCPs conducted a special valuation cycle on those same positions, however utilizing SOFR as the new, ongoing discounting rate. Based on the differences between EFFR and SOFR, the CCP issued variation margin adjustments to offset the value differences arising from the change in discount rates. In addition to variation margin adjustments, CCPs issued mandatory EFFR/SOFR basis swaps, thus restoring the account holder's original risk profile. ASU 2021-01 provides guidance for the final settlement of cashflows stating that fair value hedges may adjust the fair value hedge basis while cash flow hedges may adjust accumulated other comprehensive income. The accounting, reporting, and admittance of basis swaps was previously addressed by the Working Group in *INT 20-09: Basis Swaps as a Result of the LIBOR Transition* and is further discussed in the "Activities to Date" section of this agenda item.

Informal note, feedback received from interested parties indicates that most basis swaps were liquidated prior to year-end 2020.

Finally, the effective date of ASU 2021-01 mimics the effective date of ASU 2020-04 in that the optional, expedient guidance may be applied from the beginning of an interim period that includes or is after March 12, 2020 and terminates December 31, 2022.

Existing Authoritative Literature:

ASU 2021-01 effectively increases the scope of the optional, expedient accounting guidance for derivative instruments in ASU 2020-04. Accordingly, only applicable derivative authoritative literature will be shown below. While detailed in the original agenda item (Ref #2020-12), additional SSAPS impacted by ASU 2020-04 were *SSAP No. 15—Debt and Holding Company Obligations* and *SSAP No. 22R—Leases.*

The modifications in ASU 2020-04 address hedge accounting and the allowance for a reporting entity to change the reference rate and other critical terms related to reference rate reform without having to dedesignate the hedging relationship. While alternative benchmark interest rates were previously addressed in agenda item 2018-46 – Benchmark Interest Rate, the accounting for hedged transactions is noted below, with applicable areas bolded for emphasis.

Relevant/Applicable of Overview of existing SAP Accounting – *SSAP No. 86—Derivatives*

> 12. "Benchmark Interest Rate" is a widely recognized and quoted rate in an active financial market that is broadly indicative of the overall level of interest rates attributable to high-credit-quality obligors in that market. It is a rate that is widely used in a given financial market as an underlying basis for determining the interest rates of individual financial instruments and commonly referenced in interest-rate-related transactions. In theory, the benchmark interest rate should be a risk-free rate (that is, has no risk of default). In some markets, government borrowing rates may serve as a benchmark. In other markets, the benchmark interest rate may be an interbank offered rate. In the United States, the interest rates on direct Treasury obligations of the U.S. government, the London Interbank Offered Rate (LIBOR) swap rate, the Fed Funds Effective Rate Overnight Index Swap Rate, the Securities Industry and Financial Markets Association (SIFMA) Municipal Swap Rate, and the Secured Overnight Financing Rate (SOFR) Overnight Index Swap Rate are considered to be benchmark interest rates.

Derivatives Used in Hedging Transactions

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

21. Entities shall not bifurcate the effectiveness of derivatives. A derivative instrument is either classified as an effective hedge or an ineffective hedge. Entities must account for the derivative using fair value accounting if it is deemed to be ineffective or becomes ineffective. Entities may redesignate a derivative in a hedging relationship even though the derivative was used in a previous hedging relationship that proved to be ineffective. **A change in the counterparty to a derivative instrument that has been designated as the hedging instrument in an existing hedging relationship would not, in and of itself, be considered a termination of the derivative instrument.** An entity shall prospectively discontinue hedge accounting for an existing hedge if any one of the following occurs:

a. Any criterion in paragraphs 24-36 is no longer met;

b. The derivative expires or is sold, terminated, or exercised (the effect is recorded as realized gains or losses or, for effective hedges of firm commitments or forecasted transactions, in a manner that is consistent with the hedged transaction – see paragraph 22);

c. The entity removes the designation of the hedge; or

d. The derivative is deemed to be impaired in accordance with paragraph 17. A permanent decline in a counterparty's credit quality/rating is one example of impairment required by paragraph 17, for derivatives used in hedging transactions.

22. For those derivatives which qualify for hedge accounting, the change in the carrying value or cash flow of the derivative shall be recorded consistently with how the changes in the carrying value or cash flow of the hedged asset, liability, firm commitment or forecasted transaction are recorded. **Upon termination of a derivative that qualified 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 being hedged is subject to IMR, the gain or loss on the hedging derivative may be realized and shall be subject to IMR upon termination.)** Entities who choose the alternative method shall apply it consistently thereafter.

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

The Working Group has taken several actions related to reference rate reform; each are summarized below.

1. Agenda item 2018-46 – Benchmark Interest Rate, incorporated revisions to SSAP No. 86, adding the Securities Industry and Financial Markets (SIFMA) Municipal Swap Rate and the Secured Overnight Financing Rate (SOFR) Overnight Index Swap (OIS) Rate as acceptable benchmark interest rates for hedge accounting. Prior to this change, only LIBOR and the Fed Funds Effective Swap Rate (also referred to as the Overnight Index Swap Rate) were considered acceptable benchmark interest rates.

2. Agenda item 2020-12 reviews ASU 2020-04, the foundation of which this agenda item and related ASU (2021-01) are based. Agenda item 2020-12 resulted in the Working Group adopting INT 20-01.

3. *INT 20-01: ASU 2020-04 - Reference Rate Reform*, adopted by the Working Group in April 2020, broadly adopted ASU 2020-04 for statutory accounting stating that for statutory accounting:

    - For all contracts within scope of ASU 2020-04, modifications due to reference rate reform are afforded an optional expedient to be accounted for as a continuation of the existing contract.
    - Debt and service agreement modifications, as a result of reference rate reform, should not typically rise to the level of requiring a reversal and rebooking of the liability, as *SSAP No. 15—Debt and Holding Company Obligations* states such liabilities should only be derecognized if extinguished.
    - Lease modifications, solely caused by reference rate reform and ones eligible for optional expedience, likely do not rise to the level of a modification requiring re-recognition as a new lease under *SSAP No. 22R—Leases.*
    - For derivative transactions within scope of ASU 2020-04, a change to the critical terms of the hedging relationship (due to reference rate reform), shall be afforded similar treatment in that the hedging relationship can continue the original hedge accounting rather than dedesignate the hedging relationship.

4. *INT 20-09: Basis Swaps as a Result of the LIBOR Transition*, adopted by the Working Group in July 2020, provided statutory accounting and reporting guidance for basis swaps issued by CCPs. This INT designated that basis swaps, issued by CCPs, in response to reference rate reform (i.e., the discounting transition), shall be classified as a derivative used for hedging. This categorization allowed for the basis swap derivatives to be admitted under SSAP No. 86. Additionally, the INT directed that basis swap derivatives shall not be reported as "effective" unless the instrument qualifies, with the required documentation, as highly effective under SSAP No. 86

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

Convergence with International Financial Reporting Standards (IFRS): IFRS has taken a similar approach when considering Reference Rate Reform's impact on IFRS 9 (Financial Instruments), IAS 39 (Recognition and Measurement), and IFRS 7 (Financial Instruments – Disclosures).

NAIC Staff Recommendation:
NAIC staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose temporary (optional) expedient and exception interpretative guidance, with a expiration date of December 31, 2022. These optional expedients would expand the current exception guidance provided by *INT 20-01: ASU 2020-04 - Reference Rate Reform*. With this guidance, derivative instruments affected by changes to the interest rates used for discounting, margining or contract price alignment (regardless of whether they reference LIBOR or another rate that is expected to be discontinued as a result of reference rate reform) would be in scope of INT 20-01. This exception would allow for continuation of the existing hedge relationship and thus not requiring hedge dedesignation.

The proposed modifications to INT 20-01 temporarily override SSAP No. 86 guidance for affected policies, therefore the policy statement in Appendix F requires 2/3rd (two-thirds) of the Working Group members to be present and voting and a supermajority of the Working Group members present to vote in support of the interpretation before it can be finalized.

Staff Review Completed by: Jim Pinegar, NAIC Staff – January 2021

Status:

Interpretation of the Statutory Accounting Principles (E) Working Group

INT 20-01: *ASUs 2020-04 & 2021-01- Reference Rate Reform*

INT 20-01 Dates Discussed

Email Vote to Expose March 26, 2020; April 15, 2020; March 15, 2021

INT 20-01 References

Current:
SSAP No. 15—Debt and Holding Company Obligations
SSAP No. 22R—Leases
SSAP No. 86—Derivatives

This INT applies to all SSAPs with contracts within scope of ASU 2020-04, which allows for modifications due to reference rate reform and provides for the optional expedient to be accounted for as a continuation of the existing contract.

INT 20-01 Issue

1. This interpretation has been issued to provide statutory accounting and reporting guidance for the adoption with modification of *ASU 2020-04 – Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting* and *ASU 2021-01 – Reference Rate Reform (Topic 848)* for applicable statutory accounting principles. The Financial Accounting Standards Board (FASB) issued both ASU 2020-04 and ASU 2021-01~~in March 2020~~ to provide ~~as~~ optional, transitional and expedient guidance as a result of reference rate reform.

2. "Reference rate reform" typically refers to the transition away from referencing the London Interbank Offered Rate (LIBOR), and other interbank offered rates (IBORs), and moving toward alternative reference rates that are more observable or transaction based. In July 2017, the governing body responsible for regulating LIBOR announced it will no longer require banks to continue LIBOR submissions after 2021 – likely sunsetting both the use and publication of LIBOR. An important note is that while LIBOR is the primary interbank offering rate, other similar rates are potentially affected by reference rate reform.

3. With a significant number of financial contracts solely referencing IBORs, their discontinuance will require organizations to reevaluate and modify any contract that does not contain a substitute reference rate. A large volume of contracts and other arrangements, such as debt agreements, lease agreements, and derivative instruments, will likely need to be modified to replace all references of interbank offering rates that are expected to be discontinued. While operational, logistical, and legal challenges exist due to the sheer volume of contracts that will require modification, accounting challenges were presented as contract modifications typically require an evaluation to determine whether the modifications result in the establishment of a new contract or the continuation of an existing contract. As is often the case, a change to the critical terms (including reference rate modifications) typically requires remeasurement of the contract, or in the case of a hedging relationship, a dedesignation of the transaction.

4. The overall guidance in ASU 2020-04 is that a qualifying modification (as a result of reference rate reform) should not be considered an event that requires contract remeasurement at the modification date or reassessment of a previous accounting determination. FASB concluded that as reference rate changes are a market-wide initiative, one that is required primarily due to the discontinuance of LIBOR, it is outside the control of an entity and is the sole reason compelling an entity to make modifications to contracts or hedging strategies. As such, FASB determined that the traditional financial reporting requirements of discontinuing such contracts and treating the modified contract as an entirely new contract or hedging relationship would 1) not provide decision-useful information to financial statement users and 2) require a reporting entity to incur significant costs in the financial

statement preparation and potentially reflect an adverse financial statement impact, one of which may not accurately reflect the intent or economics of a modification to a contract or hedging transaction.

