Statutory Accounting Principles (E) Working Group
Hearing Agenda
November 16, 2022
10:00 – 11:30 (CST)

ROLL CALL

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

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

Note: This meeting will be recorded for subsequent use.

REVIEW of COMMENTS on EXPOSED ITEMS

1. *INT 22-0: Third Quarter 2022 Reporting of the Inflation Reduction Act - Corporate Alternative Minimum Tax*

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
INT 22-03 (Robin/ Julie)	*INT 22-03: Inflation Reduction Act – Corporate Alternative Minimum Tax*	**INT 22-03T- A INT 22-02-B**	**Comments Received**	**IP-1**

Summary:
On October 6, the Working Group exposed *INT 22-03: Inflation Reduction Act – Corporate Alternative Minimum Tax* to address fourth quarter 2022 and interim 2023 reporting. The exposed tentative consensus would require reporting when reasonable estimates can be made. It provides some subsequent events exceptions regarding the corporate alternative minimum tax (CAMT), allowing estimates to be updated as information becomes available. Companies subject to the CAMT are required to have their estimates recognized fully by year-end 2023. The tentative INT also provides for disclosures.

Previously, on October 24, 2022, the Working Group adopted *INT 22-02: Third Quarter 2022 Reporting of the Inflation Reduction Act – Corporate Alternative Minimum Tax* to provide exceptions to *SSAP No. 9—Subsequent Events* and *SSAP No. 101—Income Taxes* in response to the Inflation Reduction Act for 3rd quarter 2022. Pursuant to the adopted INT, it identified that reasonable estimates could not be determinable, therefore reporting entities shall not recognize impacts related to the CAMT for third quarter 2022 financial statements. The adopted INT 22-02 also provided exceptions to subsequent event reporting, and required disclosures based on whether the reporting entity (or the controlled group of corporations of which a reporting entity is a member) has determined if it expected to be liable for the CAMT in 2023.

As detailed in the comment letter received, interested parties' request extension of INT 22-02 for at least year-end 2022. The prior interested parties' comment letter requested a deferral of recognition through first quarter 2023.

Interested Parties' Comments on INT 22-03:
Interested parties is appreciative of the opportunity to comment on INT 22-03: Inflation Reduction Act – Corporate Alternative Minimum Tax (CAMT), exposed by the Statutory Accounting Principles Working Group on October 6, 2022. As noted in connection with the exposure, this INT addresses fourth quarter 2022 and interim 2023 reporting. It requires reporting when reasonable estimates can be made. It provides some subsequent events exceptions regarding the CAMT, to allow estimates to be updated as information becomes available. Companies subject to the CAMT are required to have their estimates recognized fully by year end 2023. Disclosures are also provided.

Interested parties has previously made two submissions to the Working Group on the subject of the CAMT. On September 26, 2022, we requested that the Working Group permit insurance companies to defer recognition of any statutory tax accounting effects of the CAMT until no earlier than the due date for filing the quarterly statement for the first quarter of 2023. On October 14, 2022, interested parties submitted comments on INT 22-02: Third Quarter 2022 Reporting of the Inflation Reduction Act – Corporate Alternative Minimum Tax. INT 22-02 concluded that because of the timing of the adoption of the Act and the considerable number or unknown variables, impacts related to the CAMT should not be recognized for third quarter 2022 financial statements.

INT 22-03 considers three statutory accounting issues relating to the CAMT:
1. Calculations for year-end 2022 and interim 2023 financial statements
2. Subsequent events for year-end 2022 and interim 2023 financial statements
3. Reporting changes to deferred tax assets and liabilities

Paragraph 12 of INT 22-03 provides that reporting entities that are aware that they will be subject to the CAMT shall reflect the impact on the calculations affected by the CAMT if the impacts are reasonably estimable for year-end 2022 and for the interim 2023 financial statements. For the following reasons, interested parties believes that the impact of the CAMT will not be reasonably estimable by reporting entities for year-end 2022, nor perhaps for interim 2023 statutory financial statements:

- Needed clarification from the Working Group of statutory tax accounting issues
- Inability of reporting entities this late in the calendar year to implement systems and process changes, to establish appropriate internal controls, or to adopt changes to intercompany tax sharing agreements necessary to make a reasonable estimate of the impact of the CAMT
- Lack of CAMT guidance from the U.S. Treasury

Accordingly, interested parties requests that the Working Group extend INT 22-02's deferral of recognition of the impacts of the CAMT at least through the year-end 2022 financial statements.

Needed Clarification from the Working Group of Statutory Tax Accounting Issues
Our September 26 letter noted that, as a result of the consolidated financial statement approach to applicability of and determination of the CAMT, substantive questions exist as to the proper income tax accounting for the CAMT in the statutory separate company financial statements of an insurance company. The CAMT is not effective until 2023, so there will be no current tax effects for year-end 2022 financial statements. However, because INT 22-03 requires a reasonable estimate for year-end 2022 financials, it appears to assume that the CAMT could have deferred tax effects for those financial statements. However, before any deferred tax effects can be estimated, a basic issue must be addressed by the Working Group as to how to reconcile the consolidated nature of the CAMT (both as to its potential applicability to a consolidated tax return group and the computation of the consolidated tax return group's tentative CAMT) with the tax accounting requirements for the separate statutory financial statements of insurance companies.

The attachment to this letter includes additional information about factors that are relevant to this matter:
- The consolidated determination of the applicable financial statement and the starting point for computation of adjusted financial statement income

- The circumstances under which an insurance company may or may not be includible in a consolidated Federal income tax return (with special considerations applicable to life insurers)
- The GAAP and statutory accounting guidance regarding income tax accounting in separate financial statements of companies included in a consolidated return
- Different methodologies for allocating consolidated tax liability pursuant to intercompany tax sharing agreements (TSAs)

Also included is an example illustrating a typical fact situation for a consolidated group including insurance companies and the types of statutory tax accounting-related questions that could arise. As a practical matter, reporting entities will experience a wide variety of circumstances which, we believe, requires clarifying guidance from the Working Group. In other words, we believe that before a reasonable estimate may be made, the basis or bases on which the estimate is to be determined must be clearly set forth.

For example, should an insurance company that is included in the consolidated financial statement of a consolidated tax return group that is not an "applicable corporation" as defined in the tax law (and therefore not subject to the CAMT) have to do any accounting at all for the CAMT in its separate company statutory financial statements? If an insurance company is included in a consolidated Federal income tax return of a GAAP consolidated financial statement group that is an applicable corporation, how are the impacts of the CAMT in the insurer's separate company financials determined, including in the determination of adjusted gross deferred tax assets under paragraph 11.b. of SSAP No. 101? What if the insurance company does not have available any separate company financial statements other than its statutory financial statements? How does the answers to these questions depend on whether the intercompany TSA does or does not allocate CAMT? Would the answer be different if the TSA provided for a pro rata allocation of consolidated tax liability rather than a separate return computation? Should an accounting policy election for these types of CAMT-related issues be available in the statutory financials?

Although paragraph 13 of INT 22-03 provides for reporting entities that cannot make a reasonable estimate, there is concern that audit firms will assert that such an estimate is indeed determinable. A similar concern exists with respect to the references to reasonable estimate in paragraphs 14 and 18.[1] In the absence of clarifying guidance, we are concerned that insurers and their audit firms will interpret and apply the existing tax accounting guidance in a diverse manner that will result in inappropriate inconsistencies.[2] In all these circumstances, there are threshold questions as to the basis for determining how a consolidated tax for which a consolidated tax group may be liable should be accounted for in the separate statutory financial statements of an insurance company member of the group, and interested parties requests that the Working Group issue clarifying guidance to address these CAMT-related tax accounting issues before requiring expanded CAMT disclosures.

In our letter dated September 26, 2022, we suggested a delay in the recognition of any statutory accounting effects of the CAMT until at least the first quarter 2023 statutory financial statements. This suggestion was made not only to provide additional time for initial guidance from Treasury (discussed further below), but also for consideration of the applicable statutory tax accounting issues. Interested parties will cooperate with the Working Group and NAIC staff to identify and address the various fact circumstances and issues and to consider appropriate resolutions.

<u>Systems, Processes, and Internal Controls Issues/Amendments of TSAs</u>
In addition to the statutory tax accounting uncertainties discussed above and the lack of Treasury guidance discussed below, another impediment relates to more practical matters – the inability of reporting entities at this time of year to effectively make changes in year-end reporting systems, processes, and internal controls to meet the reasonable estimate requirements of INT 22-03. Typically, by this time of year, companies have locked-down their year-end accounting processes and procedures, and it is highly unlikely that a reasonable estimate process for the CAMT

[1] Paragraphs 18.a. and 18.b of INT 22-03 require disclosures similar to those required by INT 22-02, and our comments on INT 22-02 in our October 14 letter also apply here, taken in the context of the above discussion of "reasonable estimate."
[2] It has already come to the attention of interested parties that major accounting firms may be developing differing points of view on the application of the principles of SSAP No. 101 to the CAMT.

could now be implemented in a manner that would satisfy all internal control procedures and other accounting system requirements. Instead, if the requirement is maintained, work-arounds would be required that would most likely lead to inconsistent and perhaps unreliable results.

Furthermore, while companies may be contemplating changes to their TSAs to account for the CAMT, time is insufficient to institute such requests and receive the required approvals for 2022. But even if there was adequate time, companies will be unable to make informed decisions about how their TSAs should deal with the CAMT in the absence of necessary tax law and tax accounting guidance clarifications. A circular equation exists – tax accounting is affected by TSAs, but TSAs are dependent on tax accounting. The tax accounting playing field must be clearly defined before appropriate TSA provisions may be implemented.

It also should be noted that, while TSAs generally do not provide for the CAMT, some TSAs still include provisions related to the AMT effective in pre-2018 years. Application of such provisions to a CAMT which the TSA was never designed to address would certainly lead to inconsistencies and inaccuracies.

Lack of Treasury Guidance

In our letter to the Working Group dated September 26, 2022, we noted that Treasury is required not only to provide general guidance to carry out the purpose of the CAMT, but also is directed or authorized to issue guidance to implement or clarify application of the law in approximately 20 specific instances. We also noted that one such instance where Treasury may alter application of the CAMT is in determining the applicable financial statement (AFS) for purposes of the CAMT, a determination that clearly is fundamental to the workings of the CAMT.[3] Further, we noted that Treasury would be asked to address the treatment of financial statement accounting issues specifically related to the insurance business. Both life insurance and property & casualty insurance trade associations have submitted letters to Treasury relating to insurance company-specific issues, and both have scheduled initial meetings with Treasury to discuss such issues.

We noted in our September 26 letter that substantive CAMT guidance is unlikely to occur until 2023. In the weeks since that letter was submitted, that expectation has been reinforced, as Treasury has acknowledged that issuing guidance on the energy tax credit provisions of the Inflation Reduction Act is a priority, rather than CAMT guidance which affects a smaller number of taxpayers. Accordingly, there is little expectation that Treasury guidance will be issued during the remainder of 2022 that will enhance reporting entities' ability to make a reasonable estimate of the effects of CAMT for year-end 2022.

Other Comments

We have two other comments of lesser importance than those above. First, paragraph 18.d. of INT 22-03 requires disclosure of additional information needed to complete the requirements "under ASC 740." Although this reference to ASC 740 is consistent with paragraph 7.d.ii.b) of INT 18-01: Updated Tax Estimates under the Tax Cuts and Jobs Act, we recommend that the words "under ASC 740" either be deleted or changed to "under SSAP No. 101." For the CAMT in particular, the accounting requirements and the ability of companies to make reasonable estimates for consolidated GAAP financial statement purposes differ from those applicable for separate company statutory financial statements.

Second, paragraph 15 of the INT requires evaluation of "partially issued" Treasury regulations in establishing a reasonable estimate for the impacts of the CAMT. This wording may have been intended to reflect anticipation that Treasury regulations or other guidance on the CAMT likely will be issued in piecemeal form, but clarification would be useful. Guidance on the tax law requirements for the CAMT may come in various forms - revenue rulings, notices, or proposed, temporary, or final regulations. Proposed regulations are subject to a notice and comment period before they may be issued in final form. The specific Internal Revenue Code language authorizing Treasury

[3] In an October 14, 2022, letter to Treasury, the American Institute of CPAs requested that Treasury exercise its authority to determine the AFS in a manner that apparently would make the statutory financial statements of an insurance company its AFS even if, for example, it is included in the consolidated GAAP financial statements of its parent company.

guidance on the CAMT usually refers to "regulations or other guidance." Accordingly, we recommend that the phrase "partially issued regulations" be changed to "regulations or other guidance."

