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

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

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

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

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

2. Adopted Non-Contested Positions

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

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

a. Agenda Item 2020-19

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

b. Agenda Item 2020-23

Mr. Bruggeman directed the Working Group to agenda item 2020-23: Leasehold Improvements (Attachment One-F). Jake Stultz (NAIC) stated that this nonsubstantive agenda item provides revisions to *SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements* and *SSAP No. 73—Health Care Delivery Assets and Leasehold Improvements in Health Care Facilities* to update the amortization guidance for leasehold improvements. The updated language will allow leasehold improvements to have lives that match the associated lease term, which agrees with U.S. GAAP in Accounting Standards Codification (ASC) Topic 842.

c. Agenda Item 2020-25EP

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

d. Agenda Item 2020-17

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

e. Agenda Item 2020-20

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

f. Agenda Item 2020-21

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

3. Reviewed Comments on Exposed Items

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

a. Agenda Item 2020-18

Mr. Bruggeman directed the Working Group to agenda item 2020-18: SSAP No. 97 Update. Ms. Sediqzad stated the Working Group adopted agenda item 2018-26: SCA Loss Tracking – Accounting Guidance, which incorporated guidance in SSAP No. 97 that reported equity method losses in an SCA would not create a negative value in the SCA investment, but would stop at zero. However, to the extent there is a financial guarantee or commitment, the guidance requires recognition under SSAP No. 5R. She stated that this agenda item was drafted to propose a minor revision to the end of paragraph 9 to remove an outstanding reference that guarantees or commitments can result in a negative equity value for the SCA.

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

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

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

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

b. <u>Agenda Item 2020-22</u>

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

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

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

c. <u>Agenda Item 2019-34</u>

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

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

d. Agenda Item 2020-24

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

f. <u>Agenda Item 2019-24</u>

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

4. <u>Reviewed Previously Adopted Interpretations for Possible Extension</u>

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

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

5. <u>Considered Maintenance Agenda – Pending Listing – Exposures</u>

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

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

a. <u>Agenda Item 2020-32: SSAP No. 26R – Disclosure Update</u>

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

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

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

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

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

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

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

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

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

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

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

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

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

h. Agenda Item 2020-39: Interpretation Policy Statement

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

i. Agenda Item 2020-40: Prescribed Practices

This nonsubstantive agenda item proposes revisions to clarify that while any state in which a company is licensed can issue prescribed practices, the prescribed practices directed by the domiciliary state shall be reflected in the financial statements filed with the NAIC, and they are the financial statements subject to the independent auditor requirements. The prescribed practices issued by non-domiciliary states shall be reflected in the financial statements filed with those states.

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

This nonsubstantive agenda item proposes to reject *Accounting Standards Update (ASU) 2020-06, Debt—Debt with Conversion and Other Options (Subtopic 470-20) and Derivatives and Hedging—Contracts in Entity's Own Equity (Subtopic 815-40), Accounting for Convertible Instruments and Contracts in an Entity's Own Equity* in SSAP No. 5R, *SSAP No. 72—Surplus and Quasi-Reorganizations* and SSAP No. 86.

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

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

6. Discussed Other Matters

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

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

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

b. Deferred Items

NAIC staff have identified a couple of projects related to goodwill (agenda item 2019-12 and agenda item 2019-14) that have been deferred for discussion. While these items remain deferred, NAIC staff have proposed a project to holistically review the business combinations (and goodwill) guidance in *SSAP No. 68—Business Combinations and Goodwill*. If approved, the outstanding items in these agenda items will likely be addressed in the project.

c. Agenda Item 2019-49: Retroactive Reinsurance Exception – Update

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

d. Review of GAAP Exposures:

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

e. Other Items:

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

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

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

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Draft: 10/30/20

Statutory Accounting Principles (E) Working Group
Virtual Meeting
October 15, 2020

The Statutory Accounting Principles (E) Working Group of the Accounting Practices and Procedures (E) Task Force met Oct. 15, 2020. The following Working Group members participated: Dale Bruggeman, Chair (OH); Kevin Clark and Carrie Mears, Co-Vice Chairs (IA); Kim Hudson (CA); William Arfanis (CT); Rylynn Brown (DE); Eric Moser (IL); Caroline Fletcher (LA); Judy Weaver (MI); Doug Bartlett (NH); Bob Kasinow and Tom Dudek (NY); Melissa Greiner (PA); Jamie Walker (TX); Doug Stolte and David Smith (VA); and Amy Malm (WI).

1. Heard Comments and Discussed Agenda Item 2019-24

The Working Group held a public hearing to review comments (Attachment One-A1) on the Levelized and Persistency Commissions agenda item.

Mr. Bruggeman directed the Working Group to agenda item 2019-24: Levelized and Persistency Commission.

Robin Marcotte (NAIC) stated that the Working Group has been discussing this item since August 2019. She stated that during the 2020 Summer National Meeting, the Working Group exposed nonsubstantive revisions to *SSAP No. 71—Policy Acquisition Costs and Commissions* (SSAP No. 71) to clarify levelized commission guidance and provide additional direction regarding commissions that are based on policy persistency. She stated that the revisions exposed in July 2020 were consistent with the 2019 Fall National Meeting exposure, with the inclusion of guidance to clarify that reporting entities that have not complied with the original intent shall reflect the change as a correction of an error in the year-end 2020 financial statements.

Ms. Marcotte stated that some insurers have entered into third-party arrangements with the intent to defer the recognition of initial commission costs. She noted that this goes against a long-standing statutory accounting principle that acquisition costs are to be expensed as incurred.

Ms. Marcotte noted that the comments received were from interested parties and from the American Institute of Certified Public Accountants' (AICPA) NAIC Task Force. She summarized some of the key points from the commenters. She stated that the first key point was that the revisions should be reclassified as substantive and interested parties recommended an issue paper. She stated the second key point was that the revisions are too extensive regarding renewal commission and would require premature liability recognition of traditional persistency commission at policy inception, rather than during the policy period in which it is earned. She noted the last key point was that both the interested parties and the AICPA's NAIC Task Force objected to treating the revisions as a correction of an error and instead prefer a "change in accounting principle." She noted that the September 2020 comments from interested parties reflected similar themes as prior comments, but also provided new proposed tracked revisions.

Ms. Marcotte noted that NAIC staff have worked with some of the Working Group members to prepare the alternative proposed revisions in the materials for Working Group discussion.

Mr. Bruggeman asked if any parties who provided written comments wanted to provide additional verbal comments.

Lynn Kelly (Delaware Life), representing interested parties, stated that the proposed revisions to SSAP No. 71, paragraph 3 (removal of proposed language regarding persistency commission) and paragraph 7 (removal of the correction of error guidance that was exposed) were helpful in addressing some of their comments. She noted that interested parties still believe that the proposed revisions regarding the description of funding agreements in paragraph 4 and paragraph 5 still need to be further refined, and, in response, they will submit additional comments to allow for future discussion by the Working Group, if the revisions proposed by NAIC staff are exposed.

Mr. Bruggeman stated that in working with NAIC staff to refine the proposed revisions, the main issue brought to the Working Group was funding agreements. He noted that the previously exposed revisions to paragraph 3 regarding commission were not essential to the goal of better describing funding agreements; therefore, the efforts were focused on paragraph 4 and paragraph 5 to better describe funding agreements that attempt to defer the recognition of acquisition costs. He noted that the revisions are to better identify the substance of funding agreements, including those that were being labeled or masquerading as persistency commission.

Marty Carus (Martin Carus Consulting) stated that he agrees with the commenters in that the revisions should be a change in accounting principle. He noted that he participated in the development of the statutory accounting framework beginning in the late 1970s and culminating with codification. He described the high interest rate climate in the 1980s and the rise in insurance insolvencies, which also occurred in the period, as well as other events that led up to NAIC codification of statutory accounting principles and risk-based capital (RBC). He stated that he was involved in the development of this regulatory framework, including discussions with the AICPA in the 1990s.

Mr. Bruggeman asked Mr. Carus to bring his comments around to the current topic.

Mr. Carus stated that his point was that in 1993 the NAIC reviewed options on developing statutory accounting, including whether to adopt U.S. generally accepted accounting principles (GAAP) but rather chose to embark on a project to codify statutory accounting. He stated that the NAIC determined to develop statutory accounting, and every adopted statement provides the guidance that was intended. He said SSAP No. 71 was developed with due care. He said he does not believe that there is a major issue with SSAP No. 71 to address at this time, noting that there have not been studies on the potential impact regarding the proposed revisions. He does not believe that the proposed revisions are worth the time of the experts that have been involved. He noted concerns with potential impacts to consumers.