5. Guidance in ASU 2020-04 allows a method to ensure that the financial reporting results would continue to reflect the intended continuation of contracts and hedging relationships during the period of the market-wide transition to alternative reference rates – thus, generally not requiring remeasurement or dedesignation if certain criteria are met.

~~5.~~6. Guidance in ASU 2021-01 expanded the scope of ASU 2020-04 by permitting the optional, transitional, expedient guidance to also include derivative contracts that undergo a similar transition but do not specifically reference a rate that is expected to be discontinued. While these contract modifications to not reference LIBOR (or another reference rate expected to be discontinued), the changes are the direct result of reference rate reform and were deemed to be eligible for similar exception treatment. ASU 2020-01 allows for modifications in interest rates indexes used for margining, discounting or contract price alignment, as a result of reference rate reform initiatives (commonly referred to as a "discounting transition") to be accounted for as a continuation of the existing contract and hedge accounting.

~~6.~~7. The optional, expedient and exceptions guidance provided by the amendments in ASU 2020-04 and ASU 2020-01 are applicable for all entities. However, they are only effective as of March 12, 2020 through December 31, 2022. This is because the amendments ~~in ASU 2020-04~~ are intended to provide relief related to the accounting requirements in generally accepted accounting principles (GAAP) due to the effects of the market-wide transition away from IBORs. The relief provided by the amendments is temporary in its application in alignment with the expected market transition period. However, the FASB will monitor the market-wide IBOR transition to determine whether future developments warrant any changes, including changes to the end date of the application of the amendments in this ASU. If such an update occurs, the Working Group may also consider similar action. It is not expected that the Working Group will take action prior to or in the absence of a FASB amendment.

~~7.~~8. The accounting issues are:

a. Issue 1: Should a reporting entity interpret the guidance in ASU 2020-04 as broadly accepted for statutory accounting?

b. Issue 2: Should the optional, expedient and exception guidance in ASU 2020-04 apply to debt and other service agreements addressed in SSAP No. 15?

c. Issue 3: Should the optional, expedient and exception guidance in ASU 2020-04 apply to lease transactions addressed in SSAP No. 22R?

d. Issue 4: Should the optional, expedient and exception guidance in ASU 2020-04 apply to derivative transactions addressed in SSAP No. 86?

~~d.~~e. Issue 5: Should the optional, expedient and exception guidance in ASU 2021-01 apply to derivative transactions addressed in SSAP No. 86?

INT 20-01 Discussion

~~8.~~9. For Issue 1, the Working Group came to the consensus that ASU 2020-04 shall be adopted, to include the same scope of applicable contracts or transactions for statutory accounting with the only modification related to a concept not utilized by statutory accounting, as noted below. The Working Group agreed the amendments provide appropriate temporary guidance that alleviate the following concerns due to reference rate reform:

a. Simplifies accounting analyses under current GAAP and statutory accounting principles (SAP) for contract modifications.

i. All contracts within scope of ASU 2020-04, which allows for modifications due to reference rate reform and provides for the optional expedient to be accounted for as a continuation of the existing contract.

b. Allows hedging relationships to continue without dedesignation upon a change in certain critical terms.

c. Allows a change in the designated benchmark interest rate to a different eligible benchmark interest rate in a fair value hedging relationship.

d. Suspends the assessment of certain qualifying conditions for fair value hedging relationships for which the shortcut method for assuming perfect hedge effectiveness is applied.

e. Simplifies or temporarily suspends the assessment of hedge effectiveness for cash flow hedging relationships.

f. The only SAP modification to this ASU is related to the option to sell debt currently classified held-to-maturity. This concept is not employed by statutory accounting and thus is not applicable.

~~9.~~10. For Issue 2, the Working Group came to the consensus that debt and service agreement modifications, as a result of reference rate reform, should not typically rise to the level of requiring a reversal and rebooking of the liability, as SSAP No. 15 states such liabilities should only be derecognized if extinguished. A reference rate modification should not generally require de-recognition and re-recognition under statutory accounting. Nonetheless, for clarity and consistency with ASU 2020-04, the Working Group came to the consensus that should an eligible contract be affected by reference rate reform, then the temporary guidance in ASU 2020-04 shall apply.

~~10.~~11. For Issue 3, the Working Group came to the consensus that lease modifications, solely caused by reference rate reform and ones eligible for optional expedience, likely do not rise to the level of a modification requiring re-recognition as a new lease under statutory accounting. SSAP No. 22R, paragraph 17 states only modifications in which grant the lessee additional rights shall be accounted for as a new lease. These changes are outside the scope allowed for optional expedience in ASU 2020-04. Nonetheless, for clarity and consistency with ASU 2020-04, the Working Group came to a consensus that if an eligible lease affected by reference rate reform, then the temporary guidance in ASU 2020-04 shall apply.

~~11.~~12. For Issue 4, the Working Group came to the consensus that ASU 2020-04 shall be applied to derivative transactions as the following considerations provided in the ASU are appropriate for statutory accounting:

a. For any hedging relationship, upon a change to the critical terms of the hedging relationship, allow a reporting entity to continue hedge accounting rather than dedesignate the hedging relationship.

b. For any hedging relationship, upon a change to the terms of the designated hedging instrument, allow an entity to change its systematic and rational method used to recognize the excluded component into earnings and adjust the fair value of the excluded component through earnings.

c. For fair value hedges, allow a reporting entity to change the designated hedged benchmark interest rate and continue fair value hedge accounting.

d. For cash flow hedges, adjust the guidance for assessment of hedge effectiveness to allow an entity to continue to apply cash flow hedge accounting.

13. For Issue 5, the Working Group came to a tentative consensus that ASU 2021-01 shall be applied to derivative transactions for statutory accounting. Accordingly, derivative instruments that are modified to change the reference rate used for margining, discounting, or contract price alignment that is a result of reference rate reform (regardless whether the reference rate that is expected to be discontinued) are eligible for the exception

guidance afforded in ASU 2020-04 in that such a modification is not considered a change in the critical terms that would require dedesignation of the hedging relationship.

~~12.~~14. Additionally, for GAAP purposes, if an entity has not adopted the amendments in *ASU 2017-12, Derivatives and Hedging*, it is precluded from being able to utilize certain expedients for hedge accounting. For statutory accounting purposes, only the hedge documentation requirements were adopted from ASU 2017-12, while the remainder of the items are pending statutory accounting review. The Working Group concluded that all allowed expedient methods are permitted as elections for all reporting entities under statutory accounting. However, if a reporting entity is a U.S. GAAP filer, the reporting entity may only make elections under ASU 2017-12 if such elections were also made for their U.S. GAAP financials.

INT 20-01 Status

~~13.~~15. No further discussion is planned.

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

Issue: ASU 2020-08 – Premium Amortization on Callable Debt Securities

Check (applicable entity):

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

Description of Issue: In October 2020, the Financial Accounting Standards Board (FASB) issued *ASU 2020-08, Codification Improvements to Subtopic 310-20, Receivables – Nonrefundable Fees and Other Costs* to clarify the amortization of premium associated with callable debt securities. In summary, ASU 2020-08 requires that to the extent the amortized cost basis of a callable debt security exceeds the amount repayable by the issuer, any associated premium (above the call price) is to be amortized to the next effective call price/date. For example, if a reporting entity held a bond at $104 in which could be called at $102 in a year, the $2 excess premium would be amortized over that particular year. Once amortized to $102, the reporting entity would then reassess for any excess premium to the next effective call price/date. If there is no remaining premium or further call dates, the effective yield is reset using the payment terms of the debt security.

Existing Authoritative Literature: The amortization of premiums related to debt securities is referenced in *SSAP No. 26R—Bonds.* While the requirements in ASU 2020-08 are very similar to statutory accounting guidance, SSAP No. 26R also requires the application of a yield-to-worst concept. With this concept, premium is amortized in a manner to produce the lowest asset value. Relevant guidance has been bolded below.

Amortized Cost

9. **Amortization of bond premium or discount shall be calculated using the scientific (constant yield) interest method taking into consideration specified interest and principal provisions over the life of the bond. Bonds containing call provisions (where the issue can be called away from the reporting entity at the issuer's discretion), except "make-whole" call provisions, shall be amortized to the call or maturity value/date which produces the lowest asset value (yield-to-worst).** Although the concept for yield-to-worst shall be followed for all callable bonds, make-whole call provisions, which allow the bond to be callable at any time, shall not be considered in determining the timeframe for amortizing bond premium or discount unless information is known by the reporting entity indicating that the issuer is expected to invoke the make-whole call provision.

Application of Yield-to-Worst

10. For callable bonds, the first call date after the lockout period (or the date of acquisition if no lockout period exists) shall be used as the "effective date of maturity" for reporting in Schedule D, Part 1. Depending on the characteristics of the callable bonds, the yield-to-worst concept in paragraph 9 shall be applied as follows:

a. For callable bonds with a lockout period, premium in excess of the next call price (subsequent to acquisition and lockout period) shall be amortized proportionally over the length of the lockout period. **After each lockout period (if more than one), remaining premium shall be amortized to the call or maturity value/date which <u>produces the lowest asset value.</u>**

b. For callable bonds without a lockout period, the book adjusted carrying value (at the time of acquisition) of the callable bonds shall equal the lesser of the next call price (subsequent to acquisition) or cost. Remaining premium shall then be amortized to the call or maturity value/date <u>which produces the lowest asset value.</u>

c. For callable bonds that do not have a stated call price, all premiums over par shall be immediately expensed. For callable bonds with a call price at par in advance of the maturity date, all premiums shall be amortized to the call date.

Balance Sheet Amount

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. 32R—Preferred Stocks*.)

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. 26R—Bonds* to reject ASU 2020-08 for statutory accounting. While ASU 2020-08 closely mimics existing guidance in SSAP No. 26R (amortizing applicable debt premium to the next effective call price), it does preclude statutory accounting's yield-to-worst concept, which requires amortizing premiums to the call or the maturity value/date in which produces the lowest asset value. There may be scenarios, for statutory accounting, in which premiums amortized to the maturity value/date will yield a lower asset value than simply amortizing applicable premium to the next effective call date (as is required in ASU 2020-08).