Thank you for considering our comments. We look forward to further discussion of these matters and, in particular, cooperation with the Working Group and NAIC staff in clarifying the tax accounting guidance. Please feel free to contact either one of us with any questions you may have.

Additional Information and Example

This attachment includes discussion of the following:

- An overview of the newly enacted corporate alternative minimum tax.
- An overview of Federal income tax rules relating to inclusion of insurance companies in consolidated Federal income tax returns.
- Accounting guidance on allocation of consolidated tax expense to separate financial statements of members.
- Statutory income tax accounting guidance for the separate financial statements of insurance companies included in consolidated Federal income tax return.
- An example of a typical fact situation for an insurance company group and the type of statutory accounting issues that might arise in such a situation.

Corporate Alternative Minimum Tax

The recently enacted law commonly referred to as the "Inflation Reduction Act of 2022" includes a corporate alternative minimum tax (CAMT) effective in 2023 that is based on an applicable corporation's adjusted financial statement income (AFSI) set forth on its applicable financial statement (AFS). A corporation is an "applicable corporation" if its rolling average pre-tax AFSI over three prior years (starting with 2020-2022) is greater than $1 billion. For a group of related entities (based on greater than 50% ownership), the $1 billion threshold is determined on a controlled group basis, and the group's AFS is generally treated as the AFS for all separate taxpayers in the group.[4] Except under limited circumstances that may be the subject of future Treasury guidance, once a corporation is an applicable corporation, it is an applicable corporation in all future years.

Even if a corporation is an applicable corporation, it is not automatically subject to a CAMT liability. The corporation's tentative CAMT liability is equal to 15% of its adjusted AFSI, and CAMT is payable to the extent the tentative CAMT liability exceeds regular corporate income tax. However, any CAMT paid would be indefinitely available as a credit carryover that could reduce future regular tax in excess of CAMT.

Inclusion of Insurance Companies in Consolidated Federal Income Tax Returns

The Internal Revenue Code provides that an "affiliated group" of corporations may file a consolidated US income tax return. For this purpose, an "affiliated group" is generally defined as a chain of "includible corporations" connected through stock ownership (comprising 80% or more of vote and value) with a common parent corporation. However, includible corporations do not include foreign corporations, nor (subject to the exceptions described below) life insurance companies. On the other hand, insurance companies that are not taxed as life insurance companies are includible corporations.

Two exceptions exist to the exclusion of life insurance companies from a consolidated return. First, two or more life insurance companies may file a so-called "life-life" consolidated return, provided they are in a parent-subsidiary relationship that satisfies the 80% ownership requirement. Second, an affiliated group that includes one or more life insurance companies may elect to treat such companies as includible corporations in a so-called "life-nonlife" consolidated return. However, a life insurance company may not be treated as includible until it has been a member of the affiliated group for 5 taxable years. During this 5-year waiting period, such a life insurance company is

[4] For a "foreign-parented multinational group," the $1 billion threshold is determined on a worldwide basis and the threshold for U.S.-taxpaying members of the group is reduced to $100 million.

referred to as "ineligible". After the expiration of the 5-year period, an ineligible life company automatically becomes includible in the life-nonlife consolidated return.

Accordingly, insurance companies may be included in a consolidated Federal income tax return under the following circumstances:

- A nonlife insurance company may be includible in a consolidated return that does not include life insurance companies, or in a life-nonlife consolidated return.
    - Such a nonlife insurance company may be the parent company of a consolidated return group.
        - For example, a mutual nonlife insurance company may file a consolidated return with its 80% or more owned subsidiaries.
        - If a life-nonlife election has been made, such consolidated return includes eligible life insurance companies.
- A life insurance company may be included in a life-nonlife consolidated return if it is eligible and if the common parent company has made the life-nonlife election.
    - A life insurance company may be included in a life-life consolidated return if the requisite parent-subsidiary relationship exists with another life insurance company and either:
        - A life-nonlife election has not been made by the ultimate parent company of the affiliated group
        - A life-nonlife election has been made, but the life company is ineligible during the 5-year waiting period.
            - However, an ineligible life insurance company may <u>not</u> elect to file a life-nonlife consolidated return with its nonlife insurance company subsidiaries.
    - A life insurance company may be the parent company of a life-nonlife consolidated return group.

<u>Allocation of Consolidated Tax Expense to Separate Financial Statements of Members</u>

Accounting Standards Codification (ASC) 740-10-30-27 provides that the consolidated amount of current and deferred tax expense for a group that files a consolidated tax return is allocated among the members of the group when those members issue separate financial statements. ASC 740 does not require a single allocation method; however, the method adopted must be systematic, rational, and consistent with the broad principles of the asset and liability approach established by ASC 740. A method that allocates current and deferred taxes to members of the group by applying ASC 740 to each member as if it were a separate taxpayer meets those criteria. The separate company approach also is the preferred method for separate financial statements filed with the Securities and Exchange Commission. SEC Staff Accounting Bulletin

Topic 1B states:

> The staff believes that it is material to investors to know what the effect on income would have been if the registrant had not been eligible to be included in a consolidated income tax return with its parent. Some of these subsidiaries have calculated their tax provision on the separate return basis, which the staff believes is the preferable method.

It is recognized that under the separate taxpayer approach, the sum of amounts allocated to individual members of the group may not equal the consolidated amount. This may also be the result when there are intra-entity transactions between members of a group.

ASC 740-10-30-28 provides the following examples of methods that are not consistent with the broad principles of ASC 740:

- A method that allocates only current taxes payable to a member of the group that has taxable temporary differences.
- A method that allocates deferred taxes to a member of the group using a method fundamentally different from the asset and liability method described in ASC 740.

- A method that allocates no current or deferred tax expense to a member of the group that has taxable income because the consolidated group has no current or deferred tax expense.

Although ASC 740 does not prescribe a single allocation method to apply when an entity allocates current and deferred income taxes, in practice, intercorporate tax allocations are often calculated using the separate return method, the benefits for losses method, or the pro rata method.

- The separate return method applies ASC 740 to the stand-alone financial statements of each member of the consolidated return group as if the group member were a separate taxpayer.
- The benefits for losses method modifies the hypothetical separate return by considering the subsidiary's net operating losses and capital losses as realized by the subsidiary in its separate financial statements when those losses are used by the parent in its consolidated tax return with a cash settlement at that time. Benefits for the subsidiary's tax credits utilized in the consolidated tax return may be similarly realized.
- Under the pro rata method, current and deferred income taxes are allocated to members of the group based on each member's relative contribution to the group's consolidated income tax expense or benefit.
    - Unlike the separate return method, the sum of the amounts allocated to individual members under the pro rata method should equal the amounts reported in the consolidated financial statements.
    - When applying the pro rata method, each component of income tax expense and each deferred tax asset and liability generally should be allocated to the group members rather than simply allocating total income taxes

An intercompany TSA may provide a reasonable basis on which to allocate income taxes among members of a consolidated group if it is systematic, rational, and consistent with the broad principles of ASC 740. When a TSA is not consistent with an allocation methodology that is acceptable for financial statement purposes, differences may arise between the amounts reported in the financial statements and the amounts actually payable or receivable under the TSA. These differences generally should be reported as adjustments to capital (as contributed capital or dividends) in the separate financial statements of the subsidiaries.

Statutory Separate Financial Statements of Insurance Companies

The statutory financial statements filed by insurance companies with State insurance regulators are separate company statements. In recognition of this, SSAP No. 101 – Income Taxes, provides guidance for situations when the reporting entity is a member of a consolidated income tax return with one or more affiliates. As noted below, the guidance in SSAP No. 101 refers to "separate company" or "separate legal entity" determinations.

Paragraph 16 of SSAP No. 101 provides that income tax transactions between the affiliated parties shall be recognized if a) such transactions are economic transactions as defined in SSAP No. 25, b) are pursuant to a written income tax allocation agreement, and c) income taxes incurred are accounted for in accordance with GAAP principles, as modified by SSAP No. 101. Paragraph 17 provides that amounts owed to a reporting entity pursuant to a transaction recognized under paragraph 16 shall be treated as a loan or advance, and nonadmitted, pursuant to SSAP No. 25, to the extent that the recoverable is not settled within 90 days of the filing of a consolidated income tax return, or where a refund is due the reporting entity's parent, within 90 days of the receipt of such refund.

The admissibility of income tax assets is set forth in paragraphs 9 and 10 of SSAP No. 101 for current income tax recoverables, and in paragraphs 11 (which sets forth a three-component admission calculation in 11.a., 11.b., and 11.c.) and 12 for adjusted gross deferred tax assets (DTAs). Footnote 2 of SSAP No. 101 provides that, for purposes of determining the amount of adjusted gross DTAs and the amount admitted under paragraph 11, the admission calculation shall be made on a separate company, reporting entity basis. A reporting entity that files a consolidated federal income tax return with its parent should look to the amount of taxes it paid (or were allocable to it) as a separate legal entity in determining the admitted DTA under paragraph 11.a., and the DTA admitted under this paragraph cannot exceed the amount the reporting entity could reasonably expect to have refunded by its parent. The taxes paid by the reporting entity represent the maximum DTA that may be admitted under paragraph 11.a.,

although the amount could be reduced pursuant to the group's tax allocation agreement. The amount of admitted adjusted gross DTA under paragraph 11.b.i. is limited to the amount that the reporting entity expects to realize within the applicable realization period, on a separate company basis. The reporting entity must estimate its separate company taxable income and the tax benefit that it expects to receive from reversing deductible temporary differences in the form of lower tax payments to its parent. A reporting entity that projects a tax loss in the applicable realization period cannot admit a DTA related to the loss under paragraph 11.b., even if the loss could offset taxable income of other members in the consolidated group and the reporting entity could expect to be paid for the tax benefit pursuant to its tax allocation agreement.[5]

Paragraph 12.b. of SSAP No. 101 reiterates footnote 2 in providing that the amount of carryback potential that may be considered in calculating the admitted adjusted gross DTAs under paragraph 11.a. of such a reporting entity may not exceed the amount that the reporting entity could reasonably expect to have refunded by its parent.

Certain effects of inclusion of a reporting entity in a consolidated tax return group also are addressed in SSAP No. 1 Exhibit A - Implementation Questions and Answers (Q&A). For example, Q&A 8 addresses how a company's computation of adjusted gross and admitted DTAs is impacted if it joins in the filing of a consolidated federal income tax return, and includes the following points:

- Paragraph 8.1 - For purposes of determining the amount of DTAs and the amount admitted under paragraph 11, the calculation should be made on a separate company, reporting entity basis.
- Paragraph 8.2 - A reporting entity that files a consolidated federal income tax return with its parent should look to the amount of taxes it paid (or were allocable to it) as a separate legal entity in determining the admitted adjusted gross DTAs under paragraph 11.a. Furthermore, the admitted adjusted gross DTAs under paragraph 11.a. may not exceed the amount that the reporting entity could reasonably expect to have refunded by its parent company. The taxes paid by the reporting entity represent the maximum DTAs that may be admitted under paragraph 11.a., although the amount could be reduced pursuant to the group's tax allocation agreement.
- Paragraph 8.3 - The amount of admitted adjusted gross DTAs under paragraph 11.b.i. is limited to the amount that the reporting entity expects to realize within the applicable period (determined under the Realization Threshold Limitation Tables in paragraph 11.b.) following the balance sheet date on a separate company basis. The entity must estimate its separate company taxable income and the tax benefit that it expects to receive from reversing deductible temporary differences in the form of lower tax payments to its parent. If the reporting entity had reversing adjusted gross DTAs during the applicable period for which it does not expect to realize a benefit under paragraph 11.b. on a separate company basis, the reporting entity cannot admit an amount related to such DTAs under paragraph 11.b., even though the reporting entity may be paid a tax benefit for such items pursuant to its tax allocation agreement.
- Paragraph 8.11 - Under paragraph 11.c., an entity may admit its adjusted gross DTAs, after application of paragraphs 11.a. and 11.b., based upon offset against its own existing gross deferred tax liabilities (DTLs and not against gross DTLs of other members of the affiliated or consolidated group.

<u>Example</u>
Assume A is a non-insurance holding company that owns 100% of the stock of life insurance companies B, C, and D. The ABCD group includes an audited GAAP financial statement in its Form 10-K filed with the SEC. B, C, and D each file audited separate company statutory financial statements with the applicable State insurance regulators. However, B, C, and D do not prepare or file separate company GAAP financial statements. GAAP ledgers are maintained on a line of business basis across the three companies, rather than on a legal entity basis, and separate company GAAP information is not available.