Mr. Carus further noted concerns with the requirements to recognize a liability for commission, as was required in his interpretation of the exposed guidance. He stated in some instances, he does not believe that the direct writer would have any contractual obligation to pay the agent. For example, of other liabilities that are not recognized on inception, he noted that leases do not require full recognition upfront. He noted that payment of rent for a lease is more likely than future commissions on an insurance policy. He stated that long-term employment contracts, such as those for football coaches, may include clauses that require full payment, even if the employment is terminated mid-term. He noted that such employment contracts are also not required to be recognized upfront. He stated that the NAIC rejected the most recent U.S. GAAP leasing standard. He noted that a third-party broker can contract with an insurer and the insurer can have no relationship with the direct writing agent. He noted that he believes the proposed SSAP No. 71 guidance should consider discounting of the commission liability, as well as consider expected lapse risk on the policies. He agreed with the commenters that the revisions are substantive, and an issue paper should be considered.

Ms. Marcotte stated that although the proposed revisions were different than proposed revisions submitted by interested parties, the submitted documents were informative regarding the industry’s concerns. She noted that given the comments received, the regulators tried to take a close look at the exposed guidance. She noted that the situation brought to the Working Group by a regulator was a commission funding agreement that was being characterized as a persistency commission. She stated that this example is why the prior exposure noted persistency commission. She stated that the recommendation in the meeting materials to delete the previously exposed revisions regarding persistency commission in paragraph 3 is to address the comments received regarding potential unintended impacts on traditional renewal commission. She stated that the previously exposed revisions regarding correction of an error in paragraph 7 are proposed to be removed to address comments received from interested parties and from the AICPA’s NAIC Task Force.

Ms. Marcotte stated the proposed revisions expand the description of the funding agreements in paragraph 4 and paragraph 5. She stated that using a funding agreement can be an attempt to delink the relationship between the direct writing entity and the agents. She noted that the previously exposed footnote is also proposed for deletion. She noted that the expanded language is to help identify that if a third party pays acquisition costs that the full amount should be recognized as a liability by the direct writer. She stated that the guidance provides that a third party that pays commission on behalf of a direct writer is doing so with an expectation of repayment. She noted that the revisions are to be more explicit regarding existing principles in SSAP No. 71. She stated that the nonsubstantive revisions are proposed with a Jan. 1, 2021, effective date.

Mr. Stolte made a motion, seconded by Mr. Hudson, to expose the new proposed revisions to SSAP No. 71 for a public comment period ending Oct. 30. The motion passed unanimously.

Mr. Bruggeman stated that this public comment period deadline is to allow for discussion on the Nov. 12 meeting of the Working Group. Ms. Marcotte noted that this item will be added as a second item on the Nov. 12 meeting agenda once all comments are received.

2. Received an Update on the ACA Risk Corridors

Ms. Marcotte stated that as a result of the April 2020 U.S. Supreme Court decision, the federal Centers for Medicare & Medicaid Services (CMS) has exposed draft guidance regarding how issuers must treat new recoveries of the federal Affordable Care Act (ACA) risk corridor payments related to the 2014-2016 program in their medical loss ratio (MLR) and rebate calculations. She stated that the proposed guidance has a public comment period ending Oct. 21 and can be found on the CMS website. Ms. Marcotte noted that this update is only to share information, noting that statutory accounting guidance on this topic is in *SSAP No. 107—Risk-Sharing Provisions of the Affordable Care Act*.

3. Discussed Other Matters

Julie Gann (NAIC) noted that agenda item 2019-24 and the exposure drafts from the Oct. 13 meeting of the Working Group will be posted to the Working Group's page on the NAIC website. She stated that the Working Group will not be meeting at the virtual 2020 Fall National Meeting, but a hearing on exposed items and the introduction of new items, which would normally occur at a national meeting, will occur during the Working Group's Nov. 12 meeting.

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

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Statutory Accounting Principles (E) Working Group
October 2020
Comment Letters Received

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September 14, 2020
Mr. Dale Bruggeman
Statutory Accounting Principles Working Group
National Association of Insurance Commissioners
2301 McGee Street, Suite 800
Kansas City, MO 64108-2662

Ref: 2019-24 - Levelized and Persistency Commission

Dear Mr. Bruggerman:

The American Institute of Certified Public Accountants' NAIC Task Force (Task Force) appreciates the opportunity to discuss our comments on Form A: Issue 2019-24, Levelized and Persistency Commission.

Our comments are in response to the proposed transition language in paragraph 7 related to the nonsubstantive revisions regarding levelized commissions:

> **Effective Date and Transition**
>
> 7. This statement is effective for years beginning January 1, 2001. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*. The nonsubstantive revisions adopted _______ regarding levelized commission intend to clarify the original intent of this statement. Reporting entities that have not complied with the original intent of the statement shall reflect the change as a correction of an error (as a mistake in the application of an accounting principle) pursuant to SSAP No. 3 in the December 31, 2020 financial statements. In accordance with SSAP No. 3, correction of all accounting errors in previously issued financial statements, for which an amended financial statement was not filed, shall be reported as an adjustment to unassigned funds (surplus) in the period in which the error was detected. Disclosure shall also occur in accordance with SSAP No. 3.

We believe that the requirement to account for this clarification as a correction of an error pursuant to SSAP No. 3 in the year-end 2020 financial statements would be a departure from how the NAIC has traditionally adopted clarifications to statutory accounting as changes in accounting principle. (We are not aware of any other examples of revisions to SSAPs being considered an error correction since the adoption of the revised NAIC *Accounting Practices and Procedures Manual* in 2001.) We believe that resolving the diversity in practice that currently exists in the accounting for levelized commission programs as the correction of an error would be inconsistent with the NAIC's recent treatment of other nonsubstantive revisions that were adopted to promote the uniform application of statutory accounting guidance. For example, any change in income tax balances that resulted from the comprehensive revisions to the SSAP No. 101 Q&A that were adopted in 2019 to clarify the application of the deferred tax admissibility calculation for year-end 2019 reporting purposes were allowed to be reported as a change in accounting principle in accordance with SSAP No. 3. (Since changes in DTAs only affect surplus, the issue of the income statement needing to be adjusted due to the year-end adoption of new accounting guidance did not exist in this instance, as discussed further below.)

We recommend that the NAIC consider revising the transition language in Issue 2019-24 to allow companies to account for the change as a change in accounting principle, in accordance with SSAP No.

3. Paragraphs 3 through 5 of SSAP No. 3 discuss the characteristics and application of a change in accounting principle,

> A change in accounting principle results from the adoption of an accepted accounting principle, or method of applying the principle, which differs from the principles or methods previously used for reporting purposes. A change in the method of applying an accounting principle shall be considered a change in accounting principle.
>
> A characteristic of a change in accounting principle is that it concerns a choice from among two or more statutory accounting principles. However, a change in accounting principle is neither (a) the initial adoption of an accounting principle in recognition of events or transactions occurring for the first time or previously immaterial in their effect, nor (b) the adoption or modification of an accounting principle necessitated by transactions or events that are clearly different in substance from those previously occurring.
>
> The cumulative effect of changes in accounting principles shall be reported as adjustments to unassigned funds (surplus) in the period of the change in accounting principle. The cumulative effect is the difference between the amount of capital and surplus at the beginning of the year and the amount of capital and surplus that would have been reported at that date if the new accounting principle had been applied retroactively for all prior periods.

We believe the proposed change meets the definition of a change in accounting principle, as we believe the alternative interpretation of the levelized commission guidance in SSAP No. 71 has been accepted in practice. Specifically, we are aware from comments received from industry that some regulators (as part of periodic financial examinations) have not objected to the classification of levelized commission programs with commission payments linked to persistency as allowable in accordance with paragraph 5 of SSAP No. 71.

In addition, we believe that treating the proposed change as a correction of an error will potentially result in challenges for certain reporting entities. For example, reporting entities that have followed the alternative interpretation of the levelized commission guidance in SSAP No. 71 would have previously expensed a portion of this adjustment in their quarterly financial statements filed throughout 2020. If the guidance is adopted for year-end 2020, this expensed portion would need to be identified and reversed in order to properly report the adjustment to the opening (i.e., January 1, 2020) balance of surplus for year-end 2020 reporting purposes, which would increase the complexity of adopting the change. An option to avoid these complications would be to account for the change in accounting principle as of January 1, 2021, which is consistent with the guidance in SSAP No. 3 to adopt new accounting principles at the beginning of the year.

We also wanted to bring it to the Working Group's attention that requiring this clarification to be accounted for as a correction of an error could result in the independent auditor being required to express a qualified opinion on the prior year audited statutory basis financial statements in accordance with AICPA standards. This consideration exists in situations where the misstatements are material but not pervasive to the financial statements unless the prior year financial statements are restated, regardless of the statutory account treatment provided by SSAP No. 3 to recognize the correction of the error.