Proposed Revisions to SSAP No. 26R

33. This statement rejects the GAAP guidance for debt securities, which is contained in *ASU 2020-08, Codification Improvements to Subtopic 310-20, Receivables – Nonrefundable Fees and Other Costs, ASU 2018-03, Recognition and Measurement of Financial Assets and Financial Liabilities, ASU 2017-08, Premium Amortization on Purchased Callable Debt* Securities, ASU *2016-01, Financial Instruments – Overall*, *FASB Statement No. 115, Accounting for Certain Investments in Debt and Equity Securities, FASB Statement No. 91, Accounting for Nonrefundable Fees and Costs Associated with*

Originating or Acquiring Loans and Initial Direct Costs of Leases, FASB Emerging Issues Task Force No. 89-18, Divestitures of Certain Investment Securities to an Unregulated Commonly Controlled Entity under FIRREA, and *FASB Emerging Issues Task Force No. 96-10, Impact of Certain Transactions on Held-to-Maturity Classifications Under FASB Statement No. 115*

Staff Review Completed by: Jim Pinegar, NAIC Staff – January 2021

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

Issue: SSAP No. 103R – Disclosures

Check (applicable entity):

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

Description of Issue:
This agenda item has been drafted to propose additional disclosures and to data-capture certain existing disclosure elements in *SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities.* The additional disclosures proposed herein are in response to the Working Group's continued deliberation of agenda item 2019-21: SSAP No. 43R – Equity Instruments. Agenda item 2019-21 is a substantive project to consider what investments fall within scope of *SSAP No. 43R—Loan-Backed and Structured Securities* and on Oct. 13, 2020, this project was expanded to include a review of the investments eligible for reporting on Schedule D-1: Long Term Bonds. During the continued work on this project, regulators expressed a desire to identify situations in which a reporting entity has entered into a securitization, asset-backed financing or similar transfer transaction where a significant economic interest in the transferred assets is retained by the reporting entity, its related parties or another member within the holding company group.

The existing disclosures discussed (and proposed for data-capture) are currently completed in a narrative (pdf) format. With the proposal to data-capture certain disclosures, regulators can utilize system inquiries to determine which reporting entities have a securitization, asset backed financing arrangement, or other similar transfers that have been accounted for as a sale when the transferor has continued involvement.

Note – the disclosures discussed below are only required in the event a reporting entity as entered into a securitization, asset-backed financing arrangement or other similar transfer in which it also retains a continuing involvement with the transferred financial asset. Due to the numerous circumstances that may require disclosure, data-capture of most of the applicable disclosures would not sufficiently relay the particular characteristics or circumstances of the transaction – as is required in SSAP No. 103R. <u>However, the need for regulators to have the ability to query the global population regarding the nature of these transactions remains a primary reason for this agenda item.</u> Nonetheless, certain consistent numerical disclosures are suitable for data-capture, which will significantly assist with regulator's ability to identify which reporting entities have such transactions, at which time further analysis of the narrative disclosures can be performed.

Existing Authoritative Literature:

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

28. A reporting entity shall disclose the following:

    g. For securitizations, asset-backed financing arrangements, and similar transfers accounted for as sales when the transferor has continuing involvement (as defined in the glossary) with the transferred financial assets:

        i. For each income statement presented:

            (a) The characteristics of the transfer (including a description of the transferor's continuing involvement with the transferred financial assets, the nature and initial fair value of the

assets obtained as proceeds and the liabilities incurred in the transfer, and the gain or loss from sale of transferred financial assets. For initial fair value measurements of assets obtained and liabilities incurred in the transfer, the following information:

(1) The level within the fair value hierarchy in which the fair value measurements in their entirety fall, segregating fair value measurements using quoted prices in active markets for identical assets or liabilities (Level 1), significant other observable inputs (Level 2), and significant unobservable inputs (Level 3)

(2) The key inputs and assumptions used in measuring the fair value of assets obtained and liabilities incurred as a result of the sale that relate to the transferor's continuing involvement (including, at a minimum, but not limited to, and if applicable, quantitative information about discount rates, expected prepayments including the expected weighted-average life of prepayable financial assets, and anticipated credit losses, including expected static pool losses).

(b) Cash flows between a transferor and transferee, including proceeds from new transfers, proceeds from collections reinvested in revolving-period transfers, purchases of previously transferred financial assets, servicing fees, and cash flows received from a transferor's beneficial interests.

ii. For each statement of financial position presented, regardless of when the transfer occurred:

(a) Qualitative and quantitative information about the transferor's continuing involvement with transferred financial assets that provides financial statement users with sufficient information to assess the reasons for the continuing involvement and the risks related to the transferred financial assets to which the transferor continues to be exposed after the transfer and the extent that the transferor's risk profile has changed as a result of the transfer (including, but not limited to, credit risk, interest rate risk, and other risks), including:

(1) The total principal amount outstanding, the amount that has been derecognized, and the amount that continues to be recognized in the statement of financial position.

(2) The terms of any arrangements that could require the transferor to provide financial support (for example, liquidity arrangements and obligations to purchase assets) to the transferee or its beneficial interest holders, including a description of any events or circumstances that could expose the transferor to loss and the amount of the maximum exposure to loss.

(3) Whether the transferor has provided financial or other support during the periods presented that it was not previously contractually required to provide to the transferee or its beneficial interest holders, including when the transferor assisted the transferee or its beneficial interest holders in obtaining support, including:

(i.) The type and amount of support

(ii.) The primary reasons for providing the support

(4) Information is encouraged about any liquidity arrangements, guarantees, and/or other commitments provided by third parties related to the transferred financial assets that may affect the transferor's exposure to loss or risk of the related transferor's interest.

(b) The entity's accounting policies for subsequently measuring assets and liabilities that relate to the continuing involvement with the transferred financial assets;

(c) The key inputs and assumptions used in measuring the fair value of assets or liabilities that relate to the transferor's continuing involvement (including, at a minimum, but not limited to, and if applicable, quantitative information about discount rates, expected prepayments including the expected weighted-average life of prepayable financial assets, and anticipated credit losses, including expected static pool losses);

(d) For the transferor's interests in the transferred financial assets, a sensitivity analysis or stress test showing the hypothetical effect on the fair value of those interests (including any servicing assets or servicing liabilities) of two or more unfavorable variations from the expected levels for each key assumption that is reported under paragraph 28.g.ii.(c) independently from any change in another key assumption, and a description of the objectives, methodology, and limitations of the sensitivity analysis or stress test

(e) Information about the asset quality of transferred financial assets and any other assets that it manages together with them. This information shall be separated between assets that have been derecognized and assets that continue to be recognized in the statement of financial position. This information is intended to provide financial statement users with an understanding of the risks inherent in the transferred financial assets as well as in other assets and liabilities that it manages together with transferred financial assets. For example, information for receivables shall include, but is not limited to:

(i.) Delinquencies at the end of the period; and

(ii.) Credit losses, net of recoveries, during the period.

Current Annual Statement Illustrations for Completing Disclosures:

Note 17: Sale, Transfer and Servicing of Financial Assets and Extinguishments of Liabilities

(4) For securitizations, asset-backed financing arrangements and similar transfers accounted for as sales when the transferor has continuing involvement (as defined in the glossary of the *Accounting Practices and Procedures Manual*) with the transferred financial assets:

a. For each income statement presented:

1. The characteristics of the transfer including a description of the transferor's continuing involvement with the transferred financial assets, the nature and initial fair value of the assets obtained as proceeds and the liabilities incurred in the transfer, and the gain or loss from the sale of transferred financial assets. For initial fair value measurements of assets obtained and liabilities incurred in the transfer, the following information:

(a) The level within the fair value hierarchy in which the fair value measurements in their entirety fall, segregating fair value measurements using quoted prices in active markets for identical assets or liabilities (Level 1), significant other observable inputs (Level 2) and significant unobservable inputs (Level 3).

(b) The key inputs and assumptions used in measuring the fair value of assets obtained and liabilities incurred as a result of the sale that relate to the transferor's continuing involvement (including, at a minimum, but not limited to, and if applicable, quantitative information about discount rates; expected prepayments,

including the expected weighted-average life of prepayable financial assets; and anticipated credit losses, including expected static pool losses)

- If an entity has aggregated multiple transfers during a period, it may disclose the range of assumptions.

  - The weighted-average life of prepayable assets in periods (for example, months or years) can be calculated by multiplying the principal collections expected in each future period by the number of periods until that future period, summing those products, and dividing the sum by the initial principal balance.

  - Expected static pool losses can be calculated by summing the actual and projected future credit losses and dividing the sum by the original balance of the pool of assets.

2. Cash flows between a transferor and transferee, including proceeds from new transfers, proceeds from collections reinvested in revolving-period transfers, purchases of previously transferred financial assets, servicing fees and cash flows received from a transferor's beneficial interests.

b. For each statement of financial position presented, regardless of when the transfer occurred:

1. Qualitative and quantitative information about the transferor's continuing involvement with transferred financial assets that provides financial statement users with sufficient information to assess the reasons for the continuing involvement and the risks related to the transferred financial assets to which the transferor continues to be exposed after the transfer and the extent that the transferor's risk profile has changed as a result of the transfer (including, but not limited to, credit risk, interest rate risk and other risks), including:

   (a) The total principal amount outstanding, the amount that has been derecognized and the amount that continues to be recognized in the statement of financial position.

   (b) The terms of any arrangements that could require the transferor to provide financial support (for example, liquidity arrangements and obligations to purchase assets) to the transferee or its beneficial interest holders, including a description of any events or circumstances that could expose the transferor to loss and the amount of the maximum exposure to loss.

   (c) Whether the transferor has provided financial or other support during the periods presented that it was not previously contractually required to provide to the transferee or its beneficial interest holders, including when the transferor assisted the transferee or its beneficial interest holders in obtaining support, including:

   - The type and amount of support.

   - The primary reasons for providing the support.

   (d) Information is encouraged about any liquidity arrangements, guarantees and/or other commitments provided by third parties related to the transferred financial assets that may affect the transferor's exposure to loss or risk of the related transferor's interest.

2. The entity's accounting policies for subsequently measuring assets and liabilities that relate to the continuing involvement with the transferred financial assets.

3. The key inputs and assumptions used in measuring the fair value of assets or liabilities that relate to the transferor's continuing involvement (including, at a minimum, but not limited to, and if applicable, quantitative information about discount rates; expected prepayments, including the expected weighted-average life of pre-payable financial assets; and anticipated credit losses, including expected static pool losses).

4. For the transferor's interests in the transferred financial assets, a sensitivity analysis or stress test showing the hypothetical effect on the fair value of those interests (including any servicing assets or servicing liabilities) of two or more unfavorable variations from the expected levels for each key assumption that is reported per *SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* independently from any change in another key assumption, and a description of the objectives, methodology and limitations of the sensitivity analysis or stress test.