The 3-year average annual adjusted financial statement income (AFSI) of the ABCD group per its 2020-2022 GAAP financial statements is expected to exceed $1 billion. Accordingly, the ABCD group expects to be an "applicable corporation" for 2023 and subsequent taxable years that will be required to compute a tentative minimum tax

[5] For example, under a benefits for losses TSA.

liability to compare to its regular tax liability to determine if any CAMT is owed. Company B's 3-year average annual AFSI per its 2020-2022 separate company statutory financial statements is expected to exceed $1 billion, but neither company C nor D are expected to reach that level.

The ABCD group files a life-nonlife consolidated Federal income tax return. The ABCD intercompany tax sharing agreement (TSA) provides that the consolidated tax liability that may be allocated to B, C, and D may not exceed the tax which B, C, or D would incur on a separate return basis. The TSA does not explicitly provide for the CAMT.

Given these facts, how are the impacts of the CAMT in B, C, and D's separate company statutory financial statements determined? Should B, C, and D be treated as applicable corporations potentially subject to CAMT in 2023 and subsequent years because that is the expectation for the ABCD consolidated tax return group? What if B, C, or D was not included in the life-nonlife return because it had not yet been a member of the group for 5 taxable years? How do the separate company/separate legal entity requirements of SSAP No. 101 apply to the CAMT? In determining admitted deferred tax assets under paragraph 11.b. of SSAP No. 101, do B, C, and D take into account GAAP income or statutory income? If the former, how could that be determined on a legal entity basis given that GAAP ledgers are maintained on a line of business basis? If the latter, is only company B required to compute tentative minimum tax liability? How does the ABCD group's separate return TSA affect the CAMT computations? What if the TSA is not amended to address the CAMT? Would the answer to these questions be different if the TSA provided for a pro rata allocation of consolidated tax liability? Should accounting policy elections for these types of CAMT-related issues be available in the statutory financials? If the ABCD group did not expect to be an applicable corporation, and therefore not subject to the CAMT, should B, C, and D have to do any accounting at all for the CAMT in their separate company statutory financial statements?

Recommended Action:
After reviewing the Interested Parties' comments, NAIC staff recommends that the Working Group consider an extension of the previously adopted INT 22-02 to encompass December 31, 2022, financial statements. As detailed in INT 22-02, the CAMT is effective for the 2023 tax year, therefore this deferral of recognition would at most effect the statutory valuation allowance and the potential admissibility of certain DTAs. If preferred, the Working Group could consider an extension of the INT through the first quarter 2023 financial statements with nullification of the INT on June 15, 2023.

The Working Group can consider adoption of the updated INT 22-02 or elect to expose for a short comment period ending Nov. 30, 2022. (If the Working Group would prefer to extend the INT through first quarter 2023, NAIC staff will update the INT accordingly and would recommend exposure for the short comment period.)

Because INT 22-02 provides temporary overrides to SSAP No. 9 and SSAP No. 101, the Working Group would need to adopt this interpretation with a 2/3 super majority vote and must have 67% of members present. (These requirements are detailed in the *NAIC Policy Statement on Maintenance of Statutory Accounting Principles.*).

Proposed revisions (Attachment B and detailed on the following page) have been drafted to INT 22-02 to reflect the following:

- An extension of the effective date to encompass year-end 2022 financial statements to indicate that no reasonable estimate can be made, therefore recognition is not required. With this extension, the INT will have an updated name.

- An extension of the disclosures previously included in INT 22-02, with a new disclosure to identify whether a reporting entity (or the controlled group of corporations for which the reporting is a member) has determined that they expect to be required to perform calculations to determine if they will owe the CAMT.)

- Expansion of the subsequent event exception to include events identified after December 31, 2022, through when the audited financial statements are issued, or available to be issued.

- Inclusion of a nullification date of March 15, 2023, to be clear that the INT does not pertain to first quarter 2023 financial statements, with clarification that the nullification date does not impact the subsequent event exception for audited financials issued or available to be issued between March 15 and June 1, 2023.

The primary revisions to extend INT 22-02 are shown below:

17. The consensuses in this interpretation were adopted on October 24, 2022, to provide reporting guidance regarding the calculations impacted by the CAMT and provide limited-scope, limited-time exceptions to the valuation allowance and DTA calculations in response to legislation under SSAP No. 101 as well as Type I subsequent event requirements in SSAP No. 9 for September 30, 2022, statutory reporting. As detailed, the exceptions to SSAP No. 101 and SSAP No. 9 are effective for third quarter 2022. ~~Due to the short-term nature of the SSAP No. 9 exception, this interpretation will be automatically nullified on December 1, 2022, and will be included as a nullified INT in Appendix H – Superseded SSAPs and Nullified Interpretations in the *As of March 2023 Accounting Practices and Procedures Manual.*~~

18. On November 16, 2022, the Working Group issued a tentative consensus to extend this interpretation for December 31, 2022, statutory financial statements. For application as of year-end 2022:

a. Consistent with paragraphs 12 and 13, the Working Group has concluded that a reasonable estimate is not determinable for December 31, 2022, therefore impacts related to the CAMT in the year-end 2022 financial statements are not required.

b. The reporting entity shall include disclosures in paragraph 13 in the year-end 2022 financial statements. In addition, the reporting entity shall disclose the following:

i. If, based on information regarding the projected adjusted financial statement income for 2023, the entity or the controlled group of corporations of which the reporting entity is a member has determined if it is an "applicable corporation" to determine if CAMT exceeds the regular federal income tax payable. That is, disclose if the reporting entity (or the controlled group of corporations of which the reporting entity is a member) has determined if average "adjusted financial statement income" is above the thresholds for 2023 tax year that they expect to be required to perform the CAMT calculations. This disclosure is about being applicable corporation, not if the entity is required to pay.

c. Consistent with paragraph 14, CAMT updated estimates or other calculations affected by the Act determined subsequent to filing the December 31, 2022, financial statements shall not be recognized as Type I subsequent events. For year-end 2022 financial statements, the subsequent event exception is expanded to encompass events that occur prior to the issuance of statutory financial statements as well as events that occur before the date the audited financial statements are issued, or available to be issued. This provision intends to prevent reporting entities from having to amend statutory financial statements from material Type I subsequent events as a result of updated information / estimates received after the reporting date of year-end 2022 statutory financial statements pertaining to the accounting for the enactment of the Act.

~~18.~~19. With the extension, this interpretation will be automatically nullified on March 15, 2023. This nullification date intends to clarify that the exclusions within are not permitted for 1st quarter 2023 statutory financial statements and does not impact the subsequent event exclusion detailed in paragraph 17c for audited financial statements issued or available to be issued between March 15 and June 1, 2023

The comment letter from interested parties are included in Attachment C.

<u>Any Other Matters</u>

1. *Interest Maintenance Reserve (IMR)* – **Attachment D**

The Working Group has received a comment letter from the ACLI requesting action to address the allowance of a negative IMR balance in statutory accounting. This comment letter has been included with the materials for discussion as time allows.

https://naiconline.sharepoint.com/teams/frsstatutoryaccounting/national meetings/a. national meeting materials/2022/10-24-22 int 22-02 ira/0 - 10-24-2022 - sapwg hearing agenda.docx

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Interpretation of the
Statutory Accounting Principles (E) Working Group

INT 22-03: Inflation Reduction Act - Corporate Alternative Minimum Tax

INT 22-03 Dates Discussed

October 6, 2022

INT 22-03 References

Current:
SSAP No. 9—Subsequent Events
SSAP No. 101—Income Taxes

INT 22-03 Issue

Key Provisions of the Inflation Reduction Act

1. The Inflation Reduction Act (Act) was enacted on August 16, 2022, and included a new corporate alternative minimum tax (CAMT). The Act and the CAMT go into effect for tax years beginning after 2022. Reporting entities shall refer to the Act, and the resulting regulations and other tax guidance to determine application, but a non-authoritative high-level summary based on information at the time of initial INT discussion regarding the CAMT is as follows:

a. The CAMT is 15 percent of the corporation's "adjusted financial statement income" for the tax year, reduced by corporate alternative minimum foreign tax credit.

b. The CAMT will only apply to corporations (determined on an affiliated group basis) with average adjusted financial statement income in excess of $1 billion for the three prior tax years. This threshold is reduced to $100 million in the case of certain foreign-parented corporations. When a corporation becomes subject to the CAMT, it remains an applicable to the CAMT, even if its average adjusted financial statement income is less than $1 billion, unless an exception applies.

c. A corporation's adjusted financial statement income is the amount of net income or loss the corporation reports on its applicable financial statement. The income is adjusted for various purposes including certain adjustments in the case of consolidated returns or for foreign income.

d. The Act includes references to the tax codes which provides a hierarchy for determining the "applicable financial statement." At a high level, the first choice is U.S. generally accepted accounting principles (GAAP) financial statements; the second choice is international financial reporting standards (IFRS) financial statements. If GAAP and IFRS financial statements are not available, the financial statements filed by the taxpayer with any other regulatory or government body is acceptable. If the taxpayer is part of an affiliated group of corporations filing a consolidated return the adjustable financial statement income for the group considers the group's applicable financial statement.

e. To determine its U.S. federal income tax liability, a corporation will need to compute taxes under both systems — the regular tax system and the CAMT system. The CAMT is payable to the extent the tentative CAMT exceeds the regular corporate income tax. Any CAMT

paid is available indefinitely as a credit carryover that could reduce future regular tax in future years if the regular tax liability is in excess of CAMT tax liability.

f. The Act directs the Treasury to issue regulations and other guidance relate to implementing the CAMT, so several issues are pending detailed clarifications including clarifying the definition of an applicable corporation, and providing guidance on the starting point for, and adjustments to, adjusted financial statement income, as well as handling of separate company tax returns when required under current tax law that are unique to the insurance industry.

Interpretation Issues

2. This interpretation is focused on addressing transition accounting and reporting aspects of the new corporate alternative minimum tax (CAMT). While most insurers will not be subject to the CAMT, for those that know that they are subject, and those that could be subject to the CAMT once 2022 financial results are known, there are a variety of reporting uncertainties, particularly regarding reporting year-end 2022 as well as interim reporting for 2023.

3. The CAMT is effective for the tax years on or after 2023.

4. Both statutory accounting principles and U.S. GAAP require the effects of tax changes on deferred taxes, including the valuation allowance (future realizability of existing DTAs) in the period in which the legislation is enacted (third quarter 2022). *SSAP No. 101—Income Taxes,* paragraph 7.e. requires the statutory valuation allowance adjustment as a direct reduction in the gross DTA if based on the weight of available evidence it is more likely than not that some or all of the gross DTAs will not be realized. Gross DTA, less the statutory valuation allowance results in adjusted gross DTAs. The statutory valuation allowance adjustment is not reported as a separate line in the statutory financial statements (it is an off-balance sheet item that reduces the gross DTAs). The statutory valuation allowance is disclosed.

5. The statutory accounting calculation for admissible DTAs is determined using adjusted gross DTAs (gross DTAs reduced by the valuation allowance). For statutory accounting, admittance of adjusted gross DTAs in SSAP No. 101 depends on a three-component calculation, for which the second step limits admittance of adjusted gross DTAs to those that are expected to be realized in a timeframe that does not exceed 3 years. The actual number of years permitted depends on specifics for each reporting entity (type and other information about the reporting entity), but the maximum timeframe is 3 years. The last step admits DTAs which can be offset by DTLs.

6. Guidance in *SSAP No. 9—Subsequent Events* requires consideration of Type I and Type II[1] subsequent events through the date of the statutory financial statements and the date of issuance of the audited financial statements, or the date in which audited financial statements are available to be issued. For subsequent events identified after the statutory financial statements are filed (ex. March 1), but before the audited financial statements are issued (ex. June 1), reporting entities are generally required by their domestic state to amend their filed statutory financial statements to ensure that the statutory financial statements and the audited financial statements are consistent. Under this guidance, as additional information is made available on the impact of the Act, or information becomes available to update

[1] A Type I subsequent event relates to an event or transaction that provides additional evidence with respect to conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements. Under SSAP No. 9, entities shall recognize in the financial statements the effects of all material Type I subsequent events. A Type II subsequent event pertains to events or transactions that provide evidence to conditions that did not exist at the balance sheet date but arose after that date. Type II events are disclosed in the financial statements.

estimates and assessments, under existing statutory accounting guidance in SSAP No. 9, reporting entities would need to identify updated estimates as a Type I subsequent event in the audited financial statements.