We appreciate the opportunity to express our views. If you should have any questions regarding our comments, please contact me at (440) 893-0010 or Kim Kushmerick, AICPA at (212) 596-6160.

Sincerely,

Jean Connolly
Chair - AICPA NAIC Task Force

CC:
Bob Dohrer, AICPA Chief Auditor
Tracy Harding, Chair - ASB
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September 18, 2020

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

RE: Items Exposed for Comment by the Statutory Accounting Principles Working Group on July 30 with Comments due September 18

Dear Mr. Bruggeman:

Interested parties appreciate the opportunity to comment on the exposure drafts released for comment by the NAIC Statutory Accounting Principles (E) Working Group (the Working Group). We offer the following comments:

Ref #2019-24: Levelized and Persistency Commission

The Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to *SSAP No. 71—Policy Acquisition Costs and Commissions* (SSAP No. 71) to clarify levelized commissions guidance and provide additional direction regarding commissions that are based on policy persistency. The revisions also clarify that the recognition of commission expense is based on experience to date. The revisions are intended to clarify the original intent of SSAP No. 71 regarding levelized commissions. Reporting entities that have not complied with the original intent of the statement are to reflect the change as a correction of an error (as a mistake in the application of an accounting principle) pursuant to SSAP No. 3 in the December 31, 2020 financial statements. In accordance with SSAP No. 3, correction of all accounting errors in previously issued financial statements, for which an amended financial statement was not filed, are to be reported as an adjustment to unassigned funds (surplus) in the period in which the error was detected. Disclosure shall also occur in accordance with SSAP No. 3.

Interested parties would like to propose the following edits to SSAP No. 71, similar to those sent in January 2020.

SUMMARY CONCLUSION

2. Acquisition costs are those costs that are incurred in the acquisition of new and renewal insurance contracts and include those costs that vary with and are primarily related to the acquisition of insurance contracts (e.g., agent and broker commissions, certain underwriting and policy issue costs, and medical and inspection fees). Acquisition costs and commissions shall be expensed as incurred. Determination of when acquisition costs and commissions have been incurred shall be made in accordance with SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets. For example, when commissions are paid directly to an agent based upon renewal such as in traditional trail commission arrangements, commission expense would be recognized when the obligating event (i.e., the renewal) occurs and the related premium revenue is recognized.

3. Contingent commission liabilities shall be determined in accordance with the terms of each individual commission agreement. Commission liabilities determined on the basis of a formula that relates to loss experience shall be established for the earned portion. Assumptions used to calculate the contingent commission liability shall be consistent with the terms of the policy contract and with the assumptions made in recording other assets and liabilities necessary to reflect underwriting results of the reporting entity such as retrospective premium adjustments and loss reserves, including incurred but not reported. Other than the commission arrangements discussed in Paragraph 2, commission contracts that include persistency (or other such components) shall not use these clauses to defer recognition of commission expense. If a commission is based on annual policy persistency (or other similar components), the commission shall be accrued ratably over each annual period based on experience to date for which the persistency commission will be paid.~~the policy period that the commission relates~~. In regard to persistency commission, it is inappropriate to wait until the amount is fully earned and/or unavoidable to accrue experience to date commission expenses. Actual policy cancellation would reverse the accrual of the related persistency commission.

4. Levelized commissions occur in situations where agents receive normal (non-level) commissions with payments made by a third party. It is intended, but not necessarily guaranteed, that the amounts paid to the agents by the third party would ultimately be repaid (with interest explicit or implied) to the third party by levelized payments (which are less than the normal first year commissions but exceed the normal renewal commissions) from the reporting entity. (Note: levelized repayments made by the reporting entity extend the repayment period but might not be a straight-line repayment.) These transactions are, in fact, funding agreements between a reporting entity and a third party,. A funding agreement is an agreement whereby a third party provides a lump sum of money in return for a stream of payments over a predetermined time period. The payment stream is fixed without regard to the traditional elements of continued premium payments or policy persistency. The continuance of the stream of payments specified in the levelized commission contract is a mechanism to bypass recognition of those expenses which are ordinarily charged to expense in the first year of the contract. Consequently, the normal link between the persistency of the policy, the continuance of the premium payment or the maintenance of the agent's license with the reporting entity is not maintained with respect to the payment stream.

5. The use of an arrangement such as a levelized commission arrangement where commission payments are not linked to traditional elements such as premium payments and policy persistency, but rather are linked to the repayment of an advance amount paid by a third party to the agents

requires the establishment of a liability by the reporting entity for the full amount of the unpaid principal and accrued interest which is payable to a third party related to levelized commissions [FN].

~~New Footnote – The guidance in this paragraph notes that levelized commissions which use a third party to pay agents that are linked to traditional elements require establishment of a liability for the amounts that have been paid to the agents and any interest accumulated to date.~~

Effective Date and Transition

7. This statement is effective for years beginning January 1, 2001. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*. ~~The nonsubstantive revisions adopted ________ regarding levelized commission intend to clarify the original intent of this statement. Reporting entities that have not complied with the original intent of the statement shall reflect the change as a correction of an error (as a mistake in the application of an accounting principle) pursuant to SSAP No. 3 in the December 31, 2020 financial statements. In accordance with SSAP No. 3, correction of all accounting errors in previously issued financial statements, for which an amended financial statement was not filed, shall be reported as an adjustment to unassigned funds (surplus) in the period in which the error was detected. Disclosure shall also occur in accordance with SSAP No. 3.~~

We request that the above edits be incorporated into the proposed Ref #2019-24.

In addition, we believe that what have been deemed non-substantive clarifications to the original intent of SSAP No. 71 proposed by the SAPWG in Ref #2019-24 are in fact **substantive modifications** that materially change accounting practices that were established long before the 2001 codification, and that continue today in many different forms

Per the SAPWG process, substantive statutory accounting revisions introduce original or modified accounting principles. Substantive revisions can be reflected in an existing Statement of Statutory Accounting Principles (SSAP) or a new SSAP. Nonsubstantive statutory accounting revisions are characterized as language clarifications that do not modify the original intent of a SSAP. SSAPs are considered the highest authority (Level 1) in the statutory accounting hierarchy.

The proposed accounting treatment in Ref #2019-24 is significantly different than the current interpretation of the original SSAP and general statutory principles, specifically, full recognition of an expense at the time the policy is issued versus incremental recognition of commission costs over time as the policy persists and they become legal obligations. The current proposed language does not address the many varying product/distribution compensation arrangements in the industry and IP believe this will cause unintended consequences. The link between the traditional elements such as policy persistency and the accrual of commissions is a long-standing principle. Eliminating the link to the policy persistency is not a clarification, it is a substantive change that modifies the original intent of SSAP No. 71, thus requiring further evaluation.

Interested parties believe that the exposure as written will also unintentionally impact the accounting for certain types of traditional trail commission arrangements that are commonplace in the market for life and annuity products. Although funding agreements can also have elements that are based upon policy persistency, there exists in the industry a longstanding practice of compensating agents directly based upon policy persistency. In these scenarios, the reporting entity has an agreement in place with agents that requires commission payment if and only if a policy persists (for example, at each annual renewal). If a policyholder opts not to renew, the reporting entity has no obligation to pay further commissions to the agent.

As written, interested parties believe this exposure would require the reporting entity to accrue these trail commissions at policy inception, which would be counter to the principles contained in SSAP No. 5R - *Liabilities, Contingencies and Impairment of Assets*. These commissions are not liabilities until the policy persists, and, until that time, the transaction obligating the entity has not occurred. Language added to paragraph 2 is intended to distinguish the scope of the guidance in paragraphs 3-5 from these traditional trail commission arrangements.

Further, interested parties strongly disagree with the modifications to paragraph 7. Reporting entities have filed annual statements based on the current interpretation of SSAP No. 71 with unqualified opinions from their external auditors. Regulatory examinations have also been completed by various states of domicile insurance departments without adjustment. IP believe that if the proposed revisions are adopted and result in an accounting change, these should be reflected as a change in accounting principle. Per SSAP No. 3, “A change in accounting principle results from the adoption of an accepted accounting principle, or method of applying the principle, which differs from the principles or methods previously used for reporting purposes.” Reporting entities that in good faith applied a particular method by following SSAP No. 71 and were not required to adjust statements as a result of audits or regulatory examinations, should not be considered to have made an **accounting error**. As such, interested parties disagree with the modifications in paragraph 7. As noted above, the proposed revisions to SSAP No. 71 substantially change the interpretation that has been followed for years, and therefore, the original text would apply for a reporting entity that must change its method of applying the revised SSAP No. 71.