5. Information about the asset quality of transferred financial assets and any other assets that it manages together with them. This information shall be separated between assets that have been derecognized and assets that continue to be recognized in the statement of financial position. This information is intended to provide financial statement users with an understanding of the risks inherent in the transferred financial assets, as well as in other assets and liabilities that it manages together with transferred financial assets. For example, information for receivables shall include, but is not limited to:

   - Delinquencies at the end of the period.

   - Credit losses, net of recoveries, during the period.

Activity to Date (issues previously addressed by the 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) and U.S. GAAP: N/A

<u>Staff Recommendation</u>: NAIC staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive to 1) expose new disclosure elements and 2) propose data-capture templates for existing disclosures in *SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. A blanks proposal exposure is anticipated to occur concurrently with the Working Group's exposure. With inclusion of the data templates, narrative (pdf) reporting shall still occur to provide additional information regarding transfers accounted for as a sale when the transferor maintains continuing involvement in the transferred financial assets. The purpose of the data-capture templates is so regulators can perform system inquiries to identify which reporting entities have such transactions, at which time further analysis of the narrative disclosures can be performed.

Proposed disclosures to SSAP No. 103R

28. A reporting entity shall disclose the following:

g. For securitizations, asset-backed financing arrangements, and similar transfers accounted for as sales when the transferor has continuing involvement (as defined in the glossary) with the transferred financial assets:

i. For each income statement presented:

(a) The characteristics of the transfer (including a description of the transferor's continuing involvement with the transferred financial assets, the nature and initial fair value of the assets obtained as proceeds and the liabilities incurred in the transfer, and the gain or loss from sale of transferred financial assets. For initial fair value measurements of assets obtained and liabilities incurred in the transfer, the following information:

(1) The level within the fair value hierarchy in which the fair value measurements in their entirety fall, segregating fair value measurements using quoted prices in active markets for identical assets or liabilities (Level 1), significant other observable inputs (Level 2), and significant unobservable inputs (Level 3)

(2) The key inputs and assumptions used in measuring the fair value of assets obtained and liabilities incurred as a result of the sale that relate to the transferor's continuing involvement (including, at a minimum, but not limited to, and if applicable, quantitative information about discount rates, expected prepayments including the expected weighted-average life of prepayable financial assets, and anticipated credit losses, including expected static pool losses).

(b) Cash flows between a transferor and transferee, including proceeds from new transfers, proceeds from collections reinvested in revolving-period transfers, purchases of previously transferred financial assets, servicing fees, and cash flows received from a transferor's beneficial interests.

ii. For each statement of financial position presented, regardless of when the transfer occurred:

(a) Qualitative and quantitative information about the transferor's continuing involvement with transferred financial assets that provides financial statement users with sufficient information to assess the reasons for the continuing involvement and the risks related to the transferred financial assets to which the transferor continues to be exposed after the transfer and the extent that the transferor's risk profile has changed as a result of the transfer (including, but not limited to, credit risk, interest rate risk, and other risks), including:

(1) The total original principal amount ~~outstanding~~, the amount that has been derecognized, and the outstanding amount that continues to be recognized in the statement of financial position. The percentage of original principal held in the company group and the percentage of derecognized principal held by related parties.

(2) The terms of any arrangements that could require the transferor to provide financial support (for example, liquidity arrangements and obligations to purchase assets) to the transferee or its beneficial interest holders, including a description of any events or circumstances that could expose the transferor to loss and the amount of the maximum exposure to loss.

(3) Whether the transferor has provided financial or other support during the periods presented that it was not previously contractually required to provide to the transferee or its beneficial interest holders, including when

the transferor assisted the transferee or its beneficial interest holders in obtaining support, including:

(iii.) The type and amount of support

(iv.) The primary reasons for providing the support

(4) Information is encouraged about any liquidity arrangements, guarantees, and/or other commitments provided by third parties related to the transferred financial assets that may affect the transferor's exposure to loss or risk of the related transferor's interest.

Proposed Data Capture Templates:

This data-template includes aspects from SSAP No. 103R paragraphs 28g.i.(a & b), and 28.g.ii(a) as well as the new proposed disclosure elements.

Proposed Data-Capturing Templates:

Each Material Transaction Listed Separately:

(Identification of each transaction should be consistent so that the circumstances for each item are adequately associated with the applicable transaction)

Identification of Transaction	Original Principal	% of Original Principal held within the company group	Amount Derecognized	% of derecognized held by related parties	Outstanding a~~A~~mount still recognized in the statement of financial position	Net cashflows between transferor and transferee	FV of proceeds received	Gain/loss from sale of transferred assets

Staff Review Completed by: Jim Pinegar – January 2021

Status:

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

Issue: SSAP No. 97 – Valuation of Foreign Insurance SCAs

Check (applicable entity):

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

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

In November 2020, the Working Group adopted agenda item 2020-18 - SSAP No. 97 Update and removed a lingering, superseded reference regarding negative equity method loss valuations.

However guidance in SSAP No. 97 also requires specific adjustments to 8.b.ii (insurance related SCA) and 8.b.iv (foreign insurance SCA) entities. These long-standing adjustments require the non-admission of certain assets to achieve a limited statutory basis of accounting. The adjustments have typically been viewed as necessary in order to prevent assets being held by SCA receiving more favorable treatment than had the assets been held directly by the insurer. (e.g., requiring the nonadmittance of certain assets per *SSAP No. 20—Nonadmitted Assets*). Per SSAP No. 97, an equity method of accounting for 8.b.ii and 8.b.iv entities would be a beginning point which would then be adjusted by the provisions of SSAP No. 97, paragraph 9 (see "authoritative literature section"). It is important to note the outcome of these adjustments can result in a negative equity valuation of the investment. Again, this is so assets held by an SCA aren't reported at a higher value than had they been held directly by the insurer.

During the discussion of agenda item 2020-18, industry comments requested consideration of whether 8.b.iv entities should be subject to the provisions of SSAP No. 97, specifically that paragraph 9 adjustments may result in a negative equity valuation. While stating many positions, industry's primary response that foreign insurance operations are subject to foreign jurisdiction and should be allowed to stand independently of a domestic insurer – thus in the absence of a guarantee or commitment, equity valuation should not go negative and thus stop at zero. Comments were received from industry noted that the circumstances that would cause a foreign insurance reporting entity to record negative equity is not prevalent, however indicated the potential to arise in the future.

At the direction of the NAIC staff have drafted this agenda item to determine if further edits to SSAP No. 97 are required, specifically if the required statutory adjustments to 8.b.iv entities should no longer be able to result in a negative equity valuation.

One note, NAIC staff reviewed all SCA filings for the last 3 years, noting that less than 7% of all SCA filings were 8.b.iv entities. It was further noted that there was not a single instance of an 8.b.iv in a negative equity situation.

Existing Authoritative Literature:
Paragraph 9 of SSAP No. 97 details the modifications that are necessary to adjust audited U.S .Generally Accepted Accounting Principle (GAAP) financial statements to a limited statutory basis of accounting. This long-

standing adjustments ensure that assets held by an SCA are not accounted for in a more favorable manner than had the assets been held directly by the insurer.

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

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

a. Nonadmit assets pursuant to the following statutory accounting principles as promulgated by the NAIC in the *Accounting Practices and Procedures Manual*;

i. *SSAP No. 6—Uncollected Premium Balances, Bills Receivable for Premiums, and Amounts Due From Agents and Brokers*

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

iii. *SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements*

iv. *SSAP No. 20—Nonadmitted Assets*

v. *SSAP No. 21R—Other Admitted Assets* (e.g., collateral loans secured by assets that do not qualify as investments are nonadmitted under SAP)

vi. *SSAP No. 29—Prepaid Expenses*

vii. *SSAP No. 105R—Working Capital Finance Investments*

b. Expense costs that are capitalized in accordance with GAAP but are expensed pursuant to statutory accounting as promulgated by the NAIC in the *Accounting Practices and Procedures Manual* (e.g., deferred policy acquisition costs, preoperating, development and research costs, etc.);

c. Adjust depreciation for certain assets in accordance with the following statutory accounting principles:

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

ii. *SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements*

iii. *SSAP No. 68—Business Combinations and Goodwill*

d. Nonadmit the amount of goodwill of the SCA in excess of 10% of the audited U.S. GAAP equity of the SCA's last audited financial statements.

e. Nonadmit amount of the net deferred tax assets (DTAs) of the SCA in excess of 10% of the audited U.S. GAAP equity of the SCA's last audited financial statements.

f. Nonadmit any surplus notes held by the SCA issued by the reporting entity.

g. Adjust the U.S. GAAP annuity account value reserves of a foreign insurance SCA, with respect to the business it wrote directly, using the commissioners' annuity reserve valuation method (CARVM) as defined in paragraphs 14 and 15 of Appendix A-820 (including the reserving provisions in the various Actuarial Guidelines which support CARVM). The valuation interest rate and mortality tables to be used in applying CARVM should be that prescribed by the foreign insurance SCA's country of domicile. If the Foreign SCA's country of domicile does not prescribe the necessary tables and/or rates, no reserve adjustment shall be made.

Note that the outcome of these adjustments, can result in a negative equity valuation of the investment.

SSAP No. 97, Exhibit C:

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

7.1 **A –** Yes, the equity method noninsurance SCA could have a negative equity. For example, SSAP No. 97, paragraph 8.b.ii., relating to noninsurance SCA entities, may require some assets to be reported as a negative value (nonadmitted) in paragraph 9. In this example, a paragraph 8.b.ii. SCA subsidiary that is only holding furniture, which is nonadmitted, would be reflected with negative equity to the extent the value of the nonadmitted asset(s) exceed(s) reported equity. It should be noted that although SSAP No. 97, paragraph 13.e., discusses some situations in which the equity method should be discontinued, this does not apply to SCA entities, which meet the requirements of paragraph 8.b.ii. In addition, SSAP No. 97, paragraph 13.e., lists some situations where the equity method for 8.b.ii and 8.b.iv entities would result in a valuation that is less than zero.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): Agenda items 2018-26 – SCA Loss Tracking – Accounting Guidance and 2020-18 – SSAP No. 97 Update were previously adopted. Agenda item 2018-26 resulted in revisions to *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets* and *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities* stating that equity losses of an SCA would not go negative (thus stopping at zero), however the guaranteed liabilities would be reported to the extent there is a financial guarantee or commitment. Agenda item 2020-18 resulted in revisions with clarifying edits to Exhibit C, question 7, in SSAP No. 97, as well as removed a superseded statement that guarantees or commitments from the insurance reporting entity to the SCA could result in a negative equity valuation of the SCA.