Issue 1 – Consideration of Calculations Impacted by the Act for Year-end 2022 and Interim 2023 Financial Statements

7. During the period of enactment, reporting entities would normally have to consider the applicability of the CAMT and if applicable, determine the impact on the statutory valuation allowance as well as assess DTAs for admissibility (e.g., realization timeframe). These elements will be collectively referred to as "calculations impacted by the Act" or "calculations impacted by the CAMT." This interpretation will address the following issues:

a. For year-end 2022 statutory financial statements, how the calculations impacted by the CAMT will be reported for:

i. Reporting entities that have determined that they will be subject to the CAMT; and

ii. Reporting entities that have not determined if they will be subject to the CAMT in 2023.

b. For quarterly 2023 financial statements, how the calculations impacted by the CAMT will be reported for:

i. Reporting entities that have determined that they will be subject to the CAMT in 2023. and

ii. Reporting entities that have not determined if they will be subject to the CAMT in 2023.

Issue 2 – Consideration of Subsequent Events for Year-end 2022 and Interim 2023 Financial Statements

8. SSAP No. 9 requires consideration of subsequent events through the date of the statutory financial statements and the date of issuance of the audited financial statements, or the date in which audited financial statements are available to be issued.

9. For reporting entities that materially revise or establish CAMT affected estimates, this interpretation will address the issues regarding the extent a Type I or Type II subsequent event assessment is required for the following financial reporting periods:

a. For year-end 2022 reporting at the time of statutory filing.

b. For year-end 2022 reporting between statutory filing date and audited report issuance date.

c. For interim 2023 reporting.

Issue 3 – Reporting Changes to Deferred Tax Assets and Liabilities

10. Existing statutory accounting guidance details the reporting of changes related to income taxes; tax effected unrealized capital gains and losses; and deferred tax items. This interpretation will address the issue of where changes generated from the Act shall be reported to ensure consistency.

INT 22-03 Discussion

11. The Statutory Accounting Principles (E) Working Group tentative consensuses to the noted issues are included below.

Response: Issue 1 – Consideration of Calculations Impacted by the Act for Year-end 2022 and Interim 2023 Financial Statements

12. Reporting entities that are aware that they will be subject to the CAMT shall reflect the impact on the calculations affected by the CAMT if the impacts are reasonably estimable for year-end 2022 and for the interim 2023 financial statements.

13. Year-end 2022 and interim 2023 statutory financial statements shall recognize effects to the calculations impacted by CAMT when a reasonable estimate is determinable. For example, a reporting entity may not have all of the necessary information available, prepared or analyzed for impacts of the Act and or the CAMT, but the reporting entity has determined a reasonable estimate. Reporting entities that cannot make a reasonable estimate shall not recognize impacts to the financial statements but shall disclose that they will be subject to the Act and that a reasonable estimate cannot be made, as described in the disclosures section.

14. For reporting entities that have not determined if they will be subject to the CAMT in 2023, the entity would only report impacts on the calculations affected by the CAMT for year-end 2022 and interim 2023 financial statements when a determination has been made that the reporting entity will be subject to the CAMT and when the impacts can be reasonably estimated.

15. For reporting entities that have determined that they expect to be subject to the CAMT in 2023, the interim 2023 reporting of the calculations impacted by the CAMT and other aspects of the Act shall be updated and reported when reasonable estimates can be made. The issuance of, or lack thereof, Treasury regulations may be a necessary evaluation in establishing, or not, a reasonable estimate. However, partially issued regulations should be evaluated against any missing components in establishing a reasonable estimate.

Response: Issue 2 – Consideration of Subsequent Events for Year-end 2022 and Interim 2023 Financial Statements

16. For reporting entities that materially revise or establish CAMT affected estimates (including the statutory valuation allowance, the determination of net admitted DTAs, and the applicability of the CAMT), a Type I or Type II subsequent event assessment is required as follows:

a. For year-end 2022 reporting at the time of statutory filing - Reasonable estimates to the calculations affected by the CAMT or other aspects of the Act at year-end which are available prior to the March 1 statutory filing shall be updated and recognized as a Type I subsequent event to reflect the best reasonable estimate available at the time of filing the year-end 2022 statutory financial statements.

b. For year-end 2022 reporting between statutory filing date and audited report issuance date – Updates to reasonable estimates to the calculations affected by the CAMT which are updated and or established after the issuance of the 2022 statutory financial statements, but before the issuance of the year-end 2022 audited financial statements, shall not be recognized as Type I subsequent events. Instead, these changes, shall be disclosed as Type II subsequent event, pursuant to SSAP No. 9, when the information necessary to update

the estimate becomes available. This update is a change in estimate, but inclusion within the Type II disclosure results in consistency in the reporting location.

c. For interim 2023 reporting - Reasonable estimate updates to the calculations affected by the CAMT which are updated and or established after the issuance of the 2023 interim statutory financial statements, shall not be recognized as Type I subsequent events. Instead, these changes, shall be disclosed as Type II subsequent events and pursuant to SSAP No. 9, when the information necessary to update the estimate becomes available. This update is a change in estimate, but inclusion within the Type II disclosure results in consistency with reporting location.

17. The response to issue 2, paragraph 16.b. is a specific exception to SSAP No. 9 as that statement requires a subsequent event assessment through the issuance of the audited financial statements. As domestic state regulators generally require statutory financial statements to mirror the audited financial statements, when material Type I subsequent events are recognized in the audited financial statements after the statutory financial statements have been filed, an amendment is necessary to update the statutory financial statements. This provision intends to prevent reporting entities from having to amend statutory financial statements from material Type I subsequent events as a result of updated information / estimates received after the filing of the statutory financial statements pertaining to the accounting for the enactment of the Act.

Disclosure

18. Although reporting entities will not be required to recognize updated calculations affected by the CAMT in the audited financial statements as material Type I events after the year-end 2022 statutory financial statements, reporting entities shall disclose updated estimates in accordance with SSAP No. 9, paragraph 13, audited financial statement disclosure that identifies subsequent events after the date subsequent events were reviewed for the statutory financial statements. (This would be a disclosure of the updated estimate in the audited financial statements only, not recognition of the updated estimate in the statutory financial statement.) Furthermore, reporting entities shall utilize existing notes for income taxes in SSAP No. 101 to identify the impact on calculations under the Act that cannot be reasonably estimated as follows:

a. That the Act was enacted during the reporting period on August 16, 2022.

b. A statement regarding whether the reporting entity has determined if they expect to be subject to the CAMT in 2023. For example:

   i. The reporting entity has determined that they do not expect to be subject to the CAMT in 2023.

   ii. The reporting entity has not been able to determine as of the reporting date; if they will be subject to the CAMT in 2023. The financial statements do not include the estimated impact of the CAMT, because a reasonable estimate cannot be made.

   iii. The reporting entity has determined that they expect to be subject to the CAMT in 2023, however a reasonable estimate cannot be made as of the filing date. Reporting entities that have not determined that they will be subject to the CAMT shall disclose the uncertainty of applicability in the financial statement notes.

c. Qualitative disclosures of the calculations effected by the Act for which accounting cannot be reasonably estimated, and why such estimates are unavailable as of the reporting date.

d. Disclosures of items reported as initial reasonable estimate, the additional information needed to be obtained, prepared or analyzed in order to complete the accounting requirements under ASC 740, and when the accounting for the income tax effects is expected to be fully updated for the impacts of the Act.

19. Reporting entities shall be working in good faith to complete the accounting for the changes adopted under the Act, and all accounting impacts shall be completed by year-end 2023.

Response: Issue 3 – Reporting Changes to Deferred Tax Assets and Liabilities

20. For financial statements, reporting entities shall continue to follow existing reporting instructions for reporting changes resulting from the Act, supplemented by the following clarification. These reporting lines include:

a. Change in Net Unrealized Capital Gains (Losses) Less Capital Gains Tax -Tax effects previously reflected in unrealized capital gains (to present unrealized gains (losses) as "net of tax.")

b. Change in Net Deferred Income Tax - Represents the gross change in net deferred tax, excluding any change reflected in unrealized capital gains, and excluding any change in nonadmitted deferred tax assets. This change in net deferred tax does not include changes in nonadmitted DTAs.

c. Change in Nonadmitted - Represents changes in nonadmitted DTAs pursuant to the SSAP No. 101 nonadmittance calculation.

INT 22-03 Status

21. The tentative consensuses in this interpretation were adopted predominantly to provide limited-scope, limited-time exceptions to the valuation allowance and DTA calculations in response to legislation under SSAP No. 101 as well as to the Type I subsequent event requirements in SSAP No. 9. As detailed, the exceptions to SSAP No. 101 and SSAP No. 9 are effective for year-end 2022 audited financial and the interim 2023 statements only. Due to the short-term nature of the SSAP No. 9 exception, and as the other issues only reference existing accounting and reporting guidance, this interpretation will be automatically nullified on December 1, 2023, and will be included as a nullified INT in Appendix H – Superseded SSAPs and Nullified Interpretations in the *As of March 2024 Accounting Practices and Procedures Manual*.

22. Further discussion is planned.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/Maintenance/Active Form A's/2022/INT 22-03 - Inflation Reduction ActED.docx

Interpretation of the Statutory Accounting Principles (E) Working Group

INT 22-02: Third and Fourth Quarter 2022 Reporting of the Inflation Reduction Act - Corporate Alternative Minimum Tax

INT 22-02 Dates Discussed

October 6, 2022; October 24, 2022, November 16, 2022

INT 22-02 References

Current:
SSAP No. 9—Subsequent Events
SSAP No. 101—Income Taxes

INT 22-02 Issue

Key Provisions of the Inflation Reduction Act

1. The Inflation Reduction Act (Act) was enacted on August 16, 2022, and included a new corporate alternative minimum tax (CAMT). The Act and the CAMT go into effect for tax years beginning after 2022. Reporting entities shall refer to the Act and the resulting regulations and other tax guidance to determine application, but a non-authoritative high-level summary based on information at the time of initial INT discussion regarding the CAMT is as follows:

a. The CAMT is 15% of the corporation's "adjusted financial statement income" for the tax year, reduced by corporate alternative minimum foreign tax credit.

b. The CAMT will only apply to "applicable corporations" (determined on an affiliated group basis) with average adjusted financial statement income in excess of $1 billion for the three prior tax years. This threshold is reduced to $100 million in the case of certain foreign-parented corporations. When a corporation becomes subject to the CAMT, it remains an applicable corporation for purposes of ~~to~~ the CAMT, even if its average adjusted financial statement income is less than $1 billion, unless an exception applies.

c. A corporation's adjusted financial statement income is the amount of net income or loss the corporation reports on its applicable financial statement. The income is adjusted for various purposes including certain adjustments in the case of consolidated returns or for foreign income.

d. The Act includes references to the tax codes which provides a hierarchy for determining the "applicable financial statement." At a high level, the first choice is U.S. generally accepted accounting principles (GAAP) financial statements; the second choice is international financial reporting standards (IFRS) financial statements. If GAAP and IFRS financial statements are not available, the financial statements filed by the taxpayer with any other regulatory or government body is acceptable. If the taxpayer is part of an affiliated group of corporations filing a consolidated return, the adjustable financial statement income for the group considers the group's applicable financial statement.

e. To determine its U.S. federal income tax liability, an applicable corporation will need to compute taxes under both systems—the regular tax system and the CAMT system. The

CAMT is payable to the extent the tentative CAMT exceeds the regular corporate income tax. Any CAMT paid is available indefinitely as a credit carryover that could reduce future regular tax in future years if the regular tax liability is in excess of CAMT tax liability.

f. The Act directs the Treasury to issue regulations and other guidance relate to implementing the CAMT, so several issues are pending detailed clarifications including clarifying the definition of an applicable corporation, and providing guidance on the starting point for, and adjustments to, adjusted financial statement income, as well as the handling of separate company tax returns when required under current tax law that are unique to the insurance industry.

Interpretation Issues

2. This interpretation is focused on addressing third quarter 2022 transition accounting and reporting aspects of the new CAMT. While most insurers will not be subject to the CAMT, for those that know that they are subject, and those that could be subject to the CAMT, there are a variety of reporting uncertainties, particularly regarding reporting for third quarter 2022.

3. The CAMT is effective for the tax years on or after 2023.

4. Both statutory accounting principles and U.S. GAAP require the effects of tax changes on deferred taxes, including the valuation allowance (future realizability of existing DTAs) in the period in which the legislation is enacted (third quarter 2022). *SSAP No. 101—Income Taxes,* paragraph 7.e. requires the statutory valuation allowance adjustment as a direct reduction in the gross DTA if, based on the weight of available evidence, it is more likely than not that some or all of the gross DTAs will not be realized. Gross DTA less the statutory valuation allowance results in adjusted gross DTAs. The statutory valuation allowance adjustment is not reported as a separate line in the statutory financial statements (it is an off-balance sheet item that reduces the gross DTAs). The statutory valuation allowance is disclosed.