In summary, we recommend that the NAIC consider the changes contained in the current Ref #2019-24 exposure be reclassified as **substantive, that an issue paper be drafted, and that this be re-exposed and processed accordingly.**

Ref #2019-34: Related Parties, Disclaimers of Affiliation and Variable Interest Entities

The Working Group exposed proposed changes to SSAP No. 25 as described below:

- Based on the comments from the Group Solvency Issues (E) Working Group, NAIC staff added a new disclosure that provides information on minority ownership interests, as well as significant relationships between minority owners and other U.S. domestic insurers/groups. This new disclosure is not intended to include passive fund owners, such as ETFs and mutual funds. This is in paragraph 22 in the exhibit to this agenda item.

- NAIC staff removed the direct references to U.S. GAAP and SEC guidance that was included in the initial draft revisions. It was not intended to incorporate by reference the guidance from these sources but was instead intended to show that the revisions were going to be more consistent with the U.S. GAAP and SEC guidance. The language that was added to the description of related parties in paragraph 4 in the original exposure draft are all language from either U.S. GAAP or from laws and regulations related to the SEC.

- With the proposed rejection of the U.S. GAAP VIE guidance for statutory accounting, our intention is to rely on SSAP No. 25, including the proposed revisions, to capture related parties for reporting. These updates are not intended to change reporting in Schedule BA or Schedule D for any investments.

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

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

Ref #2020-17: Updating the SCA Review Process

The Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities* to provide updated descriptive language regarding SCA reviews. Additionally, this agenda item proposes a more streamlined method for communicating SCA review results.

Interested parties offer the following comments:

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

Ref #2020-18: SSAP No. 97 Update

The Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*, removing the statement that guarantees or commitments from the insurance reporting entity to the SCA can result in a negative equity valuation of the SCA. This update reflects recently adopted guidance from agenda item 2018-27 which states that reported equity losses of an SCA shall not go negative (thus the reported basis will stop at zero), however to the extent there is a financial guarantee or commitment, that liability would be recognized in accordance with *SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets.*

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

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

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

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

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

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

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

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

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

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

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

Ref #2020-19: Clarification Edits - Mortgage Loan Participations

The Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to *SSAP No. 37—Mortgage Loans* to clarify that a participant's financial rights may include the right to take legal action against the borrower (or participate in the determination of legal action), but do not require that the participant have the right to solely initiate legal action, foreclosure, or under normal circumstances, require the ability to communicate directly with the borrower.

Interested parties support this proposal.

Ref #2020-20: Disclosure of Rolled Cash Equivalent Investments

The Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to *SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments* to require the identification/disclosure of cash equivalents and short-term investments, or substantially similar investments, which remain on the same reporting schedule for more than one consecutive reporting period. (This revision expands current disclosure requirements to include cash equivalent investments.) Additionally, the revisions clarify that the disclosure is satisfied through the use of the code on the investment schedules.

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

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

Ref #2020-21: SSAP No. 43R - Designation Categories for RMBS/CMBS Investments

The Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to *SSAP No. 43R—Loan-backed and Structured Securities*, to reflect the updated final designation guidance for RMBS/CMBS securities. This update will reflect the guidance recently adopted for the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P manual).

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

> "Step 3: Determine Final Designation – The final NAIC designation~~, as determined by the modeled price range,~~ is determined by comparing the carrying value (divided by remaining par amount) of a security (based on paragraph 27.a.ii.) to the NAIC CUSIP specific modeled breakpoint values assigned to the six (6) NAIC designations for each CUSIP. ***The final*** NAIC designations ***is*** mapped to ***an*** NAIC designation **category according to the instructions** in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office*~~, along with instructions for tranches that have no expected loss under any of the selected modeling scenarios and instructions for non-modeled securities~~. The final NAIC designation ~~and NAIC designation category~~ shall be applicable for statutory accounting and reporting purposes**, and the NAIC designation category will be used for** investment schedule reporting and establishing ~~RBC and~~ AVR charges. The final NAIC designation is not used for establishing the appropriate carrying value method in Step 2 (paragraph 27.a.ii.)."

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

Ref #2020-22: Accounting for Perpetual Bonds

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

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

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

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

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

- **Amortization of premiums and accretion of discounts:** The proposal notes that due to a lack of a maturity date, insurers do not accrete discounts or amortize premiums on perpetual bonds. However, many insurers in the interested parties group do have methodologies to amortize premiums and accrete discounts. Most often, companies amortize premiums to the call date for the bonds (i.e., apply yield to worst) and accrete discounts to a date that is far into the future (i.e., consistent with how Bloomberg treats such bonds when quoting market yields for the bonds). Investors believe this approach to estimating a yield is a reasonable depiction of the true yield expected to be earned on the investments.

- **Call date is a pseudo-maturity date:** The capital markets and investors (including insurers) consider the call date in the bonds to be a pseudo-maturity date. That is, it is expected that the perpetual bonds will be called on the call date. Oftentimes insurers price the bonds to the call date. Many times, the bonds have step-up coupon provisions at the call date, which provides an incentive for the issuer to call the bonds, or there are other reasons why there is a market compulsion for the issuer to call such bonds on the call date. The expectation that the bonds will be called is one of the key characteristics that results in many companies reporting such bonds as fixed income for US GAAP reporting purposes. In the rare cases where perpetual bonds do not have callability, all other characteristics are the same as those bonds with callability (e.g., capital markets consider them bonds, the trade like bonds, the investment objective is the same as bonds, etc.) and thus interested parties believe they should be reported the same as all other bonds.

- **How perpetual bonds trade in the market:** The market's view of the call provisions on perpetual bonds, as outlined above, is a key reason (among others) that perpetual bonds trade in the capital markets like bonds. As a result, these instruments are more sensitive to interest rate movements, are generally priced like bonds (inclusive of accrued interest) and are quantified and measured in terms of par value and not in terms of shares of stock.

- **US GAAP reporting:** Those insurers who invest in perpetual bonds generally report them as fixed income for US GAAP reporting purposes. Some companies evaluate the investment characteristics (per the guidance in Topic 815) to determine if the characteristics such as redemption rights, voting rights, conversion rights, dividend rights, and protective covenants are more debt like or equity like when determining the appropriate reporting. Additionally, companies consider how the investments are viewed in the capital markets. The analysis performed generally concludes that perpetual bonds are more bond like than equity like. When classified as bonds, they are evaluated for impairment like any other bond (e.g., insurers assess the ability for the issuer to pay interest and principal).

- **Investment strategy for perpetual bonds:** Insurers invest in perpetual bonds for their fixed cash flows (interest and expected return of principal when called by the issuer) and not for market appreciation. Like other bonds, the expected fixed cash flows are used for cash flow matching to insurance liabilities. Many perpetual bonds have a fixed coupon and if not called the coupon adjusts to a current floating rate plus a spread (e.g., that is stepped-up significantly from original issuance spreads). Also, when insurers manage their investment portfolios (e.g., investment allocations, assessing risks, etc.), perpetual bonds are classified as bonds and not equities.

- **Monetization of perpetual bonds:** A key reason equity securities are reported at fair value for Statutory reporting purposes is because there is no certainty in the cash flows they generate and return to the investor (return of principal and return on investment), which includes dividend payments. Additionally, the return of an investor's original investment can only be monetized by selling the equity security at fair value. As a result, fair value is an important measurement when considering the expected return to the investor. Regarding perpetual bonds, the opposite situation exists. The cash flows have a much higher level of certainty (interest to be paid for the life of the investment is contractual and does not require the issuer's board declaring a dividend like a preferred stock and the return of par at the call date) like any other bond. As a result, similar to other bonds, we do not believe fair value is a relevant measurement principle for such investments for Statutory reporting purposes.

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

Ref #2020-23: Update to Leasehold Improvements

The Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to *SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements* and *SSAP No. 73—Health Care Delivery Assets and Leasehold Improvements in Health Care Facilities*, to allow the amortization of leasehold improvements to match the associated lease term, which is guidance that agrees with U.S. GAAP, ASC Topic 842.

Interested parties support this proposal.

Ref #2020-24: Accounting and Reporting of Credit Tenant Loans

The Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed this agenda item with a request for comments on the two general options for the accounting treatment of credit tenant loans (CTL). Notification will also be sent to the Valuation of Securities (E) Task Force of this agenda item in response to their referral. With this notification, NAIC staff will request further confirmation that a SVO-Listing could be developed to capture the CTLs that meet the SVO's structural and legal analysis and possess bond characteristics.