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:
Staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose the intent to move this item to the disposal listing without statutory edits. Per staff's review of SCA Sub 2 filings filed with an 8b(iv) valuation method, there were no noted instances of negative value SCAs, therefore we do not recommend revisions to the existing guidance. This exposure will allow industry to determine if they are aware of any prevalent examples of a negative equity valuation in a foreign insurance SCA (8.b.iv) and provide detailed information to NAIC staff for assessment.

NAIC staff highlights that if such an event (negative equity due to nonadmitted assets) was to actually occur at some point, and the company was to question whether the negative equity in the SCA should be reported, that this should be addressed directly with the state of domicile. With this approach, the domiciliary state would be able to assess the limited statutory edits that were performed, the extent to which assets are held in the SCA that would be nonadmitted if held directly by the insurer, and how the SCA obtained those assets.

Staff Review Completed by:
Fatima Sediqzad - NAIC Staff
February 2021

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

Issue: Accounting for Cryptocurrencies

Check (applicable entity):

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

Description of Issue:
NAIC staff have received several inquiries related to the statutory accounting treatment for cryptocurrencies, which are defined as a digital currency in which transactions are verified and records maintained by a decentralized system using cryptography, rather than by a centralized authority, such as the Federal Reserve System. These questions generally inquiry whether Bitcoin is permitted to be admitted, but a recent inquiry asked whether Bitcoin is captured in the cash definition within *SSAP No. 2R—Cash, Cash Equivalents, Drafts, and Short-Term Investments.*

The most valuable cryptocurrency as of February 2021 is Bitcoin, which has been in circulation since 2009. Cryptocurrencies are currently purchased and exchanged using a limited number of unregulated digital currency exchanges. As of February 2021, there are approximately 4,000 different cryptocurrencies available on 200 different cryptocurrency exchanges. Cryptocurrencies have seen significant price volatility and have experienced an extreme increase in value over the past year, with the value of total outstanding cryptocurrencies nearing $1 trillion as of February 2021. The total market value and increased popularity has led to increased interest in the market by traditional financial institutions. Additionally, the recently steep increase in value has attracted speculative investors.

For statutory accounting, cash is defined in SSAP No. 2R as a "medium of exchange that a bank or other similar financial institution will accept for deposit and allow an immediate credit to the depositor's account." **Cryptocurrencies do not meet this definition because these assets are not able to be deposited or exchanged with most U.S. banks and financial institutions**. There have been some recent changes in the market as PayPal now allows users to buy, sell and hold some cryptocurrencies. It is important to note that PayPal is not recognized as a bank. In addition to Bitcoin, some banks have shown interest in stablecoins, which trade like cryptocurrencies but are pegged to existing government-backed currencies, such as the U.S. dollar. NAIC staff are aware that this treatment is evolving and that in the future banks may accept cryptocurrencies in the same manner as true government-backed currencies, which could then meet the statutory accounting definition of cash. However, at this time, NAIC staff note that cryptocurrencies currently do not meet the definitions of cash equivalents, drafts, or short-term investments as they are defined in SSAP No. 2R.

With regards to the inquiry on whether cryptocurrencies are considered admitted assets, pursuant to *SSAP No. 4—Assets and Nonadmitted Assets*, paragraph 3, assets are not permitted to be admitted unless specifically identified as an admitted asset within the *Accounting Practices and Procedures Manual*. As such, as cryptocurrencies are not specifically identified as admitted, these are nonadmitted assets.

At this time, no Committees or groups at the NAIC, including the Securities Valuation Office (SVO), have taken any action or established a position on cryptocurrencies. Currently, auditors must rely on guidance provided by the American Institute of Certified Public Accountants through a nonauthoritative practice guide.

Existing Authoritative Literature:
Cash is defined in *SSAP No. 2R—Cash, Cash Equivalents, Drafts, and Short-Term Investments* as a "medium of exchange that a bank or other similar financial institution will accept for deposit and allow an immediate credit to

the depositor's account." *SSAP No. 4— Assets and Nonadmitted Assets* provides guidance that assets which are not addressed in the *Accounting Practices and Procedures Manual* default to nonadmitted status. Nonadmitted assets are detailed in *SSAP No. 20—Nonadmitted Assets*.

SSAP No. 4

3. As stated in the Statement of Concepts, "The ability to meet policyholder obligations is predicated on the existence of readily marketable assets available when both current and future obligations are due. Assets having economic value other than those which can be used to fulfill policyholder obligations, or those assets which are unavailable due to encumbrances or other third-party interests should not be recognized on the balance sheet," and are, therefore, considered nonadmitted. For purposes of statutory accounting principles, a nonadmitted asset shall be defined as an asset meeting the criteria in paragraph 2, which is accorded limited or no value in statutory reporting, and is one which is:

a. Specifically identified within the *Accounting Practices and Procedures Manual* as a nonadmitted asset; or

b. Not specifically identified as an admitted asset within the *Accounting Practices and Procedures Manual*.

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): IFRS has not yet taken a firm position on cryptocurrencies.

Staff Recommendation:
NAIC staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose the interpretative guidance provided by *INT 21-01T: Statutory Accounting Treatment for Cryptocurrencies*. This guidance clarifies that cryptocurrencies do not meet the definition of cash in *SSAP No. 2R—Cash, Cash Equivalents, Drafts, and Short-Term Investments* and are nonadmitted assets for statutory accounting. NAIC staff will continue to monitor the evolution of cryptocurrencies and address this topic further, including addressing any statements made by FASB or the AICPA, for any significant changes in the usage and design of cryptocurrencies.

With this exposure, the Working Group requests input from Interested Parties and the insurance company trade groups that follow the Working Group to gather information from their members on current ownership of cryptocurrencies. The Working Group requests information on:

1. Extent to which companies currently hold cryptocurrencies,
2. How the acquisition in cryptocurrency is held (held directly by the insurer or indirectly through and SCA),
3. Which cryptocurrencies they are acquiring in (Bitcoin, Ethereum, Litecoin, etc.), and
4. General level of interest for future investment by both companies that currently do and do not own cryptocurrencies.

Staff Review Completed by: Jake Stultz, February 2021

Interpretation of the Statutory Accounting Principles Working Group

INT 21-01T: Accounting for Cryptocurrencies

INT 21-01T Dates Discussed

March 15, 2021

INT 21-01T References

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

INT 21-01T Issue

1. This agenda item is to address questions regarding statutory accounting treatment for cryptocurrencies, which are defined as a digital currency in which transactions are verified and records maintained by a decentralized system using cryptography, rather than by a centralized authority. Cryptocurrencies are purchased and exchanged using a limited number of unregulated digital currency exchanges and are not held or offered by major banks.

2. The most valuable cryptocurrency as of February 2021 is Bitcoin, which has been in circulation since 2009, and there are approximately 4,000 different cryptocurrencies available on 200 different cryptocurrency exchanges. Cryptocurrencies have seen significant price volatility and have experienced an extreme increase in value over the past year, with the value of the total outstanding cryptocurrencies nearing $1 trillion as of February 2021. The total market value and increased popularity has led to increased interest in the market by traditional financial institutions and insurance companies.

3. No NAIC Committees or groups have taken any action or established a position on cryptocurrencies. Currently, auditors must rely on guidance provided by the American Institute of Certified Public Accountants through a nonauthoritative practice guide.

4. This Interpretation intends to clarify that cryptocurrencies are nonadmitted assets for statutory accounting.

INT 21-01T Discussion

5. Cryptocurrencies have not been identified in the *Accounting Practices and Procedures Manual* (AP&P Manual) as an admitted asset, and do not meet the definition of any admitted asset that is defined in the AP&P Manual. Accordingly, by default they are a nonadmitted asset per *SSAP No. 4—Assets and Nonadmitted Assets*, paragraph 3, as they are not specifically identified in the *Accounting Practices and Procedures Manual* as an admitted asset.

6. Cash is defined in *SSAP No. 2R—Cash, Cash Equivalents, Drafts, and Short-Term Investments* as a "medium of exchange that a bank or other similar financial institution will accept for deposit and allow an immediate credit to the depositor's account." Cryptocurrencies are currently not accepted by major banks and do not operate like a traditional currency, and as such do not meet the definition of cash in SSAP No. 2R.

INT 21-01T Consensus

7. The Statutory Accounting Principles (E) Working Group reached a tentative consensus that cryptocurrencies do not meet the definition of an admitted asset and are therefore considered to be a nonadmitted asset for statutory accounting. The Working Group intends to rely on this interpretation for statutory accounting and will address cryptocurrencies further once FASB has provided definitive guidance.

INT 21-01T Status

8. Further discussion is planned.

9. The Statutory Accounting Principles (E) Working Group will continue to monitor the evolution of cryptocurrencies and subsequently review this interpretation as appropriate.

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NAIC Accounting Practices and Procedures Manual
Editorial and Maintenance Update
March 15, 2021

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

SSAP/Appendix	Description/Revision
SSAP No. 53	Minor modification to the SSAP title to be consistent with similar SSAP titles.
SSAP No. 97	Corrects grammatical errors in paragraph 54 of *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities.*
SSAP Glossary	Removes the footnote noted in the *Glossary to the Statements of Statutory Accounting Principles* and replaces it as an opening paragraph with updated verbiage.

Recommendation:
NAIC staff recommend that the Statutory Accounting Principles (E) Working Group move this agenda item to the active listing, categorize as nonsubstantive, and expose editorial revisions as illustrated below.

SSAP No. 53—Property Casualty Contracts – Premiums

Retitle to *SSAP No. 53—Property and Casualty Contracts – Premiums*. This minor modification will title SSAP No. 53 in a consistent manner with other SSAPs (i.e., *SSAP No. 62R—Property and Casualty Reinsurance).*

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

54. The purpose of a Sub 1 filing is to gather basic information about the SCA. If the NAIC determines that the reported transaction meets the tests specified, it will complete the filing in the VISION database. If the NAIC determines that the transaction does not meet the tests specified, it ~~shall~~ will not complete the filing in the VISION database and instead shall notify~~notifies~~ the reporting insurance company and the state of domicile in writing of its determination.

SSAP Glossary

1) Remove the footnote in the SSAP Glossary title:
GLOSSARY to the Statements of Statutory Accounting Principles ~~(FN)~~
~~FN – Note that some SSAPs may have terminology that is specific to that topic. Refer to the SSAP for clarification. Accordingly, they are not intended to be applied to other topics~~.

2) Add an opening paragraph:
The terms in this Glossary are common in most SSAPs. Some SSAPs may have terminology that is topic-specific and not intended to be applied to other topics.