5. The statutory accounting calculation for admissible DTAs is determined using adjusted gross DTAs (gross DTAs reduced by the valuation allowance). For statutory accounting, admittance of adjusted gross DTAs in SSAP No. 101 depends on a three-component calculation, for which the second step limits admittance of adjusted gross DTAs to those that are expected to be realized in a timeframe that does not exceed three years. The actual number of years permitted depends on specifics for each reporting entity (type and other information about the reporting entity), but the maximum timeframe is three years. The last step admits DTAs which can be offset by DTLs.

6. Guidance in *SSAP No. 9—Subsequent Events* requires consideration of Type I and Type II[1] subsequent events through the date of the statutory financial statements and the date of issuance of the audited financial statements, or the date in which audited financial statements are available to be issued. For subsequent events identified after the statutory financial statements are filed (example, March 1), but before the audited financial statements are issued (example, June 1), reporting entities are generally required by their domestic state to amend their filed statutory financial statements to ensure that the statutory financial statements and the audited financial statements are consistent. Under this guidance, as additional information is made available on the impact of the Act, or information becomes available to update

[1] A Type I subsequent event relates to an event or transaction that provides additional evidence with respect to conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements. Under SSAP No. 9, entities shall recognize in the financial statements the effects of all material Type I subsequent events. A Type II subsequent event pertains to events or transactions that provide evidence to conditions that did not exist at the balance sheet date but arose after that date. Type II events are disclosed in the financial statements.

estimates and assessments, under existing statutory accounting guidance in SSAP No. 9, reporting entities would need to identify updated estimates as a Type I subsequent event in the audited financial statements.

Issue 1 – Consideration of the Act for Third Quarter 2022 Financial Statements

7. During the period of enactment (third quarter 2022) reporting entities filing statutory financial statements would normally have to consider the applicability of the CAMT and if applicable, determine the impact on the statutory valuation allowance as well as assess DTAs for admissibility (e.g., realization timeframe). These elements will be collectively referred to as "calculations impacted by the Act" or "calculations impacted by the CAMT."

8. This interpretation will address the issue for what reporting entities are required to report or disclose regarding the calculations impacted by the CAMT for September 30, 2022, financial statements.

Issue 2 – Consideration of Subsequent Events for Third Quarter 2022 Financial Statements

9. SSAP No. 9 requires consideration of subsequent events through the date of the statutory financial statements and the date of issuance of the audited financial statements, or the date in which audited financial statements are available to be issued.

10. For reporting entities that materially revise or establish calculations impacted by the CAMT subsequent to September 30, 2022 (including the statutory valuation allowance, the timing of determination of net admitted DTAs, and the determination of the applicability of the CAMT), this interpretation will address the extent a Type I or Type II subsequent event assessment is required for third quarter 2022 financial reporting.

INT 22-02 Discussion

11. The Statutory Accounting Principles (E) Working Group consensuses to the noted issues are included below.

Response: Issue 1 – Consideration of the Act for Third Quarter 2022 Financial Statements

12. Reporting entities that are aware they will be subject to the CAMT would normally reflect the effects of the Act on the calculations impacted by the CAMT if reasonably estimable for third quarter 2022. Because of the timing of the adoption of the Act and the considerable number of unknown variables for September 30, 2022, reporting, the Working Group has determined that a reasonable estimate is not determinable for third quarter 2022 interim financial statements for the calculations impacted by the CAMT.

13. Because reasonable estimates of calculations impacted by the CAMT are not determinable, reporting entities shall not recognize impacts related to CAMT for third quarter 2022 financial statements, but shall make the following disclosures regarding the CAMT and the Act:

a. The Act was enacted during the reporting period on August 16, 2022.

b. A statement regarding whether the reporting entity (or the controlled group of corporations of which the reporting entity is a member) has determined if it expects to be liable for CAMT in 2023. For example:

i. The reporting entity (or the controlled group of corporations of which the reporting entity is a member) has determined that it does not expect to be liable for CAMT in 2023.

ii. The reporting entity (or the controlled group of corporations of which the reporting entity is a member) has not determined as of the reporting date if it will be liable for CAMT in 2023. The third quarter 2022 financial statements do not include an estimated impact of the CAMT because a reasonable estimate cannot be made.

iii. The reporting entity (or the controlled group of corporations of which the reporting entity is a member) has determined that it expects to be liable for CAMT in 2023. The third quarter 2022 financial statements do not include an estimated impact of the CAMT, because a reasonable estimate cannot be made.

Response: Issue 2 – Consideration of Subsequent Events for Third Quarter 2022 Financial Statements

14. For third quarter 2022 reporting, CAMT updated estimates or other calculations affected by the Act determined subsequent to third quarter statutory financial statement or filing date shall not be recognized as Type I subsequent events. Meaning, amended financial statements are not required to reflect updated estimates subsequent to the third quarter filing date and prior to the filing the third quarter financial statements. With the disclosure required under Issue 1, additional subsequent event disclosure (such as what would be required for Type II event) is not required.

15. Reporting entities shall be working in good faith to complete the accounting for the changes adopted under the Act.

INT 22-02 Status

16. The consensuses in this interpretation were adopted on October 24, 2022, to provide reporting guidance regarding the calculations impacted by the CAMT and provide limited-scope, limited-time exceptions to the valuation allowance and DTA calculations in response to legislation under SSAP No. 101 as well as Type I subsequent event requirements in SSAP No. 9 for September 30, 2022, statutory reporting. As detailed, the exceptions to SSAP No. 101 and SSAP No. 9 are effective for third quarter 2022. ~~Due to the short-term nature of the SSAP No. 9 exception, this interpretation will be automatically nullified on December 1, 2022, and will be included as a nullified INT in Appendix H – Superseded SSAPs and Nullified Interpretations in the *As of March 2023 Accounting Practices and Procedures Manual*.~~

17. On November 16, 2022, the Working Group issued a tentative consensus to extend this interpretation for December 31, 2022, statutory financial statements. For application as of year-end 2022:

a. Consistent with paragraphs 12 and 13, the Working Group has concluded that a reasonable estimate is not determinable for December 31, 2022, therefore impacts related to the CAMT in the year-end 2022 financial statements are not required.

b. The reporting entity shall include disclosures in paragraph 13 in the year-end 2022 financial statements. In addition, the reporting entity shall disclose the following:

i. If, based on information regarding the projected adjusted financial statement income for 2023, the entity or the controlled group of corporations of which the reporting entity is a member has determined if it is an "applicable corporation" to determine if CAMT exceeds the regular federal income tax payable. That is, disclose if the reporting entity (or the controlled group of corporations of which the reporting entity is a member) has determined if average "adjusted financial

statement income" is above the thresholds for 2023 tax year that they expect to be required to perform the CAMT calculations. This disclosure is about being applicable corporation, not if the entity is required to pay.

c. Consistent with paragraph 14, CAMT updated estimates or other calculations affected by the Act determined subsequent to filing the December 31, 2022, financial statements shall not be recognized as Type I subsequent events. For year-end 2022 financial statements, the subsequent event exception is expanded to encompass events that occur prior to the issuance of statutory financial statements as well as events that occur before the date the audited financial statements are issued, or available to be issued. This provision intends to prevent reporting entities from having to amend statutory financial statements from material Type I subsequent events as a result of updated information / estimates received after the reporting date of year-end 2022 statutory financial statements pertaining to the accounting for the enactment of the Act.

~~17.~~18. With the extension, this interpretation will be automatically nullified on March 15, 2023. This nullification date intends to clarify that the exclusions within are not permitted for 1st quarter 2023 statutory financial statements and does not impact the subsequent event exclusion detailed in paragraph 17c for audited financial statements issued or available to be issued between March 15 and June 1, 2023

~~18.~~19. Further discussion is planned.

Attachment C

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October 28, 2022

Mr. Dale Bruggeman, Chairman
Statutory Accounting Principles Working Group
National Association of Insurance Commissioners
1100 Walnut Street, Suite 1500
Kansas City, MO 64106-2197

RE: Interested Parties Comments on INT 22-03: Inflation Reduction Act – Corporate Alternative Minimum Tax

Dear Mr. Bruggeman:

Interested parties is appreciative of the opportunity to comment on INT 22-03: Inflation Reduction Act – Corporate Alternative Minimum Tax (CAMT), exposed by the Statutory Accounting Principles Working Group on October 6, 2022. As noted in connection with the exposure, this INT addresses fourth quarter 2022 and interim 2023 reporting. It requires reporting when reasonable estimates can be made. It provides some subsequent events exceptions regarding the CAMT, to allow estimates to be updated as information becomes available. Companies subject to the CAMT are required to have their estimates recognized fully by year end 2023. Disclosures are also provided.

Interested parties has previously made two submissions to the Working Group on the subject of the CAMT. On September 26, 2022, we requested that the Working Group permit insurance companies to defer recognition of any statutory tax accounting effects of the CAMT until no earlier than the due date for filing the quarterly statement for the first quarter of 2023. On October 14, 2022, interested parties submitted comments on INT 22-02: Third Quarter 2022 Reporting of the Inflation Reduction Act – Corporate Alternative Minimum Tax. INT 22-02 concluded that because of the timing of the adoption of the Act and the considerable number or unknown variables, impacts related to the CAMT should not be recognized for third quarter 2022 financial statements.

INT 22-03 considers three statutory accounting issues relating to the CAMT:
1. Calculations for year-end 2022 and interim 2023 financial statements
2. Subsequent events for year-end 2022 and interim 2023 financial statements

3. Reporting changes to deferred tax assets and liabilities

Paragraph 12 of INT 22-03 provides that reporting entities that are aware that they will be subject to the CAMT shall reflect the impact on the calculations affected by the CAMT if the impacts are reasonably estimable for year-end 2022 and for the interim 2023 financial statements. For the following reasons, interested parties believes that the impact of the CAMT will not be reasonably estimable by reporting entities for year-end 2022, nor perhaps for interim 2023 statutory financial statements:

- Needed clarification from the Working Group of statutory tax accounting issues
- Inability of reporting entities this late in the calendar year to implement systems and process changes, to establish appropriate internal controls, or to adopt changes to intercompany tax sharing agreements necessary to make a reasonable estimate of the impact of the CAMT
- Lack of CAMT guidance from the U.S. Treasury

Accordingly, interested parties requests that the Working Group extend INT 22-02's deferral of recognition of the impacts of the CAMT at least through the year-end 2022 financial statements.

<u>Needed Clarification from the Working Group of Statutory Tax Accounting Issues</u>
Our September 26 letter noted that, as a result of the consolidated financial statement approach to applicability of and determination of the CAMT, substantive questions exist as to the proper income tax accounting for the CAMT in the statutory separate company financial statements of an insurance company. The CAMT is not effective until 2023, so there will be no current tax effects for year-end 2022 financial statements. However, because INT 22-03 requires a reasonable estimate for year-end 2022 financials, it appears to assume that the CAMT could have deferred tax effects for those financial statements. However, before any deferred tax effects can be estimated, a basic issue must be addressed by the Working Group as to how to reconcile the consolidated nature of the CAMT (both as to its potential applicability to a consolidated tax return group and the computation of the consolidated tax return group's tentative CAMT) with the tax accounting requirements for the separate statutory financial statements of insurance companies.

The attachment to this letter includes additional information about factors that are relevant to this matter:

- The consolidated determination of the applicable financial statement and the starting point for computation of adjusted financial statement income
- The circumstances under which an insurance company may or may not be includible in a consolidated Federal income tax return (with special considerations applicable to life insurers)
- The GAAP and statutory accounting guidance regarding income tax accounting in separate financial statements of companies included in a consolidated return
- Different methodologies for allocating consolidated tax liability pursuant to intercompany tax sharing agreements (TSAs)

Also included is an example illustrating a typical fact situation for a consolidated group including insurance companies and the types of statutory tax accounting-related questions that could arise. As a practical matter, reporting entities will experience a wide variety of circumstances which, we believe, requires clarifying guidance from the Working Group. In other words, we believe that before a reasonable estimate may be made, the basis or bases on which the estimate is to be determined must be clearly set forth.

For example, should an insurance company that is included in the consolidated financial statement of a consolidated tax return group that is not an "applicable corporation" as defined in the tax law (and therefore not subject to the CAMT) have to do any accounting at all for the CAMT in its separate company statutory financial statements? If an insurance company is included in a consolidated Federal income tax return of a GAAP consolidated financial statement group that is an applicable corporation, how are the impacts of the CAMT in the insurer's separate company financials determined, including in the determination of adjusted gross deferred tax assets under paragraph 11.b. of SSAP No. 101? What if the insurance company does not have available any separate company financial statements other than its statutory financial statements? How does the answers to these questions depend on whether the intercompany TSA does or does not allocate CAMT? Would the answer be different if the TSA provided for a pro rata allocation of consolidated tax liability rather than a separate return computation? Should an accounting policy election for these types of CAMT-related issues be available in the statutory financials?