Interested parties' response – please see separate letter

Ref #2020-25EP: Editorial and Maintenance Update

The Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed editorial revisions to *SSAP No. 5R—Liabilities, Contingencies and Impairments of Asset* and *SSAP No. 62R—Property and Casualty Reinsurance*.

Interested parties have no comments on this item.

Ref #2020-26: *ASU 2015-10, Technical Corrections & Improvements*

The Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to *Appendix D—Nonapplicable GAAP Pronouncements* to reject *ASU 2015-10, Technical Corrections & Improvements* as not applicable to statutory accounting.

Interested parties have no comments on this item.

Ref #2020-27: *ASU 2019-09, Financial Services – Insurance; Effective Date*

The Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to *Appendix D—Nonapplicable GAAP Pronouncements* to reject *ASU 2019-09—Financial Services – Insurance* as not applicable to statutory accounting.

Interested parties have no comments on this item.

Ref #2020-28: *ASU 2020-01, Investments—Equity Securities (Topic 321), Investments—Equity Method and Joint Ventures (Topic 323), and Derivatives and Hedging (Topic 815), Clarifying the Interactions between Topic 321, Topic 323, and Topic 815*

The Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to reject *ASU 2020-01, Investments—Equity Securities (Topic 321), Investments—Equity Method and Joint Ventures (Topic 323), and Derivatives and Hedging (Topic 815), Clarifying the Interactions between Topic 321, Topic 323, and Topic 815* for statutory accounting. The revisions note rejection are proposed to *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*, *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities* and *SSAP No. 86—Derivatives*.

Interested parties have no comments on this item.

Ref #2020-29: ***ASU 2020-05—Effective Dates for Certain Entities***

The Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to *Appendix D—Nonapplicable GAAP Pronouncements* to reject *ASU 2020-05, Revenue from Contracts with Customers (Topic 606) and Leases (Topic 842), Effective Dates for Certain Entities* as not applicable to statutory accounting.

Interested parties have no comments on this item.

Ref #2020-30: Premium Refunds and Other Adjustments

The Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed the agenda item with a request for comments/input on the issues described in the proposal. NAIC staff was also directed to draft guidance to address premium refunds and other policy adjustments for both property and casualty and accident and health lines of business.

Comments were requested on the following:

1. NAIC Staff's preliminary recommendation is that the proposed guidance should follow the existing principles of adjustable premium and shall be recognized as adjustments to premium based on experience to date.

2. Examples of existing products that have premium adjustments for reasons other than the existing guidance or how the existing guidance can be expanded.

3. If accounting treatment that is being applied is different from premium adjustments, please provide overview of key attributes.

Interested parties offer the following comments:

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

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

Suggested revisions to Paragraph 4 of SSAP No. 54-R:

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

a. For refunds or reductions in premiums under the terms of the policyholder or group contract refer to:
   1. Contracts Subject to Redetermination – Paragraphs 27-32 below
   2. Retrospectively Rated Contracts - SSAP No. 66

b. For voluntary refunds or reductions in premiums that are not specified by the terms of the policyholder or group contract, the timing of the recognition of the payment (or credit to gross billed premiums) is based on when the corresponding gross premium is or has been earned. To illustrate (not intended to be an exhaustive list):
   1. For premium reductions pertaining to previous or expired periods of coverage, the full amount of the reduction is recognized immediately.
   2. For premium reductions that relate to the current month's coverage, the reduction is recognized in the current month.
   3. For reductions that relate to subsequent months' coverage, the reduction will be recognized in the month to which it pertains so as to match the recognition of the reduction with that of the gross premium and coverage period to which it pertains.

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

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

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

Interested parties offer our assistance in developing additional guidance or in providing feedback on draft guidance.

Ref #2020-31: Early application of *SSAP No. 32R—Preferred Stock*

The Working Group voted by e-vote to move this item to the active listing, categorized as nonsubstantive, and exposed edits to *SSAP No. 32R—Preferred Stock* as detailed above. This item has a comment period deadline ending September 18, 2020.

Interested parties have no comments on this item.

* * *

Thank you for considering interested parties' comments. If you have any questions in the interim, please do not hesitate to contact us.

Sincerely,

D. Keith Bell Rose Albrizio

cc: NAIC staff
Interested parties

Draft: 10/29/20

Statutory Accounting Principles (E) Working Group
Virtual Meeting
October 13, 2020

The Statutory Accounting Principles (E) Working Group of the Accounting Practices and Procedures (E) Task Force met Oct. 13, 2020. The following Working Group members participated: Dale Bruggeman, Chair (OH); Kevin Clark and Carrie Mears, Vice Chairs (IA); Richard Ford (AL); Kim Hudson (CA); Bill Arfanis (CT); Rylynn Brown (DE); Eric Moser and Kevin Fry (IL); Stewart Guerin (LA); Judy Weaver (MI); Doug Bartlett (NH); Bob Kasinow (NY); Melissa Greiner and Kim Rankin (PA); Jamie Walker (TX); Doug Stolte and David Smith (VA); and Amy Malm (WI).

1. Adopted Non-Contested Statutory Accounting Revisions During its Public Hearing

The Working Group held a public hearing to review comments (Attachment One-B1 and Attachment One-B2) on previously exposed items.

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

a. Agenda Item 2020-31

Mr. Bruggeman directed the Working Group to agenda item 2020-31: Early Application of *Statement of Statutory Accounting Principles (SSAP) No. 32R—Preferred Stock* (Attachment One-B3).

Jim Pinegar (NAIC) stated that this nonsubstantive agenda item incorporates edits, in response to an industry request, to allow the substantively revised SSAP No. 32R—adopted July 30 with a Jan. 1, 2021, effective date—to be early adopted for year-end 2020. He stated that the industry did not have any comments on the exposed edits.

b. Agenda Item 2020-26

Mr. Bruggeman directed the Working Group to agenda item 2020-26: *Accounting Standards Update (ASU) 2015-10, Technical Corrections and Improvements* (Attachment One-B4).

Julie Gann (NAIC) stated that this nonsubstantive agenda item proposes to reject ASU 2015-10 in *Appendix D—Nonapplicable GAAP Pronouncements* as not applicable to statutory accounting. She stated that this ASU was issued to update the Financial Accounting Standards Board (FASB) codification for minor corrections or clarifications. She stated that each modification was reviewed for statutory accounting, with rationale detailing the recommendation for statutory accounting rejection. She stated that the industry did not have any comments on the exposed intent to reject in Appendix D.

c. Agenda Item 2020-27

Mr. Bruggeman directed the Working Group to agenda item 2020-27: *ASU 2019-09, Financial Services – Insurance; Effective Date* (Attachment One-B5).

Fatima Sediqzad (NAIC) stated that this nonsubstantive agenda item proposes to reject ASU 2019-09 in *Appendix D—Nonapplicable GAAP Pronouncements* as not applicable to statutory accounting. She stated that this ASU was issued to defer the effective date of the amendments in *ASU 2018-12, Targeted Improvements to the Accounting for Long-Duration Contracts*, which was previously rejected for statutory accounting. She stated that the industry did not have any comments on the exposed intent to reject in Appendix D.

d. Agenda Item 2020-28

Mr. Bruggeman directed the Working Group to agenda item 2020-28: *ASU 2020-01, Investments, Equity Securities (Topic 321), Investments – Equity Method and Joint Ventures (Topic 323), and Derivatives and Hedging (Topic 815), Clarifying the Interactions between Topic 321, Topic 323 and Topic 815* (Attachment One-B6).

Ms. Sediqzad stated that this nonsubstantive agenda item proposes to reject ASU 2020-01 in *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*; *SSAP No. 86—Derivatives*; and *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*. She stated that the interaction addressed in ASU 2020-01 related to the guidance issued in *ASU 2016-01, Financial Instruments, Recognition and Measurement of Financial Assets and Financial Liabilities*, which allowed entities to measure certain equity securities at cost, less impairments. As the guidance in ASU 2016-01 was rejected for statutory accounting, ASU 2020-01 would also not be applicable for statutory accounting. She stated that the industry did not have any comments on the exposed intent to reject ASU 2020-01 in SSAP No. 48, SSAP No. 86 and SSAP No. 97.

e. <u>Agenda Item 2020-29</u>

Mr. Bruggeman directed the Working Group to agenda item 2020-29: ASU 2020-05, Effective Dates for Certain Entities (Attachment One-B7).

Jake Stultz (NAIC) stated that this nonsubstantive agenda item proposes to reject *ASU 2020-05, Revenue from Contracts with Customers (Topic 606) and Leases (Topic 842), Effective Dates for Certain Entities* in *Appendix D—Nonapplicable GAAP Pronouncements* as not applicable to statutory accounting. He stated that ASU 20-05 was issued to update the effective dates for *ASU 2014-19, Revenue from Contracts with Customers* and *ASU 2016-02, Leases (Topic 842)*, and both of those ASUs were rejected for statutory accounting. He stated that the industry did not have any comments on the exposed intent to reject in Appendix D.