Status:

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

Issue: *ASU 2020-11, Financial Services—Insurance: Effective Date and Early Application*

Check (applicable entity):

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

Description of Issue: FASB issued *ASU 2020-11, Financial Services—Insurance: Effective Date and Early Application*, which updates guidance on the effective date of the amendments in *ASU 2019-09, Financial Services – Insurance* and *ASU 2018-12, Targeted Improvements to the Accounting for Long-Duration Contracts* because of COVID-19.

Existing Authoritative Literature: Both ASU 2019-09 and 2018-12 were rejected for statutory accounting.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): 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 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 2020-11, Financial Services—Insurance: Effective Date and Early Application* as not applicable for statutory accounting. This ASU was issued to only address the effective dates of ASU 2019-09 and ASU 2018-12, which were both previously rejected by the Working Group.

Staff Review Completed by Jake Stultz, January 2021

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

Issue: ***ASU 2021-02, Franchisors—Revenue from Contracts with Customers (Subtopic 952-606)***

Check (applicable entity):

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

Description of Issue:
In January 2021, the Financial Accounting Standards Board (FASB) issued *ASU 2021-02, Franchisors—Revenue from Contracts with Customers (Subtopic 952-606)*, slightly amending the guidance which was issued in *ASU 2014-09, Revenue from Contracts with Customers*, as it relates to franchisors. As a reminder, the revenue recognition updates were the result of a joint project between FASB and the International Accounting Standards Board (IASB). This project clarified the principles for recognizing revenue and develop a common revenue standard for U.S. GAAP and IFRS (the IASB issued *IFRS 15 – Revenue from Contracts with Customers*) and FASB created ASC Topic 606 – Revenue from Contracts with Customers.

In 2018, the Working Group rejected the guidance in ASU 2014-09 and several other ASUs related to Revenue Recognition in *SSAP No. 47—Uninsured Plans*. Since 2018, all additional ASUs related to revenue recognition have been reviewed by NAIC staff and have been rejected for statutory accounting. The guidance in ASU 2021-02 provides updates and clarifications to the guidance for franchisors, which include several unique accounting concepts that were not fully covered by ASU 2014-09 and ASC Topic 606.

The updates in ASU 2021-02 apply to entities that are not public business entities that are within the scope of Topic 952, which includes all entities that meet the definition of franchisor, that is, the party who grants business rights (the franchise) to the party (the franchisee) who will operate the franchised business. The amendments in this ASU were intended to reduce the cost and complexity of applying Topic 606 to pre-opening services for franchisors that are not public business entities by providing a practical expedient for applying Topic 606 to pre-opening services.

Existing Authoritative Literature:
Premium revenue recognition is detailed throughout the SSAPs, including the following: *SSAP No. 51—Life Contracts; SSAP No. 53—Property Casualty Contracts – Premiums; SSAP No. 54—Individual and Group Accident and Health Contracts* and *SSAP No. 57—Title Insurance*. The ASUs related to ASC Topic 606 have been rejected in SSAP No. 47.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): Agenda item 2016-19 and 2017-37 address the main ASUs related to ASC Topic 606 and there have been several other agenda items for minor updates to revenue recognition guidance.

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

Convergence with International Financial Reporting Standards (IFRS): ASC Topic 606 and IFRS 15 are the result of the joint project between the FASB and IASB to improve financial reporting by creating common revenue recognition guidance.

Staff Recommendation:
NAIC staff recommends the Working Group move this agenda item to the active listing, categorized as nonsubstantive and expose revisions to reject ASU 2021-02 in *SSAP No. 47—Uninsured Plans*. This recommendation is consistent with how the prior ASUs related to Topic 606 have been treated.

Staff Review Completed by: Jake Stultz, February 2021

Proposed Revisions to SSAP No. 47:

15. This statement rejects *ASU 2014-09, Revenue from Contracts with Customers; ASU 2015-14, Revenue From Contracts With Customers; ASU 2016-08, Revenue From Contracts with Customers: Principal versus Agent Considerations (Reporting Revenue Gross versus Net); ASU 2016-10, Revenue from Contracts with Customers: Identifying Performance Obligations and Licensing; ASU 2016-12, Revenue from Contracts with Customers: Narrow-Scope Improvements and Practical Expedients; ~~and~~ ASU 2016-20, Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers* and *ASU 2021-02, Franchisors—Revenue from Contracts with Customers*.

G:\FRS\DATA\Stat Acctg\3. National Meetings\A. National Meeting Materials\2021\March 15 (Spring)\Meeting\J - 21-08 - ASU 2021-02 - Franchisors - Revenue from Contracts with Customers.docx

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

Issue: State ACA Reinsurance Programs

Check (applicable entity):

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

Description of Issue:
SSAP No. 107—Risk-Sharing Provisions of the Affordable Care Act provides guidance regarding the three Affordable Care Act (ACA) risk sharing programs known as risk adjustment, the transitional reinsurance program and risk corridors. All three programs were to assist with rate stabilization in the individual market. Risk adjustment was originally the only permanent program and the other two were temporary. Although the 2014-2016 transitional reinsurance program has ended, several states have received approval from the Department of Health and Human Services (HHS) to run similar state ACA reinsurance programs under what are known as Section 1332 waivers.

This agenda item is to provide accounting and reporting guidance regarding State ACA reinsurance programs being run under Section 1332 waivers. Note that states can seek Section 1332 waivers to address a variety of issues such as:

- Individual and employer mandates;
- Essential health benefits (EHBs);
- Limits on cost sharing for covered benefits;
- Metal tiers of coverage;
- Standards for health insurance marketplaces, including requirements to establish a website, a call center, and a navigator program; and
- Premium tax credits and cost-sharing reductions.

To date, most of the states that have sought 1332 waivers did so to implement state ACA reinsurance programs which have the goal of using the reinsurance programs to lower individual health insurance premium in the jurisdiction. As these programs seek to operate to cover higher individual health claims in a manner similar to the transitional reinsurance program, the initial recommendation is to provide guidance that such state programs should follow the guidance in SSAP No. 107 to the extent the state program has similar terms.

The original transitional reinsurance program and the subsequent state ACA reinsurance programs are not reinsurance in the true sense. They typically rely on group products to help fund the program, but do not typically allow the group products to receive reinsurance distributions. Therefore the group products help fund the program but are not true participants. Because of this, a hybrid approach was incorporated into the SSAP No. 107 accounting guidance. A similar hybrid approach is recommended for state ACA reinsurance programs. At a high level this approach divides products into 3 broad categories. This includes:

1. Subject individual products (typically individual plans) that may pay an insurance contribution and are eligible to receive reinsurance distributions. These programs report like an involuntary reinsurance pool as is described in *SSAP No. 63—Underwriting Pools*.

2. Other insured health products (typically group plans) that are not eligible for reinsurance distributions under the terms of the state ACA reinsurance program. These products treat the amounts as assessments reported in taxes, licenses and fees similar to treatment under *SSAP No. 35R—Guaranty Funds and Other Assessments*.

3. Self-insured plans where the reporting entity is acting as an administrator, and will exclude the payments made on behalf of the self-insured plan from the reporting entity's operations, consistent with the guidance in *SSAP No. 47—Uninsured Plans*.

Existing Authoritative Literature:
SSAP No. 35R—Guaranty Funds and Other Assessments provides guidance on assessments.

SSAP No. 63—Underwriting Pools provides guidance regarding involuntary pools.

SSAP No. 107—Risk-Sharing Provisions of the Affordable Care Act provides the following:

Transitional Reinsurance Program – Description and Overview

17. The transitional reinsurance program based on Section 1341 of the ACA is effective for plan years 2014 through 2016. Reinsurance assessments will be collected and distributions will be issued during the three-year term.

18. All issuers of major medical commercial products and third party administrators (TPAs) on behalf of uninsured group health plans are required to contribute funding at the national contribution rate to HHS. States establishing reinsurance programs may collect additional funding. Non-grandfathered individual plans are eligible to receive benefit program distributions via an excess-of-loss reinsurance system. Grandfathered plans are ineligible. Group plans are required to contribute funding, but are not eligible to receive reinsurance program distributions.

19. In general, this transitional reinsurance program provides funding to issuers in the individual market that incur high claims costs for enrollees. The program requires assessments from all issuers and TPAs on behalf of group health plans based on a per member annual fee established by HHS. The reinsurance assessment will fund reinsurance program distributions plus disbursements to the U.S. Treasury, in addition to covering administrative expenses of the program.

20. Consequently, the term "reinsurance" does not represent actual reinsurance between licensed insurers as defined by *SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance*. This program is similar to an involuntary pool in *SSAP No. 63—Underwriting Pools* for the individual insured health products subject to the 2014 ACA market reforms. For the group plans, which are required to contribute funding but are not eligible to receive program distributions, the program is an assessment payable by the reporting entity and not a pool.

21. The national transitional reinsurance program assessment rate for all issuers and TPAs will be established by HHS and will be designed to collect more than $12 billion in 2014 to cover the required $10 billion for the reinsurance program, the $2 billion contribution to the U.S. Treasury, and additional amounts to cover the administrative costs of the federal government entity and applicable reinsurance entities. States electing to operate their own reinsurance program have the option to increase the reinsurance assessment rate to provide additional funding for the reinsurance program or to fund the administrative expenses of the applicable reinsurance entity. Assessments for the reinsurance program must fund the reinsurance program of $10 billion in 2014, $6 billion in 2015 and $4 billion in 2016, plus disbursements to the U.S. Treasury of $2 billion, $2 billion and $1 billion for years 2014 through 2016, in addition to covering administrative expenses of the applicable reinsurance entity or HHS.

22. Reinsurance program distributions will be processed either by the applicable reinsurance entity or by HHS and will be made to issuers of non-grandfathered individual market plans for high claim costs of enrollees. Distributions from the applicable reinsurance entity to insurers providing individual coverage will be calculated as a coinsurance rate multiplied by the eligible claims submitted for an individual enrollee's covered benefits between an attachment point and the reinsurance cap for each benefit year. The coinsurance rate, attachment point and

reinsurance cap are initially determined by HHS, but may be modified by the state, if the state chooses to establish its own reinsurance program.

23. Each state is eligible to establish a reinsurance program, regardless of whether the state establishes a Marketplace Exchange. If a state establishes a reinsurance program, the state must enter into a contract with an applicable reinsurance entity or entities or establish a reinsurance entity to carry out the program. If a state does not elect to establish its own reinsurance program, HHS will administer the reinsurance program on behalf of that state. HHS establishes the annual administrative portion for the fee. (For example, the 2014 fee will be $0.11 per-member per-year resulting in $20.3 million of administrative expense funding).