Although paragraph 13 of INT 22-03 provides for reporting entities that cannot make a reasonable estimate, there is concern that audit firms will assert that such an estimate is indeed determinable. A similar concern exists with respect to the references to reasonable estimate in paragraphs 14 and 18.[1] In the absence of clarifying guidance, we are concerned that insurers and their audit firms will interpret and apply the existing tax accounting guidance in a diverse

[1] Paragraphs 18.a. and 18.b of INT 22-03 require disclosures similar to those required by INT 22-02, and our comments on INT 22-02 in our October 14 letter also apply here, taken in the context of the above discussion of "reasonable estimate."

manner that will result in inappropriate inconsistencies.[2] In all these circumstances, there are threshold questions as to the basis for determining how a consolidated tax for which a consolidated tax group may be liable should be accounted for in the separate statutory financial statements of an insurance company member of the group, and interested parties requests that the Working Group issue clarifying guidance to address these CAMT-related tax accounting issues before requiring expanded CAMT disclosures.

In our letter dated September 26, 2022, we suggested a delay in the recognition of any statutory accounting effects of the CAMT until at least the first quarter 2023 statutory financial statements. This suggestion was made not only to provide additional time for initial guidance from Treasury (discussed further below), but also for consideration of the applicable statutory tax accounting issues. Interested parties will cooperate with the Working Group and NAIC staff to identify and address the various fact circumstances and issues and to consider appropriate resolutions.

Systems, Processes, and Internal Controls Issues/Amendments of TSAs

In addition to the statutory tax accounting uncertainties discussed above and the lack of Treasury guidance discussed below, another impediment relates to more practical matters – the inability of reporting entities at this time of year to effectively make changes in year-end reporting systems, processes, and internal controls to meet the reasonable estimate requirements of INT 22-03. Typically, by this time of year, companies have locked-down their year-end accounting processes and procedures, and it is highly unlikely that a reasonable estimate process for the CAMT could now be implemented in a manner that would satisfy all internal control procedures and other accounting system requirements. Instead, if the requirement is maintained, work-arounds would be required that would most likely lead to inconsistent and perhaps unreliable results.

Furthermore, while companies may be contemplating changes to their TSAs to account for the CAMT, time is insufficient to institute such requests and receive the required approvals for 2022. But even if there was adequate time, companies will be unable to make informed decisions about how their TSAs should deal with the CAMT in the absence of necessary tax law and tax accounting guidance clarifications. A circular equation exists – tax accounting is affected by TSAs, but TSAs are dependent on tax accounting. The tax accounting playing field must be clearly defined before appropriate TSA provisions may be implemented.

It also should be noted that, while TSAs generally do not provide for the CAMT, some TSAs still include provisions related to the AMT effective in pre-2018 years. Application of such provisions to a CAMT which the TSA was never designed to address would certainly lead to inconsistencies and inaccuracies.

Lack of Treasury Guidance

[2] It has already come to the attention of interested parties that major accounting firms may be developing differing points of view on the application of the principles of SSAP No. 101 to the CAMT.

In our letter to the Working Group dated September 26, 2022, we noted that Treasury is required not only to provide general guidance to carry out the purpose of the CAMT, but also is directed or authorized to issue guidance to implement or clarify application of the law in approximately 20 specific instances. We also noted that one such instance where Treasury may alter application of the CAMT is in determining the applicable financial statement (AFS) for purposes of the CAMT, a determination that clearly is fundamental to the workings of the CAMT.[3] Further, we noted that Treasury would be asked to address the treatment of financial statement accounting issues specifically related to the insurance business. Both life insurance and property & casualty insurance trade associations have submitted letters to Treasury relating to insurance company-specific issues, and both have scheduled initial meetings with Treasury to discuss such issues.

We noted in our September 26 letter that substantive CAMT guidance is unlikely to occur until 2023. In the weeks since that letter was submitted, that expectation has been reinforced, as Treasury has acknowledged that issuing guidance on the energy tax credit provisions of the Inflation Reduction Act is a priority, rather than CAMT guidance which affects a smaller number of taxpayers. Accordingly, there is little expectation that Treasury guidance will be issued during the remainder of 2022 that will enhance reporting entities' ability to make a reasonable estimate of the effects of CAMT for year-end 2022.

Other Comments

We have two other comments of lesser importance than those above. First, paragraph 18.d. of INT 22-03 requires disclosure of additional information needed to complete the requirements "under ASC 740." Although this reference to ASC 740 is consistent with paragraph 7.d.ii.b) of INT 18-01: Updated Tax Estimates under the Tax Cuts and Jobs Act, we recommend that the words "under ASC 740" either be deleted or changed to "under SSAP No. 101." For the CAMT in particular, the accounting requirements and the ability of companies to make reasonable estimates for consolidated GAAP financial statement purposes differ from those applicable for separate company statutory financial statements.

Second, paragraph 15 of the INT requires evaluation of "partially issued" Treasury regulations in establishing a reasonable estimate for the impacts of the CAMT. This wording may have been intended to reflect anticipation that Treasury regulations or other guidance on the CAMT likely will be issued in piecemeal form, but clarification would be useful. Guidance on the tax law requirements for the CAMT may come in various forms - revenue rulings, notices, or proposed, temporary, or final regulations. Proposed regulations are subject to a notice and comment period before they may be issued in final form. The specific Internal Revenue Code language authorizing Treasury guidance on the CAMT usually refers to "regulations or other guidance." Accordingly, we recommend that the phrase "partially issued regulations" be changed to "regulations or other guidance."

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[3] In an October 14, 2022, letter to Treasury, the American Institute of CPAs requested that Treasury exercise its authority to determine the AFS in a manner that apparently would make the statutory financial statements of an insurance company its AFS even if, for example, it is included in the consolidated GAAP financial statements of its parent company.

Thank you for considering our comments. We look forward to further discussion of these matters and, in particular, cooperation with the Working Group and NAIC staff in clarifying the tax accounting guidance. Please feel free to contact either one of us with any questions you may have.

Sincerely,

D. Keith Bell

Rose Albrizio

c: Interested parties
NAIC staff

Additional Information and Example

This attachment includes discussion of the following:

- An overview of the newly enacted corporate alternative minimum tax.
- An overview of Federal income tax rules relating to inclusion of insurance companies in consolidated Federal income tax returns.
- Accounting guidance on allocation of consolidated tax expense to separate financial statements of members.
- Statutory income tax accounting guidance for the separate financial statements of insurance companies included in consolidated Federal income tax return.
- An example of a typical fact situation for an insurance company group and the type of statutory accounting issues that might arise in such a situation.

Corporate Alternative Minimum Tax

The recently enacted law commonly referred to as the "Inflation Reduction Act of 2022" includes a corporate alternative minimum tax (CAMT) effective in 2023 that is based on an applicable corporation's adjusted financial statement income (AFSI) set forth on its applicable financial statement (AFS). A corporation is an "applicable corporation" if its rolling average pre-tax AFSI over three prior years (starting with 2020-2022) is greater than $1 billion. For a group of related entities (based on greater than 50% ownership), the $1 billion threshold is determined on a controlled group basis, and the group's AFS is generally treated as the AFS for all separate taxpayers in the group.[4] Except under limited circumstances that may be the subject of future Treasury guidance, once a corporation is an applicable corporation, it is an applicable corporation in all future years.

Even if a corporation is an applicable corporation, it is not automatically subject to a CAMT liability. The corporation's tentative CAMT liability is equal to 15% of its adjusted AFSI, and CAMT is payable to the extent the tentative CAMT liability exceeds regular corporate income tax. However, any CAMT paid would be indefinitely available as a credit carryover that could reduce future regular tax in excess of CAMT.

Inclusion of Insurance Companies in Consolidated Federal Income Tax Returns

The Internal Revenue Code provides that an "affiliated group" of corporations may file a consolidated US income tax return. For this purpose, an "affiliated group" is generally defined as a chain of "includible corporations" connected through stock ownership (comprising 80% or more of vote and value) with a common parent corporation. However, includible corporations do not include foreign corporations, nor (subject to the exceptions described below) life insurance companies. On the other hand, insurance companies that are not taxed as life insurance companies are includible corporations.

Two exceptions exist to the exclusion of life insurance companies from a consolidated return. First, two or more life insurance companies may file a so-called "life-life" consolidated return,

[4] For a "foreign-parented multinational group," the $1 billion threshold is determined on a worldwide basis and the threshold for U.S.-taxpaying members of the group is reduced to $100 million.

provided they are in a parent-subsidiary relationship that satisfies the 80% ownership requirement. Second, an affiliated group that includes one or more life insurance companies may elect to treat such companies as includible corporations in a so-called "life-nonlife" consolidated return. However, a life insurance company may not be treated as includible until it has been a member of the affiliated group for 5 taxable years. During this 5-year waiting period, such a life insurance company is referred to as "ineligible". After the expiration of the 5-year period, an ineligible life company automatically becomes includible in the life-nonlife consolidated return.

Accordingly, insurance companies may be included in a consolidated Federal income tax return under the following circumstances:

- A nonlife insurance company may be includible in a consolidated return that does not include life insurance companies, or in a life-nonlife consolidated return.
    - Such a nonlife insurance company may be the parent company of a consolidated return group.
        - For example, a mutual nonlife insurance company may file a consolidated return with its 80% or more owned subsidiaries.
        - If a life-nonlife election has been made, such consolidated return includes eligible life insurance companies.
- A life insurance company may be included in a life-nonlife consolidated return if it is eligible and if the common parent company has made the life-nonlife election.
    - A life insurance company may be included in a life-life consolidated return if the requisite parent-subsidiary relationship exists with another life insurance company and either:
        - A life-nonlife election has not been made by the ultimate parent company of the affiliated group
        - A life-nonlife election has been made, but the life company is ineligible during the 5-year waiting period.
            - However, an ineligible life insurance company may <u>not</u> elect to file a life-nonlife consolidated return with its nonlife insurance company subsidiaries.
    - A life insurance company may be the parent company of a life-nonlife consolidated return group.

<u>Allocation of Consolidated Tax Expense to Separate Financial Statements of Members</u>
Accounting Standards Codification (ASC) 740-10-30-27 provides that the consolidated amount of current and deferred tax expense for a group that files a consolidated tax return is allocated among the members of the group when those members issue separate financial statements. ASC 740 does not require a single allocation method; however, the method adopted must be systematic, rational, and consistent with the broad principles of the asset and liability approach established by ASC 740. A method that allocates current and deferred taxes to members of the group by applying ASC 740 to each member as if it were a separate taxpayer meets those criteria. The separate company approach also is the preferred method for separate financial statements filed with the Securities and Exchange Commission. SEC Staff Accounting Bulletin

Topic 1B states:

> The staff believes that it is material to investors to know what the effect on income would have been if the registrant had not been eligible to be included in a consolidated income tax return with its parent. Some of these subsidiaries have calculated their tax provision on the separate return basis, which the staff believes is the preferable method.

It is recognized that under the separate taxpayer approach, the sum of amounts allocated to individual members of the group may not equal the consolidated amount. This may also be the result when there are intra-entity transactions between members of a group.

ASC 740-10-30-28 provides the following examples of methods that are not consistent with the broad principles of ASC 740:

- A method that allocates only current taxes payable to a member of the group that has taxable temporary differences.
- A method that allocates deferred taxes to a member of the group using a method fundamentally different from the asset and liability method described in ASC 740.
- A method that allocates no current or deferred tax expense to a member of the group that has taxable income because the consolidated group has no current or deferred tax expense.

Although ASC 740 does not prescribe a single allocation method to apply when an entity allocates current and deferred income taxes, in practice, intercorporate tax allocations are often calculated using the separate return method, the benefits for losses method, or the pro rata method.

- The separate return method applies ASC 740 to the stand-alone financial statements of each member of the consolidated return group as if the group member were a separate taxpayer.
- The benefits for losses method modifies the hypothetical separate return by considering the subsidiary's net operating losses and capital losses as realized by the subsidiary in its separate financial statements when those losses are used by the parent in its consolidated tax return with a cash settlement at that time. Benefits for the subsidiary's tax credits utilized in the consolidated tax return may be similarly realized.
- Under the pro rata method, current and deferred income taxes are allocated to members of the group based on each member's relative contribution to the group's consolidated income tax expense or benefit.
    - Unlike the separate return method, the sum of the amounts allocated to individual members under the pro rata method should equal the amounts reported in the consolidated financial statements.
    - When applying the pro rata method, each component of income tax expense and each deferred tax asset and liability generally should be allocated to the group members rather than simply allocating total income taxes

An intercompany TSA may provide a reasonable basis on which to allocate income taxes among members of a consolidated group if it is systematic, rational, and consistent with the broad principles of ASC 740. When a TSA is not consistent with an allocation methodology that is acceptable for financial statement purposes, differences may arise between the amounts reported in the financial statements and the amounts actually payable or receivable under the TSA. These differences generally should be reported as adjustments to capital (as contributed capital or dividends) in the separate financial statements of the subsidiaries.