2. <u>Heard Comments and Discussed the SSAP No. 43R Issue Paper / Agenda Item 2019-21</u>

The Working Group held a public hearing to review comments (Attachment One-B2) on specific topics reflected in the comments received on the SSAP No. 43R exposed issue paper.

Mr. Bruggeman directed the Working Group to agenda item 2019-21: *SSAP No. 43R—Loan-Backed and Structured Securities*.

Julie Gann (NAIC) stated that the Working Group has a project to review SSAP No. 43R. She stated that this project originally started from noted investments with equity risk, particularly with collateralized fund obligations (CFOs), but was expanded in January 2020 to be a comprehensive review of SSAP No. 43R in accordance with the Working Group's Investment Classification Project.

Ms. Gann stated that on March 18, the Working Group exposed an initial issue paper for public comment. This issue paper was in the form of a discussion document, as it did not contain any tracked changes to statutory accounting principles, but instead identified a variety of issues and potential concepts to consider for possible revisions. She stated that in response to the industry request due to COVID-19, the comment deadline was extended to July 31, and one comment letter was received from interested parties.

Ms. Gann stated that the interested parties' comment letter was detailed, at 67 pages, and included several elements. However, she stated that the comment letter included two key themes that would need to be addressed before moving forward with other aspects. She stated that the purpose of the current meeting is to hear comments and focused discussion on the two topics: 1) classification of certain investments in the scope of *SSAP No. 26R—Bonds* or SSAP No. 43R; and 2) definition of "asset-backed security." Ms. Gann stated that the distributed agenda includes many discussion points on these topics, as well as specific excerpts from the interested parties' comment letter.

Mike Reis (Northwestern Mutual), representing interested parties, stated that he hopes the Working Group has read the detailed interested parties' letter, noting that while long, it is important. He stated that the issues the NAIC staff are trying to solve are complicated, technical, nuanced and have real-world ramifications. He stated that it should first be clear that interested parties are committed to helping address regulator concerns.

Mr. Reis stated that the interested parties are committed to transparency surrounding the nuances of the issues involved, as well as full transparency surrounding visibility into investments that may be problematic for state insurance regulators, and he hopes the comment letter is perceived as reflecting that intent. He stated that the SSAP No. 43R project is likely the most complicated issue he has been involved in and it certainly has the attention of the industry, with its potential for significant negative investment consequences.

Mr. Reis stated that he has had several discussions with various industry representatives, and a key question that often arises is clarity on the problem the state insurance regulators are trying to solve. He stated that that original agenda item was focused on certain CFOs where interest and/or principal moves up or down with equity performance, and perceived abuses in attempting to arbitrage NAIC investment risk-based capital (RBC) by packaging Schedule BA assets into a special purpose vehicle (SPV), and with an SPV issuance, creating a bond for a lower RBC charge. He stated that the industry agrees that these are abusive practices, are not reflective of bonds, and they want to help address these issues.

Mr. Reis stated that the specific scenarios identified, such as with certain CFOs, is just a single manifestation of a larger perceived problem with specifically tailored securities, often referred to as "bespoke" securities. He provided characteristics of these securities, noting: 1) they are almost always in an SPV; 2) they are often in the private letter space where state insurance regulators—and the NAIC Securities Valuation Office (SVO) as the "eyes and ears" of state insurance regulators—do not have visibility into these types of investments; and 3) they often have a related party component.

Mr. Reis stated that the specific CFOs and principal-protected notes (PPNs) are two examples where perceived abuses have been noted by state insurance regulators, but there is regulatory concern that these situations potentially reflect just the "tip of the iceberg" and there are other similar abusive type of investments that state insurance regulators do not believe should be reported on Schedule D, Part 1 as long-term bonds. Mr. Reis stated that this information is an important backdrop for the issues planned for discussion, as the discussion only makes sense if everyone is focused, and in agreement with, the problem to be solved.

Mr. Reis stated that for the noted problem, the industry has five proposed suggestions that they believe will go a long way toward solving the problem:

1. Interested parties have responded to the Valuation of Securities (E) Task Force "bespoke" securities exposure, offering full transparency into all existing investments subject to a private letter rating. This will allow for the identification of further abusive investments within this space, both currently and on an ongoing basis.

2. Per the comment letter submitted for this SSAP No. 43R project, interested parties have noted that all affiliated investments are not filing exempt, per the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual) and need to be filed with the SVO for a designation. However, as affiliated investments are only a subset of related party investments, interested parties have suggested it may be appropriate to take on this issue separately if the current filings do not capture all investments of concern.

3. Interested parties have offered clarifying guidance, in a letter dated October 2019, that would prohibit moving assets from one reporting schedule to another (for example, from Schedule BA – Other Long-Term Assets to Schedule D, Part 1– Long-Term Bonds) if the transaction does not meet the accounting definition of a "sale" per *SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. Interested parties believe this would help eliminate such abuses, especially in conjunction with the first two discussion items.

4. Interested parties have offered to help define safeguards on CFOs, so abuses can be eliminated, but in a way that does not eliminate the many good types of CFOs as viable investments. Interested parties believe this is similar to what the Iowa Insurance Division is going to propose.

5. Interested parties are supportive of additional granular disclosure surrounding investments that regulators deem appropriate. For example, putting all CFOs in one spot on Schedule D, Part 1, perhaps in bifurcated categories such as closed-end fund debt or other types of CFOs and/or the amount of overcollateralization. This approach could be extrapolated to other investments where there is a regulatory need for more information about specific risk profiles.

Mr. Reis stated that with the current discussion focus, interested parties believe that any security that meets the definition of "bond" in *SSAP No. 26R—Bonds* should be reported as a bond and reported on Schedule D, Part 1, with the exception of identified special cases, such as PPNs or other identified abuses. With this statement, he noted an important question to address is whether moving anything captured in an SPV or trust from SSAP No. 26R into SSAP No. 43R helps to solve the underlying problem. Mr. Reis said that interested parties would prefer to refrain, at least for the time being, on debating whether the changes made to SSAP No. 43R in 2010 were intended to capture all issuances from a SPV/trust in scope of SSAP No. 43R instead of SSAP No. 26R. He stated that nothing is inherently bad about debt issued from a SPV/trust, and that in most instances, the structure serves as a useful tool to make the assets or business of the SPV/trust bankruptcy remote.

Mr. Reis stated that that interested parties would rather focus on what a classification into SSAP No. 43R is attempting to solve, and/or whether the classification to SSAP No. 43R solves the problem. As an example, he stated that insurance companies hold billions of dollars of project finance investments, which are always in an SPV, and they are often reported in scope of SSAP No. 26R. He stated that moving them to be in scope of SSAP No. 43R does not accomplish any real changes. He stated that because those investments do not have prepayment or extension risk, there is no change in the reported amortized cost. He noted that there could be some secondary changes related to impairment, but those impacts are not significant. He stated that the industry does not believe it is appropriate to reclassify these investments to SSAP No. 43R, but the industry is not too concerned whether they are in SSAP No. 26R or SSAP No. 43R, as long as they are reported on Schedule D, Part 1 as long-term bonds and permitted amortized cost accounting.

Mr. Reis stated that the industry is concerned with moving securities to SSAP No. 43R if they are challenging filters in SSAP No. 43R that renders the standard complex and/or subjects the investments to detrimental accounting because they do not meet certain requirements. He stated that negative accounting would render such asset classes less favorable as an investment and hurt both insurance companies and policyholders, and ultimately regulators. He stated that the historical actions that moved equipment trust certificates (ETCs) and credit tenant loans (CTLs) from SSAP No. 26R to SSAP No. 43R made no significant change to the accounting and reporting and did not solve any real problem.

Mr. Reis stated that the second topic planned for discussion on the definition of "asset-backed security" is inextricably linked to the first topic. He stated that anything that meets the definition of "bond" in SSAP No. 26R is captured on Schedule D, Part 1 as a bond, and asset-backed securities captured in SSAP No. 43R are simply a subset of that definition. He stated that those items are in a separate SSAP because of the special accounting for prepayment and extension risk. He stated that moving anything in an SPV/trust to SSAP No. 43R would include billions of dollars of securities that are not asset-backed securities. He stated that this movement does not actually solve any accounting problems.