24. Reinsurance assessments to fund the program are made on an annual basis with billing beginning December 15, 2014. An insurer may submit claims for reimbursement when an enrollee of the reinsurance-eligible plan has met the applicable criteria as determined by either the state or HHS. Claims may be submitted through April 30 of the year following the benefit year. HHS will distribute reinsurance program funds among issuers nationally based on submitted claims. Issuers will be notified of pending reinsurance distributions by June 30 following the benefit year. If the requests for distributions exceed the actual assessments collected, HHS will reduce reinsurance distributions on a pro-rata basis. If the requests for distributions are less than actual assessments collected, HHS will increase reinsurance distributions on a pro-rata basis.

Transitional Reinsurance Program – Accounting Treatment

25. Due to the diverse elements of the transitional reinsurance program, which includes characteristics of traditional reinsurance, involuntary pools and governmental assessments, a hybrid accounting approach is required. The accounting treatment for the transitional reinsurance program outlined below is discussed in terms of the payables and receivables and the impact to the health insurance products subject to the program.

26. The following are the broad groupings of the health insurance products subject to the transitional reinsurance program:

a. Individual insured health products subject to the 2014 ACA market reforms. This excludes grandfathered and non-grandfathered 2013 products (referred to as subject individual insured products);

b. Other insured health products. This encompasses products which are not subject to the ACA market reforms including individual grandfathered and non-grandfathered (referred to as other insured health products);

c. Self-insured health products.

27. The guidance in this section will provide treatment for each of the assessments payable and program distribution receivable elements of the program listed below for the health insurance products listed in paragraph 26.

a. Assessments for reinsurance

b. Administrative costs assessments

c. Additional U.S. Treasury assessment

d. Reinsurance distributions

Subject Individual Insured Health Products

Subject Individual Insured Issuers - Assessments Payable for Reinsurance

28. Transitional reinsurance assessments attributable to enrollees in individual plans are treated as ceded reinsurance premium. This applies both to assessments made at the national assessment rate and to any state-elected additional assessments that will fund reinsurance program distributions. Ceded premiums would be

reported as a reinsurance cession and follow reinsurance accounting in accordance with SSAP No. 61R, paragraph 17 and paragraphs 25-27:

29. For the individual coverage issuers, this is an involuntary pool and under the terms of the transitional reinsurance program, the transfer of risk and timely reimbursement requirements of SSAP No. 61R are deemed to be met.

30. With regard to individual coverage issuers, the transitional reinsurance program is more similar to traditional reinsurance than it is to an assessment, because program assessments are made to and program distributions are received from the government or government-sponsored entity. Accordingly, the program is accounted for as reinsurance for individual insured products subject to the transitional reinsurance program.

31. The provisions of SSAP No. 63, paragraph 3, define involuntary pools.

32. The transitional reinsurance program differs from an involuntary pool, in that there is not a proportionate sharing of the entire results of a pool. However, the purpose is very similar: to address the additional costs associated with high-risk individuals. Furthermore, HHS has noted, *"the Affordable Care Act … requires that states eliminate or modify high-risk pools to the extent necessary to carry out the reinsurance program,"* which likewise highlights the similar purposes of the two mechanisms. Therefore, SSAP No. 63, paragraph 8, provides additional relevant guidance. As the transitional reinsurance program is a mechanism for sharing the additional costs associated with high-risk individuals, it is accounted for as traditional reinsurance.

Subject Individual Insured Issuers - Reinsurance Administrative Expense Assessments

33. The assessment payable by the reporting entity for administrative expenses attributable to individual coverage is reflected as ceded premium. This applies both to assessments made at the national assessment rate and to any state-required assessments that will provide additional funding for administrative expenses.

34. Normally reinsurance premiums are set at a level intended to cover anticipated claim costs and include an administrative charge component. Therefore, as a matter of consistency, it is appropriate to include the administrative charge component for the transitional reinsurance program in ceded premium for individual insured products.

Subject Individual Insured Issuers - U.S. Treasury Assessment

35. Because this portion of the assessment is earmarked for the U.S. Treasury and not for the reimbursement of claims or to cover the operating costs of the reinsurance program, it is a federal assessment not based on income. This portion of the assessment is not treated as ceded premium, but as an assessment under SSAP No. 35R and is reflected in the same expense category as taxes, licenses and fees. This is also consistent with annual statement expense reporting categories.

Subject Individual Insured Issuers - Reinsurance Program Distributions

36. Program distributions received from the ACA transitional reinsurance program for individual insurance is reflected as ceded claim benefit recoveries. This applies both to distributions received pursuant to the uniform federal reinsurance parameters and to any state distribution received.

37. In keeping with the rationale for reinsurance assessments above, distributions receivable from the transitional reinsurance program for individual insurance products is reflected the same as traditional reinsurance recoveries as described in SSAP No. 61R, paragraph 27.

38. Therefore, recoveries received are reported in the summary of operations and will reduce the ceding entity's reported benefits paid.

39. HHS and all applicable reinsurance entities shall be reported consistent with providers to an involuntary pool and will be treated as authorized reinsurers for the purposes of financial reporting for subject individual health products.

40. All receivables from the transitional reinsurance program are subject to the 90-day nonadmission rule beginning from when program receivables are due to be disbursed by the government or a government-sponsored entity. That is, the 90-day rule begins when governmental receivables are due, not from the date of initial accrual. The announced governmental or government-sponsored entity distribution date shall be the contractual due date similar to Appendix A-791, paragraph 2.h., which requires that payments due from the reinsurer are made in cash within ninety (90) days of the settlement date. The receivable is also subject to impairment analysis.

Other Insured Health Products

Other Insured Health Products – Assessments Payable for Reinsurance

41. Transitional reinsurance program reinsurance assessments made for enrollees in fully insured plans other than individual plans are treated as an assessment payable by the reporting entity and charged to taxes, licenses and fees. This applies both to assessments made at the national assessment rate and to any state assessments that will fund reinsurance program distributions. In this case, for fully insured non-individual plans, the entity cannot, under the terms of the program, be deemed to be "participating," as funds for claim recoveries will not be re-distributed back to the issuer for the coverage that is being assessed. Therefore, issuers of other insured health products that are not for individuals are paying an involuntary fee but are not participating in an involuntary pool.

42. The treatment of the transitional reinsurance program reinsurance assessments for non-individual fully insured plans differs from the treatment for individual plans. Since the non-individual plans are not eligible for reimbursement, they are not participating in a reinsurance arrangement, and thus, the assessments are not treated as ceded premium. As an involuntary assessment, the transitional reinsurance program reinsurance assessments, consistent with SSAP No. 35R are treated as an assessment payable by the reporting entity and charged to taxes, licenses and fees expense. The expense is accrued in proportion to the other insured health enrollees base that will be used to determine the assessments payable as the premium subject to the assessment is written.

Other Insured Health Products - Reinsurance Administrative Expense Assessments

43. The reinsurance program administrative costs for other insured health products are an assessment payable by the reporting entity. This applies both to assessments made at the national assessment rate and to any state assessment that will fund administrative expenses and is reflected in the same expense category as taxes, licenses and fees.

Other Insured Health Products - U.S. Treasury Assessment

44. The additional U.S. Treasury assessment for other insured health products is a federal assessment payable by the reporting entity which is not based on income and is reflected in the same expense category as taxes, licenses and fees.

Other Insured Health Products - Reinsurance Program Distributions (not applicable)

45. Reinsurance recoveries will not occur for insured health products other than individual. Other insured health products will pay the transitional reinsurance program assessments payable but not receive program distributions for claims.

Self-Insured Health Products

Self-Insured Health Products - Assessments Payable for Reinsurance

46. Assessments made on behalf of self-insured plans which are administered by the reporting entity are uninsured plans and are excluded from the reporting entity's statement of operations, with respect to both monies received from the plans and assessments disbursed by the reporting entity. Any resulting liabilities or receivables shall be reported as liabilities and receivables held in connection with uninsured plans. This treatment is consistent with *SSAP No. 47—Uninsured Plans,* paragraphs 5 and 8-11.

47. The self-insured plan, not the reporting entity, is legally liable for assessments for the transitional reinsurance program. The funds are a bona fide pass-through by the reporting entity, which is merely providing a

service for the self-insured (uninsured) plan. Therefore, the reporting entity will not report revenues or expenses for the assessments for the transitional reinsurance program.

48. The reporting entity may have received funds from the self-insured plans in advance of making disbursements. In that event, a liability is established for funds held in connection with self-insured plans.

49. The reporting entity, depending on its arrangement with the (uninsured) plan, may make a disbursement before receiving full funding from the plan. In that event, an asset is established for amounts receivable in connection with uninsured plans. The asset would be subject to the rules for admissibility and impairment as prescribed in SSAP No. 47, paragraphs 9-10.

Self-Insured Health Products - Reinsurance Administrative Expense Assessments Payable and U.S. Treasury Assessment

50. A reporting entity providing a service for a self-insured plan that is uninsured shall apply the pass-through treatment for the transitional reinsurance program's administrative cost assessments and additional U.S. Treasury contribution amounts. The uninsured plan, not the reporting entity, is legally liable. Therefore, the reporting entity will not report revenues or expenses with respect to the transitional reinsurance program's administrative cost assessments and additional U.S. Treasury contribution amounts.

Self-Insured Health Products - Reinsurance Payments (not applicable)

51. Reinsurance recoveries will not occur for self-insured health products, as these products will pay fees but not receive claims reimbursements.

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: The following website provides a useful overview and map of existing state Section 1332 waivers.
https://www.kff.org/health-reform/fact-sheet/tracking-section-1332-state-innovation-waivers/

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. 107 as illustrated below. These revisions would include State ACA reinsurance programs which are using Section 1332 waivers in the scope of *SSAP No. 107—Risk-Sharing Provisions of the Affordable Care Act*. The intent of the proposed accounting revisions is to continue to follow the SSAP No. 107 hybrid accounting approach for the state ACA programs as they operate in a similar manner.

In general, state ACA reinsurance programs provide funding to issuers in the individual market that incur high claims costs for enrollees. The programs often require assessments from issuers typically on behalf of group health plans. At a high level this hybrid accounting approach divides products into 3 broad categories. This includes:

a. Subject individual products (typically individual plans) that may pay a reinsurance funding contribution and are eligible to receive reinsurance distributions shall report similar to an involuntary reinsurance pool as described in *SSAP No. 63—Underwriting Pools*.

b. Other insured Health products (typically group plans) that are not eligible for reinsurance distributions under the terms of the state ACA reinsurance program shall treat the amounts as assessments reported in taxes, licenses and fees similar to treatment under *SSAP No. 35R—Guaranty Funds and Other Assessments*.

c. Self-insured plans where the reporting entity is acting as an administrator, and will exclude the payments made on behalf of the self-insured plan from the reporting entity's operations, shall report consistent with the guidance in *SSAP No. 47—Uninsured Plans*.