Statutory Separate Financial Statements of Insurance Companies

The statutory financial statements filed by insurance companies with State insurance regulators are separate company statements. In recognition of this, SSAP No. 101 – Income Taxes, provides guidance for situations when the reporting entity is a member of a consolidated income tax return with one or more affiliates. As noted below, the guidance in SSAP No. 101 refers to "separate company" or "separate legal entity" determinations.

Paragraph 16 of SSAP No. 101 provides that income tax transactions between the affiliated parties shall be recognized if a) such transactions are economic transactions as defined in SSAP No. 25, b) are pursuant to a written income tax allocation agreement, and c) income taxes incurred are accounted for in accordance with GAAP principles, as modified by SSAP No. 101. Paragraph 17 provides that amounts owed to a reporting entity pursuant to a transaction recognized under paragraph 16 shall be treated as a loan or advance, and nonadmitted, pursuant to SSAP No. 25, to the extent that the recoverable is not settled within 90 days of the filing of a consolidated income tax return, or where a refund is due the reporting entity's parent, within 90 days of the receipt of such refund.

The admissibility of income tax assets is set forth in paragraphs 9 and 10 of SSAP No. 101 for current income tax recoverables, and in paragraphs 11 (which sets forth a three-component admission calculation in 11.a., 11.b., and 11.c.) and 12 for adjusted gross deferred tax assets (DTAs). Footnote 2 of SSAP No. 101 provides that, for purposes of determining the amount of adjusted gross DTAs and the amount admitted under paragraph 11, the admission calculation shall be made on a separate company, reporting entity basis. A reporting entity that files a consolidated federal income tax return with its parent should look to the amount of taxes it paid (or were allocable to it) as a separate legal entity in determining the admitted DTA under paragraph 11.a., and the DTA admitted under this paragraph cannot exceed the amount the reporting entity could reasonably expect to have refunded by its parent. The taxes paid by the reporting entity represent the maximum DTA that may be admitted under paragraph 11.a., although the amount could be reduced pursuant to the group's tax allocation agreement. The amount of admitted adjusted gross DTA under paragraph 11.b.i. is limited to the amount that the reporting entity expects to realize within the applicable realization period, on a separate company basis. The reporting entity must estimate its separate company taxable income and the tax benefit that it expects to receive from reversing deductible temporary differences in the form of lower tax payments to its parent. A reporting entity that projects a tax loss in the applicable realization period cannot admit a DTA related to the loss under paragraph 11.b., even if the loss

could offset taxable income of other members in the consolidated group and the reporting entity could expect to be paid for the tax benefit pursuant to its tax allocation agreement.[5]

Paragraph 12.b. of SSAP No. 101 reiterates footnote 2 in providing that the amount of carryback potential that may be considered in calculating the admitted adjusted gross DTAs under paragraph 11.a. of such a reporting entity may not exceed the amount that the reporting entity could reasonably expect to have refunded by its parent.

Certain effects of inclusion of a reporting entity in a consolidated tax return group also are addressed in SSAP No. 1 Exhibit A - Implementation Questions and Answers (Q&A). For example, Q&A 8 addresses how a company's computation of adjusted gross and admitted DTAs is impacted if it joins in the filing of a consolidated federal income tax return, and includes the following points:

- Paragraph 8.1 - For purposes of determining the amount of DTAs and the amount admitted under paragraph 11, the calculation should be made on a separate company, reporting entity basis.
- Paragraph 8.2 - A reporting entity that files a consolidated federal income tax return with its parent should look to the amount of taxes it paid (or were allocable to it) as a separate legal entity in determining the admitted adjusted gross DTAs under paragraph 11.a. Furthermore, the admitted adjusted gross DTAs under paragraph 11.a. may not exceed the amount that the reporting entity could reasonably expect to have refunded by its parent company. The taxes paid by the reporting entity represent the maximum DTAs that may be admitted under paragraph 11.a., although the amount could be reduced pursuant to the group's tax allocation agreement.
- Paragraph 8.3 - The amount of admitted adjusted gross DTAs under paragraph 11.b.i. is limited to the amount that the reporting entity expects to realize within the applicable period (determined under the Realization Threshold Limitation Tables in paragraph 11.b.) following the balance sheet date on a separate company basis. The entity must estimate its separate company taxable income and the tax benefit that it expects to receive from reversing deductible temporary differences in the form of lower tax payments to its parent. If the reporting entity had reversing adjusted gross DTAs during the applicable period for which it does not expect to realize a benefit under paragraph 11.b. on a separate company basis, the reporting entity cannot admit an amount related to such DTAs under paragraph 11.b., even though the reporting entity may be paid a tax benefit for such items pursuant to its tax allocation agreement.
- Paragraph 8.11 - Under paragraph 11.c., an entity may admit its adjusted gross DTAs, after application of paragraphs 11.a. and 11.b., based upon offset against its own existing gross deferred tax liabilities (DTLs and not against gross DTLs of other members of the affiliated or consolidated group.

<u>Example</u>

[5] For example, under a benefits for losses TSA.

Assume A is a non-insurance holding company that owns 100% of the stock of life insurance companies B, C, and D. The ABCD group includes an audited GAAP financial statement in its Form 10-K filed with the SEC. B, C, and D each file audited separate company statutory financial statements with the applicable State insurance regulators. However, B, C, and D do not prepare or file separate company GAAP financial statements. GAAP ledgers are maintained on a line of business basis across the three companies, rather than on a legal entity basis, and separate company GAAP information is not available.

The 3-year average annual adjusted financial statement income (AFSI) of the ABCD group per its 2020-2022 GAAP financial statements is expected to exceed $1 billion. Accordingly, the ABCD group expects to be an "applicable corporation" for 2023 and subsequent taxable years that will be required to compute a tentative minimum tax liability to compare to its regular tax liability to determine if any CAMT is owed. Company B's 3-year average annual AFSI per its 2020-2022 separate company statutory financial statements is expected to exceed $1 billion, but neither company C nor D are expected to reach that level.

The ABCD group files a life-nonlife consolidated Federal income tax return. The ABCD intercompany tax sharing agreement (TSA) provides that the consolidated tax liability that may be allocated to B, C, and D may not exceed the tax which B, C, or D would incur on a separate return basis. The TSA does not explicitly provide for the CAMT.

Given these facts, how are the impacts of the CAMT in B, C, and D's separate company statutory financial statements determined? Should B, C, and D be treated as applicable corporations potentially subject to CAMT in 2023 and subsequent years because that is the expectation for the ABCD consolidated tax return group? What if B, C, or D was not included in the life-nonlife return because it had not yet been a member of the group for 5 taxable years? How do the separate company/separate legal entity requirements of SSAP No. 101 apply to the CAMT? In determining admitted deferred tax assets under paragraph 11.b. of SSAP No. 101, do B, C, and D take into account GAAP income or statutory income? If the former, how could that be determined on a legal entity basis given that GAAP ledgers are maintained on a line of business basis? If the latter, is only company B required to compute tentative minimum tax liability? How does the ABCD group's separate return TSA affect the CAMT computations? What if the TSA is not amended to address the CAMT? Would the answer to these questions be different if the TSA provided for a pro rata allocation of consolidated tax liability? Should accounting policy elections for these types of CAMT-related issues be available in the statutory financials? If the ABCD group did not expect to be an applicable corporation, and therefore not subject to the CAMT, should B, C, and D have to do any accounting at all for the CAMT in their separate company statutory financial statements?

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October 31, 2022

Mr. Dale Bruggeman, Chairman
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National Association of Insurance Commissioners
1100 Walnut Street, Suite 1500
Kansas City, MO 64106-2197

Dear Mr. Bruggeman:

Re: Proposal for the NAIC to Fulfil the Original Intent of the Interest Maintenance Reserve

The American Council of Life Insurers (ACLI) would like to request urgent action on an issue that was never fully resolved by the NAIC and has become a pressing matter for the industry due to the rapid rise in interest rates – the allowance of a net negative Interest Maintenance Reserve (IMR) balance.

The ACLI proposes the allowance of a negative IMR balance in statutory accounting. Negative IMR balances are expected to become more prevalent in a higher interest rate environment and their continued disallowance will only serve to project misleading optics on insurers' financial strength (e.g. inappropriate perception of decreased financial strength through lower surplus and risk-based capital even though higher rates are favorable to an insurer's financial health) while creating uneconomic incentives for asset-liability management (e.g. discourage prudent investment transactions that are necessary to avoid mismatches between assets and liabilities just to avoid negative IMR).

ACLI believes the necessary changes can be implemented quickly and with minimal changes to the annual statement reporting instructions.

The remainder of this letter expands upon these points.

Historical Context and Background

The IMR, first effective in statutory accounting in 1992, requires that a realized fixed income gain or loss, attributable to changes in interest rates (but not gains or losses that are credit related), be amortized into income over the remaining term to maturity of the fixed income investments (and related hedging programs) sold rather than being reflected in income immediately.

Since statutory accounting practices for life insurance companies are the primary determinant of obtaining an accurate picture for assessing solvency, it was imperative that the accounting practices be consistent for assets, liabilities, and income and that they be reported on a financially consistent basis. If assets and liabilities were not reported on a financially consistent basis, then the financial statements would not be useful in determining an accurate assessment of solvency or whether there were sufficient assets to pay contractual obligations when they become due.

Amortized cost valuation of fixed income investments reflects the outlook at the time of purchase and amortization reflects the yields available at time of purchase. Policy reserve liabilities are established at the same time, and the interest rate assumptions are consistent with the yields at that time. But if fixed income investments are sold, with the proceeds reinvested in new fixed income investments, a new amortization schedule is established which may be based on an entirely different yield environment, which may be inconsistent with the reserve liabilities when they were established.

IMR was created to prevent the timing of the realization of gains or losses on fixed income investments, related to interest rates changes, to affect the immediate financial performance of the insurance company. This recognized that the gains and losses were transitory without any true economic substance since the proceeds would be reinvested at offsetting lower or higher interest rates.

For example, without the IMR, if a company sold all bonds in a declining interest environment (e.g., from 4% to 2%), and reinvested in new bonds, surplus would increase through significant realized gains. The increased surplus would inappropriately reflect increased financial strength that is illusory, due to a now lower yielding portfolio, as there would be no change to the income needed to support the liabilities.

Likewise, if a company sold all bonds in an increasing interest rate environment (e.g., from 2% to 4%), and reinvested in new bonds, surplus would decrease through significant realized losses. The decreased surplus would inappropriately reflect decreased financial strength that is similarly illusory due to the reinvestment at higher yields relative to when the bonds were originally purchased.

A net negative IMR is currently disallowed in statutory accounting. This handling is contrary to its original intent which recognized that interest related gains and losses are both transitory without any true economic substance since the proceeds would be reinvested at offsetting lower or higher interest rates, respectively. See attachment I to this letter that illustrates the financially consistent

treatment of assets, liabilities, and income and how IMR is needed to achieve that objective for both realized gains and losses.

That IMR should conceptually apply to both realized gains and losses was recognized by the NAIC during and after IMR development. The below is a quote from a 2002 report by the NAIC AVR/IMR Working Group to the E-Committee:

> *"The basic rationale for the IMR would conclude that neither a maximum nor a minimum is appropriate. If the liability values are based on the assumption that the assets were purchased at about the same time as the liabilities were established, then there should be no bounds to the reserve which corrects for departures from that assumption;* ***if a company has to set up a large reserve because of trading gains, it is in no worse position that if it had held the original assets. As for negative values of the IMR, the same rationale applies*****.** **However, the concept of a negative reserve in the aggregate has not been adopted."**

While realized losses can offset realized gains in IMR, the IMR instructions require the disallowance of a net negative IMR balance (e.g., as noted in the last sentence of the aforementioned quote). See attachment II to this letter, which includes the pertinent IMR instructions where negative IMR balances are currently disallowed and in need of amendment.