Mr. Reis stated that the Iowa Insurance Division proposal is a step in the right direction, which proposes to first identify what should be reported on Schedule D, Part 1, inclusive of asset-backed securities. He said if that is successfully done, then SSAP No. 43R is only needed for investments with prepayment or extension risk. He stated that otherwise, interested parties would like to understand the problem that needs to be addressed, as the industry cannot assist to solve that problem until it has been clearly and succinctly articulated.

Mr. Reis stated that interested parties support moving forward with the Iowa proposal along with the industry's five suggested solutions. He stated that interested parties are willing to work with state insurance regulators and NAIC staff to help address regulatory concerns, and in reviewing the Iowa definition for Schedule D, Part 1 as a starting point for discussion. He stated support for working with NAIC staff and state insurance regulators during the exposure period, noting it is more efficient for continuous discussions than waiting to discuss until after the exposure period.

Mr. Bruggeman responded to Mr. Reis' comments, noting that the overarching issue is that certain investments have been put into SPV/trust structures, with the SPV issuing an instrument, and under the existing provisions of SSAP No. 26R and SSAP No. 43R, these investments have been classified as bonds on Schedule D, Part 1. He stated that it is not appropriate to recharacterize an equity instrument as debt, simply because it has been structured in this manner. He stated agreement with reviewing certain investments, such as certain CFOs and PPNs, but using a SPV/trust for reclassification is the underlying cause of discussion.

Mr. Bruggeman stated a letter with an updated proposal was received from the Iowa Insurance Division.

Mr. Clark stated that this project was undertaken to address concerns that certain investments that have been reported on Schedule D, Part 1 as long-term bonds may not be of the type that state insurance regulators expect to qualify for Schedule D, Part 1. When the project was defined as a SSAP No. 43R scoping project, it was expected that all the investments of concern were being accounted for under SSAP No. 43R. However, it has since been identified that there is diversity in practice in how these investments are classified, noting that some companies believe that many of the investments identified for evaluation in this project are within the scope of SSAP No. 26R. He stated that while the appropriate classification between SSAP No. 26R and SSAP No. 43R is an important topic, it is not the purpose for which this project was intended to address, which is determining whether investments with certain unique characteristics should qualify for Schedule D, Part 1 reporting, regardless of which of the two SSAPs apply.

Mr. Clark stated that the definition of "bond" under current statutory accounting is broad, and allows an insurer to convert virtually any asset into a bond through the use of a trust or SPV structure, even if the insurer is in the identical economic position as if that asset were held directly on their balance sheet. In most cases, securitizations serve a legitimate economic purpose and can create high-quality bonds out of a pool of otherwise non-investable assets through overcollateralization and the prioritization of payments to debtholder classes. However, the current guidance is too broad to distinguish between those with economic substance and those without, leaving the reporting of these assets susceptible to abuse.

Mr. Clark stated that the Iowa proposal recommends that the Working Group take a step back and focus its efforts on developing a principles-based definition for those assets that qualify for reporting on Schedule D, Part 1 as the initial step for this project. It may be that—after determining which investments qualify as Schedule D, Part 1—there may be certain characteristics of such investments that, if present, warrant separate identification or consideration of specific accounting and measurement, or other reporting requirements. He stated that until the Working Group first determines what qualifies as a Schedule D, Part 1 "bond," it is difficult to address any of these secondary objectives.

Mr. Clark stated that as part of the Iowa proposal, a draft definition for Schedule D, Part 1 reporting has been included to facilitate further discussion. The draft provides a basis for distinguishing between the two types of Schedule D, Part 1 "bonds" that have been identified through the discussions to date. Those are issuer obligations and asset-backed securities. Mr. Clark stated that the draft definition includes the following initial concepts:

- Issuer obligations are those backed by the credit of an operating entity. He stated that a debt security that is issued by an entity whose sole purpose is the pass-through of collateral cash flows is not an issuer obligation under this definition.

- Asset-backed securities involve the securitization of financial assets. When an insurer invests in a securitization of assets, it is important that the nature of those assets lend themselves to the production of cash flows. As such, the securitization of non-financial assets is proposed to receive bond treatment only in instances when the nature of the assets lends itself to the production of cash flows. Mr. Clark stated that those specific instances would be separately identified for Schedule D, Part 1 qualification, as is currently the case with lease-backed securities and ETCs.

- An asset-backed security redistributes the risk of the underlying collateral such that the investor is in a different position than if the underlying collateral were held directly. Under this definition, an entity that simply passes through the proceeds of the underlying collateral and has done nothing to alter the nature of the investment has no economic substance, and should, therefore, be looked through to determine the appropriate accounting.

- A key characteristic of a bond and what makes it a debt investment, rather than an equity-like investment, is that it represents a senior or priority interest in the assets of the issuer. This is true for issuer obligations, as well as asset-backed securities. Therefore, for something to meet the definition of "bond," there must be a subordinated interest or overcollateralization present. The residual position is akin to an equity investment and should not qualify for Schedule D, Part 1 reporting.

Mr. Clark stated that this definition is intended to serve as a starting point for discussions of the Working Group and the industry, noting that the Iowa Insurance Division looks forward to hearing feedback on both the draft and the proposed direction of the project.

Mr. Reis agreed with the step-back approach presented by Iowa and first focusing on statutory principles. He inquired whether the SSAP No. 26R footnote definition of "security" is intended to be removed from the proposed draft definition.

Mr. Clark clarified that the proposed draft definition is not proposing revisions to either SSAP No. 26R or SSAP No. 43R, noting that this is an important aspect to highlight with the exposure. Rather, the proposal is to establish principle-based concepts on what should be reported in Schedule D, Part 1, which would include items that are reported in SSAP No. 26R and SSAP No. 43R. He stated that once the intent of Schedule D, Part 1 is determined, consideration would then occur as to revisions to the individual SSAPs.

Regarding the specific question, Mr. Clark noted that the definition of "security," adopted from U.S. generally accepted accounting principles (GAAP), is not proposed to be an explicit removal; therefore, when revisions are considered to SSAP No. 26R it is anticipated that the definition of "security" referenced in the existing footnote would be retained. Mr. Clark agreed with Mr. Reis for discussion to occur with NAIC staff, the industry and key regulators during the exposure period as a productive way to work forward.

Ms. Mears stated that while there are similarly related topics at the Valuation of Securities (E) Task Force, it is important to highlight that this Working Group's focus in on the identification of what is a Schedule D, Part 1 "bond" for accounting and reporting. The intent is not to overlap with the Task Force project on risk assessment and credit rating.

Mr. Bruggeman agreed with Ms. Mears, noting that the Task Force's work is to identify a "bespoke" security. He said principles that involve bespoke securities, either including them on Schedule D, Part 1—or perhaps excluding them from Schedule D, Part 1—should be particularly identified and discussed.

Mr. Reis agreed that the two separate missions of the Working Group and the Task Force should not overlap.

Mr. Bruggeman inquired about the potential of a sub-schedule for Schedule D, Part 1.

Ms. Gann stated that all investments in scope of SSAP No. 26R and SSAP No. 43R are reported on Schedule D, Part 1 – Long-Term Bonds. With the current structure of that schedule, there are several broad categories—such as U.S. Government, Other Government, Industry and Misc.—but in each category there are four reporting lines to capture issuer obligations, commercial mortgage-backed securities, residential mortgage-backed securities and other asset-backed securities. It has been raised to NAIC staff that these four reporting lines may not provide the level of detail to identify the differing types of investments that are being captured on Schedule D, Part 1. As such, consideration can occur to have a secondary Schedule D, Part 1 schedule that provides the ability to have more reporting lines for better disaggregation of investment types and additional reporting information for these investments. She stated that if this is considered, it would be envisioned that the totals from the schedules would roll-up collectively as "bonds" on the balance sheet (on line 1). Furthermore, it would not be intended for investments to be duplicated on more than one schedule; i.e., the sub-schedule would detail investments that qualified for Schedule D, Part 1, but were an investment type that was on a reporting line of the sub-schedule.

Mr. Bruggeman directed the Working Group to the second topic planned for discussion regarding the definition of "asset-backed security."

Ms. Gann noted that the discussion has already addressed a variety of aspects, but as an introduction, the exposed issue paper proposed the use of a specific citation from the Code of Federal Regulation (CFR) as a starting point in determining whether a security is an asset-backed security for inclusion in SSAP No. 43R. For investments that do not meet the definition, four principles are proposed to capture traditional securitizations. The issue paper proposed that investments that fall out from either of the two distinctions could possibly be subject to additional review to determine appropriate accounting and reporting. With the comments received from interested parties on the use of the CFR definition, and discussion on whether that was intended to include investments captured in the federal Securities Act of 1933 and/or the federal Securities Exchange Act of 1934, NAIC staff were proposing to move away from the CFR reference and use principles in determining whether an investment is an asset-backed security. Ms. Gann stated that additional discussion may not be necessary for this call, as it is perceived that this recommendation is in line with the Iowa proposal to move forward with principles to initially determine what is reported on Schedule D, Part 1.