Staff Review Completed by:
Robin Marcotte
NAIC Staff

SCOPE OF STATEMENT

1. The Affordable Care Act (ACA) imposes fees and premium stabilization provisions on health insurance issuers offering commercial health insurance. This statement provides accounting for three programs known as risk adjustment, reinsurance and risk corridors that take effect in 2014. Risk adjustment is a permanent risk-spreading program (ACA Section 1343). The temporary transitional reinsurance program (ACA Section 1341) and temporary risk corridors program (ACA Section 1342) are for years 2014 through 2016. Subsequent to the end of the transitional reinsurance program, several states received waivers to have state specific ACA reinsurance programs, which operate similarly to the transitional reinsurance program. These programs are addressed in this statement.

State ACA Reinsurance Programs – Overview

52. After the 2014-2016 transitional reinsurance program ended, several states received approval from the HHS to run similar state ACA reinsurance programs under what are known as Section 1332 waivers. While Section 1332 waivers can be sought on a variety of topics, state ACA reinsurance programs are the most common. These state ACA reinsurance programs have similar goals of lowering individual health insurance premium in the jurisdiction.

53. The terms of these programs will have jurisdiction-specific variations. For example, the percentage of claims covered and the cap on claims covered varies by jurisdiction and sometimes by year. The initial flow of funding and covered policies may also have differences from the original transitional reinsurance program. However, several of the state ACA programs also include excess of loss coverage for individual claims in excess of a specified amount. One example would be reimbursing 80% of claims in excess of $50,000 up to a cap of $250,000 in the individual market in a state.

54. In general, state ACA reinsurance programs provide funding to issuers in the individual market that incur high claims costs for enrollees. The programs often require assessments from issuers and TPAs typically on behalf of group health plans based on a per member annual fee established by the state specific ACA reinsurance program.

55. Consequently, the term "reinsurance" does not represent actual reinsurance between licensed insurers as defined by *SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance*. These programs are similar to an involuntary pool in *SSAP No. 63—Underwriting Pools* for the individual insured health products subject to the State ACA reinsurance program. For the group plans, which are required to contribute funding but are not eligible to receive program distributions, the program is an assessment payable by the reporting entity and not a reinsurance pool.

State ACA Reinsurance Programs – Accounting Treatment

56. The state ACA reinsurance programs shall follow the same principles of accounting and reporting as the transitional reinsurance program to the extent that the state ACA reinsurance program has similar features. The state ACA reinsurance program components including the treatment of reinsurance assessments, administrative costs assessments, and the reinsurance distributions, shall follow similar accounting and reporting principles as the transitional reinsurance program.

57. Due to the diverse elements of the State ACA reinsurance programs, which include characteristics of traditional reinsurance, involuntary pools and governmental assessments, a hybrid accounting approach

is required for the state ACA reinsurance programs. The accounting treatment for the state ACA reinsurance programs is discussed in terms of the payables and receivables and the impact to the health insurance products which are subject to the program.

58. The broad groupings for health insurance products used for the original transitional programs discussed in paragraph 26 will continue to apply to the state ACA reinsurance programs with jurisdiction specific modifications regarding the scope of health products subject to the market reforms. At a high level this approach divides products into 3 broad categories which are detailed in the accounting guidance below more specifically. This includes:

a. Subject individual products (typically individual plans) that may pay a reinsurance funding contribution and are eligible to receive reinsurance distributions. These programs shall report similar to an involuntary reinsurance pool as described in *SSAP No. 63—Underwriting Pools*.

b. Other insured Health products (typically group plans) that are not eligible for reinsurance distributions under the terms of the state ACA reinsurance program. These products shall treat the amounts as assessments reported in taxes, licenses and fees similar to treatment under *SSAP No. 35R—Guaranty Funds and Other Assessments*.

c. Self-insured plans where the reporting entity is acting as an administrator, and will exclude the payments made on behalf of the self-insured plan from the reporting entity's operations, shall report consistent with the guidance in *SSAP No. 47—Uninsured Plans*.

State ACA - Subject Individual Insured Health Products

59. For subject individual insured products which are subject to reinsurance assessments and also eligible for reinsurance distributions according to the program's terms, should follow the same guidance as provided in paragraphs 28-40 to the extent the state program incorporates similar terms. For example, if the state ACA reinsurance program does not incorporate an assessment to the U.S. treasury, paragraph 35 would not apply.

60. For subject individual insured products, the accounting is similar to an involuntary reinsurance pool. The subject individual insured products will report both the state ACA reinsurance funding and State ACA reinsurance administrative assessments as premium ceded. Program distributions received from the state ACA reinsurance program for individual insurance is reflected as ceded claim benefit recoveries.

State ACA - Other Insured Health Products

61. Fully insured health products which are required to contribute to funding state ACA reinsurance programs, but are not eligible to receive reinsurance program distributions under the terms of the program, shall report the contributed reinsurance and administrative expense funding as assessments which is charged to taxes, licenses and fees expense. For these products, the accounting shall be consistent with paragraphs 41-45 to the extent the state ACA reinsurance program incorporates similar terms.

State ACA – Self-Insured Health Products

62. If a reporting entity is an administrator for a self-insured health plan, the accounting for the state ACA reinsurance program amounts for the self-insured plan administrator is similar to the accounting in SSAP No. 47. The administrator of such plans shall follow the accounting described in paragraphs 46-51 to the extent the state program incorporates similar terms. The self-insured plan, not the administrator reporting entity, is legally liable for assessments for the state ACA reinsurance program. The funds are a bona fide pass-through by the reporting entity, which is merely providing a service for the self-insured (uninsured) plan. Therefore, the reporting entity will not report revenues or expenses for the assessments for the transitional reinsurance program.

Disclosures

~~60.~~72. The financial statements shall disclose on an annual and quarterly basis beginning in the first quarter of 2014, the assets, liabilities and revenue elements by program regarding the risk-sharing provisions of the Affordable Care Act for the reporting periods which are impacted by the programs including the listing in paragraphs 60.a. through 60.c. Reporting entities shall also indicate if they wrote any accident and health insurance premium, which is subject to the Affordable Care Act risk-sharing provisions. In the event that the balances are zero, the reporting entity should provide context to explain the reasons for the zero balances, including insufficient data to make an estimate, no balances or premium was excluded from the program, etc. Asset balances shall reflect admitted asset balances. The disclosure shall include the following:

a. ACA Permanent Risk Adjustment Program

i. Premium adjustments receivable due to ACA Risk Adjustment (including high-cost risk pool payments)

ii. Risk adjustment user fees payable for ACA Risk Adjustment

iii. Premium adjustments payable due to ACA Risk Adjustment (including high-cost risk pool ceded premium)

iv. Reported as revenue in premium for accident and health contracts (written/collected) due to ACA Risk Adjustment

v. Reported in expenses as ACA risk adjustment user fees (incurred/paid)

b. ~~ACA Transitional Reinsurance Program~~ State ACA Reinsurance Program

i. Amounts recoverable for claims paid due to state ACA Reinsurance Programs

ii. Amounts recoverable for claims unpaid due to state ACA Reinsurance (contra-liability)

iii. Amounts receivable relating to uninsured plans for contributions for state ACA Reinsurance

iv. Liabilities for contributions payable due to state ACA Reinsurance - not reported as ceded premium

v. Ceded reinsurance premiums payable due to state ACA Reinsurance

vi. Liability for amounts held under uninsured plans contributions for state ACA Reinsurance

vii. Ceded reinsurance premiums due to state ACA Reinsurance

viii. Reinsurance recoveries (income statement) due to state ACA Reinsurance payments or expected payments

ix. State ACA Reinsurance Contributions – not reported as ceded premium

c. ACA Temporary Risk Corridors Program

i. Accrued retrospective premium due from ACA Risk Corridors

ii. Reserve for rate credits or policy experience rating refunds due to ACA Risk Corridors

iii. Effect of ACA Risk Corridors on net premium income (paid/received)

iv. Effect of ACA Risk Corridors on change in reserves for rate credits

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March 15th Interim Meeting (in lieu of Spring National Meeting) - Review of GAAP Exposures for Statutory Accounting:

Pursuant to a 2014 direction from the SAPWG chair, there is a desire for the Statutory Accounting Principles (E) Working Group to be more proactive in considering FASB exposures that may be significant to statutory accounting and reporting. Historically, the SAPWG has commented on limited, key FASB exposures – mostly pertaining to insurance contracts and financial instruments. To ensure consideration of all FASB exposures, staff has prepared this memorandum to highlight the current exposures, comment deadlines, and to provide a high-level summary of the exposed item's potential impact to statutory accounting. It is anticipated that this information would assist the Working Group in determining whether a comment letter should be submitted to the FASB on the issues. Regardless of the Working Group's election to submit comments to the FASB on proposed accounting standards, under the NAIC Policy Statement on Statutory Accounting Principles Maintenance Agenda Process, issued US GAAP guidance noted in the hierarchy within Section V of the Preamble to the *Accounting Practices and Procedures Manual* must be considered by the Statutory Accounting Principles (E) Working Group.

FASB Exposures: http://www.fasb.org/jsp/FASB/Page/SectionPage&cid=1175805074609

Exposed FASB Guidance	Comment Deadline & Initial Staff Comments
Proposed Accounting Standards Update—*Business Combinations (Topic 805): Accounting for Contract Assets and Contract Liabilities from Contracts with Customers*	March 15, 2021 Review ASU under the SAP Maintenance Process

Proposed Accounting Standards Update—*Business Combinations (Topic 805): Accounting for Contract Assets and Contract Liabilities from Contracts with Customers — Comment Deadline: March 15, 2021*

Information from FASB Exposure Draft:

In May 2014, FASB issued *ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606)*, which provides a single comprehensive accounting model on revenue recognition for contracts with customers. In connection with the issuance of Topic 606, stakeholders raised questions on how to apply Topic 805, Business Combinations, to a contract with a customer acquired in a business combination after the acquirer has adopted Topic 606. This ASU would require the acquirer to recognize and measure contract assets and contract liabilities acquired in a business combination in accordance with Topic 606. However, on the acquisition date, an acquirer would assess how the acquiree applied Topic 606 to determine what to record for the acquired revenue contracts. This would usually result in an acquirer recognizing and measuring the acquired contract assets and contract liabilities consistent with how they were recognized and measured in the acquiree's financial statements (if the acquiree's financial statements were prepared in accordance with U.S. GAAP. The amendments in this Update also provide specific guidance on how to recognize and measure acquired revenue contracts in a business combination.

Staff Review and Commentary:

Comment deadline is March 15, 2021.
Review ASU under the SAP Maintenance Process as detail in *Appendix F—Policy Statements.*