When IMR was originally developed, it was intended to achieve its purpose in both a declining and rising interest rate environment. The originally adopted disallowed status of a negative IMR was expected to be addressed in subsequent years. However, over time with the persistent declining interest rates, the issue lost urgency since a negative IMR would not have been a significant issue for any company. The NAIC AVR/IMR Working Group ultimately disbanded without ever addressing this longstanding item on their agenda.

With a rising interest rate environment, it is important that the allowance of a negative IMR be addressed to fulfill its original purpose. In general, rising interest rates are favorable to the financial health of the insurance industry as well as for policyowners.

Without a change, the rising interest rate environment will give the inappropriate perception of decreased financial strength through lower surplus and risk-based capital and worse, create incentives for insurance companies to take action, or not take actions, to prevent uneconomic surplus impacts where the actions (or lack thereof) themselves may be economically detrimental.

Symmetrical treatment of a negative IMR (i.e., the allowance of a negative IMR balance) would appropriately not change surplus as a sale and reinvestment would not affect the underlying insurance company liquidity, solvency, or claims paying ability, just like with a positive IMR. See attachment III to this letter that illustrates that the sale of a fixed income investment, and reinvestment in a new fixed income investment, has no bearing on a life insurance company's liquidity, solvency, or claims paying ability.

As it was initially recognized by the NAIC that IMR should apply to both gains and losses, adequate safeguards were already built into the IMR instructions for asset adequacy, risk-based capital, and troubled companies.

Negative IMR – Reserve Adequacy and Risk-Based Capital

When IMR was developed, it was anticipated that a negative IMR balance would be reflected in asset adequacy analysis. This inclusion ensures that the assets, with the appropriate allocation from the IMR (whether negative or positive), would be adequate to fund future benefit obligations and related expenses of the company.

From the standpoint of reserve adequacy, the inclusion of a negative IMR balance appropriately reduces the investment income in asset adequacy testing. Without the inclusion of negative IMR, reserve inadequacies would potentially not be recognized.

Further, with the inclusion of a negative IMR balance in asset adequacy testing, the disallowance of a negative IMR can result in double counting of losses (i.e., through the disallowance on the balance sheet and the potential AAT-related reserve deficiency). The Actuarial Opinion that covers asset adequacy analysis requires the appropriate assessment of negative IMR in its analysis.

If a negative IMR balance is used in the asset adequacy analysis, its allowance is appropriate. Likewise, if only a portion of a company's negative IMR balance is reflected in the asset adequacy analysis, only the allowance for that portion of the negative IMR balance reflected is appropriate. If a negative IMR balance is disallowed, it would be inappropriate to include in asset adequacy analysis. It is imperative there is symmetry between both reserving and accounting considerations, and there is already precedent in the asset adequacy analyses for inclusion of IMR.

Below are the current references to IMR in the valuation manual and risk-based capital calculations.

Regulation	Use	IMR references
Actuarial Opinion and Memorandum Regulation (VM-30)	Asset adequacy analysis for annual reserve opinion	An appropriate allocation of assets in the amount of the IMR, whether positive or negative, shall be used in any asset adequacy analysis.
Life principle-based reserves (VM-20)	Calculation of deterministic reserve	Calculate the deterministic reserve equal to the actuarial present value of benefits, expenses, and related amounts less the actuarial present value of premiums and related amounts, less the positive or negative pre-tax IMR balance at the valuation date allocated to the group of one or more policies being modeled
Life principle-based reserves (VM-20)	Calculation of stochastic reserve	Add the CTE amount (D) plus any additional amount (E) less the positive or negative pre-tax IMR balance allocated to the group of one or more policies being modeled
Variable annuities principle-based reserves (VM-21)	Reserving for variable annuities	The IMR shall be handled consistently with the treatment in the company's cash-flow testing, and the amounts should be adjusted to a pre-tax basis.
C3 Phase 1 (Interest rate risk capital)	RBC for fixed annuities and single premium life	IMR assets should be used for C3 modeling.

Additional IMR Safeguards

The IMR instructions do provide additional safeguards in situations where it would be appropriate to recognize interest-rate related gains and losses immediately rather than be included in the IMR.

They were established to prevent situations where the liability the IMR supports, no longer exists. Examples noted in the annual statement instructions include:

- Major book-value withdrawals or increases in policy loans occurring at a time of elevated interest rates.

- Major book value withdrawals resulting from a "run on the bank" due to adverse publicity.

As a result, the IMR instructions include an IMR Exclusion whereby all gains or losses which arise from the sale of investments related to "Excess Withdrawal Activity" are to be excluded from IMR and reflected in net income. In short, Excess Withdrawal Activity is defined as 150% of the product of the lower of the withdrawal rate in the preceding or in the next preceding year calendar year times the withdrawal reserves at the beginning of the year.

Summary

With a rising interest rate environment, it is important that the allowance of a negative IMR be addressed to fulfill its original purpose. In general, rising interest rates are favorable to the financial health of the insurance industry as well as for policyowners. Without a change, the rising interest rate environment will give the inappropriate perception of decreased financial strength through lower surplus and risk-based capital.

The inability to recognize negative IMR could also impact the rating agency view of the industry, or worse, incentivize companies to avoid prudent investment transactions that are necessary to avoid mismatches between assets and liabilities. Furthermore, there are adequate safeguards in place to ensure that allowing a negative IMR does not cause any unrecognized reserve or capital inadequacies or any overstatement of claims paying ability.

Current statutory accounting guidance creates two equally objectionable alternatives for insurers and their policyowners. Following the current statutory guidance will improperly reflect financial strength through understating surplus, so additional surplus may need to be retained. Alternatively, one could take steps to manage the current situation by limiting trading of fixed income investments and related hedging programs, which would diminish significant economic value for policyowners, as well as create a mismatch between assets and liabilities.

Both scenarios encourage short-term non-economic activity not in the best long-term interest of the insurance company's financial health or its policyowners. For insurers with diminishing IMR balances due to the rapid increase in interest rates, this dilemma is either here or fast approaching and can only be resolved now with certainty of the appropriate treatment of IMR by the NAIC.

The ACLI looks forward to urgently working with the NAIC toward fulfilling the original intent of IMR. It is imperative that insurers receive relief for year-end 2022.

If you have any questions regarding this letter, please do not hesitate to contact us.

Sincerely,

Mike Monahan
Senior Director, Accounting Policy

Paul Graham
Senior Vice President, Chief Actuary

Simplified Example – Need for Reporting Assets, Liabilities, and Income on a Consistent Basis:

- This example shows the appropriate interrelationship of IMR on assets, reserve liabilities, and income.
- Assume a bond is held with the following characteristics:
  - Par Value: $1,000
  - Coupon: 3%
  - Term-to-maturity: 10 years
- Assume the bond is then sold at "time zero" and the proceeds are immediately reinvested in a bond with the same characteristics (e.g., term-to maturity, credit quality, coupon equivalent to market rate, etc.).
- Assume a simplified example with no existing IMR balance, where the bond supports a fixed insurance liability with the same duration as the original bond, as well as a present value of $1,000.

Table 1: Market Interest Rate Scenario			
	Same	**Lower**	**Higher**
Market interest rate	3%	2%	4%
Bond's market value	$1,000	$1,090	$919
Realized gain/(loss) if sold	$0	$90	($81)*

Realized gain/(loss) deferred to balance sheet IMR and amortized into income over remaining life of bond sold (i.e., 10 years).

Table 2: Statutory Investment Income			
IMR amortization	$0	$9	($8)
Interest income on new bond	$30	$21	$38
Total annual stat income	$30	$30	$30

On average, future income is approximately the same in each interest rate scenario as the IMR gets reduced through amortization to income.

Table 3: Statutory Balance Sheet			
Balance Sheet Bonds	$1,000	$1,090	$919
IMR	$0	($90)	$0*
Stat assets net of IMR	$1,000	$1,000	$919*
Reserves	$1,000	$1,000	$1,000
Surplus	$0	$0	($81)*

Even though the sale of the bond (and subsequent reinvestment) is non-economic, and the same income is being produced to support the liability, a negative surplus position makes it appear there is now a deficiency. Allowing the negative IMR appropriately would show no surplus impact, as is shown when a gain occurs, as there is no change in reported reserve liabilities. Appropriately consistent financial results require the allowance of negative IMR

***The negative IMR balance is currently disallowed and directly reduces surplus. This treatment is not supported by theoretical rationale and gives a distorted view of solvency.**

Pertinent Annual Statement Instructions

Line 6 – Reserve as of December 31, Current Year

Record any positive or allowable negative balance in the liability line captioned "Interest Maintenance Reserve" on Page 3, Line 9.4 of the General Account Statement and Line 3 of the Separate Accounts Statement. A negative IMR balance may be recorded as a negative liability in either the General Account or the Separate Accounts Statement of a company only to the extent that it is covered or offset by a positive IMR liability in the other statement.

If there is any disallowed negative IMR balance in the General Account Statement, include the change in the disallowed portion in Page 4, Line 41 so that the change will be appropriately charged or credited to the Capital and Surplus Account on Page 4. If there is any disallowed negative IMR balance in the Separate Accounts Statement, determine the change in the disallowed portion (prior year less current year disallowed portions), and make a direct charge or credit to the surplus account for the "Change in Disallowed Interest Maintenance Reserve" in the write-in line, in the Surplus Account on Page 4 of the Separate Accounts Statement.

The following information is presented to assist in determining the proper accounting:

General Account IMR Balance	Separate Account IMR Balance	Net IMR Balance
Positive	Positive	Positive (see rule a)
Negative	Negative	Negative (see rule b)
Positive	Negative	Positive (see rule c)
Positive	Negative	Negative (see rule d)
Negative	Positive	Positive (see rule e)
Negative	Positive	Negative (see rule f)

Rules:

a. If both balances are positive, then report each as aa liability in its respective statement.

b. If both balances are negative, then no portion of the negative balances is allowable as a negative liability in either statement. Report a zero for the IMR liability in each statement and follow the above instructions for handling disallowed negative IMR balances in each statement.

c. If the general account balance is positive, the separate accounts balance is negative and the combined net balance is positive, then all of the negative IMR balance is allowable as a negative liability in the Separate Accounts Statement.

d. If the general account balance is positive, the separate account balance is negative, and the combined net balance is negative, then the negative amount not covered by the positive amount is not allowable. Report only the allowable portion as a negative liability in the Separate Accounts Statement and follow the above instructions for handling the disallowed portion of negative IMR balances in the Separate Accounts Statement.

e. If the general account balance is negative, the separate account balance is positive, and the combined net balance is positive, then all of the negative IMR balance is allowable as a negative liability in the General Account Statement.

f. If the general account balance is negative, the separate account balance is positive, and the combined net balance is negative, then the negative amount not covered by the positive amount is not allowable. Report only the allowable portion as a negative liability in the General Account Statement and follow the above instructions for handling the disallowed portion of negative IMR balances in the General Account Statement.

Attachment III

IMR Illustration – Liquidity, Solvency and Claims Paying Ability

Essentially, a negative IMR balance from an individual trade represents the present value of the future positive interest rate differential, from the new investment compared to the old investment, that puts one in the same economic position, when compared to before the trade, including total liquid assets available to pay claims.

This phenomenon can be illustrated in the following table where a 10-year bond is sold, one year after purchase, and immediately reinvested in another 10-year bond with equivalent credit quality in an interest rate environment where market interest rates increased from 2% to 4% in the intervening year.

	Coupon Rate of Bond	Market Interest Rate @ Purchase	Par Value of Bond	Fair Value @ Purchase	Fair Value @ Time of Sale	Loss on Sale	Claims Paying Liquidity
Old Bond	2%	2%	100	100	85.13	14.87	85.13
New Bond	4%	4%	85.13	85.13	85.13	N/A	85.13

The short-term acceleration of negative IMR to surplus (e.g., its disallowance) is strictly a timing issue and not a true loss of financial strength or claims paying liquidity, but it does present a temporary and inappropriate optics issue in surplus/financial strength until the IMR is fully amortized.

This phenomenon can further be illustrated by comparing two separate hypothetical companies. Assume Company A and B both have the exact same balance sheets. Then assume Company A keeps the old bond and Company B affects the trade mentioned above.

With the disallowance of a negative IMR balance, Company B now has a balance sheet that shows a relative decline of financial strength of $14.87. This weakened balance sheet contrasts with both the principle behind the development of IMR, the relative actual economic financial strength, and claims paying ability of the two entities.

There is no difference in balance sheet economics of the two entities. The negative IMR balance for Company B essentially represents the difference between cost and fair value of the investment sold, that is already embedded on Company A's balance sheet based on the existing interest rate environment. The negative IMR balance should be recognized as there is no change in economics pre and post trade (or in this instance between Company A and Company B) which is consistent with the overall principle behind IMR.