Mr. Reis agreed with Ms. Gann's comments and the use of the principles approach.

Allen Stoltman (Thrivent), representing the Private Placement Investors Association (PPIA), stated support for the establishment of principle-based concepts for Schedule D, Part 1, and agreed that transferring assets to an SPV without enhancements or subordination should not result with different accounting treatment from if the assets were held directly.

Mr. Bruggeman requested comments on ETCs and CTLs during the exposure period, and whether the proposed Iowa principles would encompass these transactions. He stated that there is a separate project for CTLs, and whether structures that are conforming or non-conforming should be captured in scope of SSAP No. 43R. Mr. Bruggeman stated that comment letters received on this project will be discussed during a subsequent Working Group meeting.

Ms. Mears made a motion, seconded by Mr. Hudson, to expose the Iowa Insurance Division proposal to establish principle-based concepts for investments to be reported on Schedule D, Part 1 for a public comment period ending Dec. 4 (Attachment One-B8). The motion passed unanimously.

Mr. Bruggeman stated that this comment deadline is optimal to allow for focused discussion to begin early in 2021. However, if additional time is needed, an extension could be considered to Dec. 11.

Mr. Reis stated that interested parties would work to meet the deadline and will advise if more time is needed. Additionally, Mr. Reis confirmed that the industry would be working with NAIC staff and key regulators during the exposure period.

3. Discussed Other Matters

Ms. Gann stated that the Working Group has virtual meetings scheduled for Oct. 15 and Nov. 12. She advised that the Oct. 15 call will focus on agenda item 2019-24: Levelized and Persistency Commission. She informed that the Working Group will not be meeting during the formal virtual Fall National Meeting, but a hearing on exposed items and the introduction of new items, which would normally occur during a national meeting, will occur on the Nov. 12 call.

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

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September 18, 2020

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

RE: Items Exposed for Comment by the Statutory Accounting Principles Working Group on July 30 with Comments due September 18

Dear Mr. Bruggeman:

Interested parties appreciate the opportunity to comment on the exposure drafts released for comment by the NAIC Statutory Accounting Principles (E) Working Group (the Working Group). We offer the following comments:

Ref #2019-24: Levelized and Persistency Commission

The Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to *SSAP No. 71—Policy Acquisition Costs and Commissions* (SSAP No. 71) to clarify levelized commissions guidance and provide additional direction regarding commissions that are based on policy persistency. The revisions also clarify that the recognition of commission expense is based on experience to date. The revisions are intended to clarify the original intent of SSAP No. 71 regarding levelized commissions. Reporting entities that have not complied with the original intent of the statement are to reflect the change as a correction of an error (as a mistake in the application of an accounting principle) pursuant to SSAP No. 3 in the December 31, 2020 financial statements. In accordance with SSAP No. 3, correction of all accounting errors in previously issued financial statements, for which an amended financial statement was not filed, are to be reported as an adjustment to unassigned funds (surplus) in the period in which the error was detected. Disclosure shall also occur in accordance with SSAP No. 3.

Interested parties would like to propose the following edits to SSAP No. 71, similar to those sent in January 2020.

SUMMARY CONCLUSION

2. Acquisition costs are those costs that are incurred in the acquisition of new and renewal insurance contracts and include those costs that vary with and are primarily related to the acquisition of insurance contracts (e.g., agent and broker commissions, certain underwriting and policy issue

costs, and medical and inspection fees). Acquisition costs and commissions shall be expensed as incurred. Determination of when acquisition costs and commissions have been incurred shall be made in accordance with SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets. For example, when commissions are paid directly to an agent based upon renewal such as in traditional trail commission arrangements, commission expense would be recognized when the obligating event (i.e., the renewal) occurs and the related premium revenue is recognized.

3. Contingent commission liabilities shall be determined in accordance with the terms of each individual commission agreement. Commission liabilities determined on the basis of a formula that relates to loss experience shall be established for the earned portion. Assumptions used to calculate the contingent commission liability shall be consistent with the terms of the policy contract and with the assumptions made in recording other assets and liabilities necessary to reflect underwriting results of the reporting entity such as retrospective premium adjustments and loss reserves, including incurred but not reported. Other than the commission arrangements discussed in Paragraph 2, commission contracts that include persistency (or other such components) shall not use these clauses to defer recognition of commission expense. If a commission is based on annual policy persistency (or other similar components), the commission shall be accrued ratably over each annual period based on experience to date for which the persistency commission will be paid.~~the policy period that the commission relates~~. In regard to persistency commission, it is inappropriate to wait until the amount is fully earned and/or unavoidable to accrue experience to date commission expenses. Actual policy cancellation would reverse the accrual of the related persistency commission.

4. Levelized commissions occur in situations where agents receive normal (non-level) commissions with payments made by a third party. It is intended, but not necessarily guaranteed, that the amounts paid to the agents by the third party would ultimately be repaid (with interest explicit or implied) to the third party by levelized payments (which are less than the normal first year commissions but exceed the normal renewal commissions) from the reporting entity. (Note: levelized repayments made by the reporting entity extend the repayment period but might not be a straight-line repayment.) These transactions are, in fact, funding agreements between a reporting entity and a third party,. A funding agreement is an agreement whereby a third party provides a lump sum of money in return for a stream of payments over a predetermined time period. The payment stream is fixed without regard to the traditional elements of continued premium payments or policy persistency. The continuance of the stream of payments specified in the levelized commission contract is a mechanism to bypass recognition of those expenses which are ordinarily charged to expense in the first year of the contract. Consequently, the normal link between the persistency of the policy, the continuance of the premium payment or the maintenance of the agent's license with the reporting entity is not maintained with respect to the payment stream.

5. The use of an arrangement such as a levelized commission arrangement where commission payments are not linked to traditional elements such as premium payments and policy persistency, but rather are linked to the repayment of an advance amount paid by a third party to the agents requires the establishment of a liability by the reporting entity for the full amount of the unpaid principal and accrued interest which is payable to a third party related to levelized commissions [FN].

~~New Footnote – The guidance in this paragraph notes that levelized commissions which use a third party to pay agents that are linked to traditional elements require establishment of a liability for the amounts that have been paid to the agents and any interest accumulated to date.~~

Effective Date and Transition

7. This statement is effective for years beginning January 1, 2001. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*. ~~The nonsubstantive revisions adopted _______ regarding levelized commission intend to clarify the original intent of this statement. Reporting entities that have not complied with the original intent of the statement shall reflect the change as a correction of an error (as a mistake in the application of an accounting principle) pursuant to SSAP No. 3 in the December 31, 2020 financial statements. In accordance with SSAP No. 3, correction of all accounting errors in previously issued financial statements, for which an amended financial statement was not filed, shall be reported as an adjustment to unassigned funds (surplus) in the period in which the error was detected. Disclosure shall also occur in accordance with SSAP No. 3.~~

We request that the above edits be incorporated into the proposed Ref #2019-24.

In addition, we believe that what have been deemed non-substantive clarifications to the original intent of SSAP No. 71 proposed by the SAPWG in Ref #2019-24 are in fact **substantive modifications** that materially change accounting practices that were established long before the 2001 codification, and that continue today in many different forms

Per the SAPWG process, substantive statutory accounting revisions introduce original or modified accounting principles. Substantive revisions can be reflected in an existing Statement of Statutory Accounting Principles (SSAP) or a new SSAP. Nonsubstantive statutory accounting revisions are characterized as language clarifications that do not modify the original intent of a SSAP. SSAPs are considered the highest authority (Level 1) in the statutory accounting hierarchy.

The proposed accounting treatment in Ref #2019-24 is significantly different than the current interpretation of the original SSAP and general statutory principles, specifically, full recognition of an expense at the time the policy is issued versus incremental recognition of commission costs over time as the policy persists and they become legal obligations. The current proposed language does not address the many varying product/distribution compensation arrangements in the industry and IP believe this will cause unintended consequences. The link between the traditional elements such as policy persistency and the accrual of commissions is a long-standing principle. Eliminating the link to the policy persistency is not a clarification, it is a substantive change that modifies the original intent of SSAP No. 71, thus requiring further evaluation.

Interested parties believe that the exposure as written will also unintentionally impact the accounting for certain types of traditional trail commission arrangements that are commonplace in the market for life and annuity products. Although funding agreements can also have elements that are based upon policy persistency, there exists in the industry a longstanding practice of compensating agents directly based upon policy persistency. In these scenarios, the reporting entity has an agreement in place with agents that requires commission payment if and only if a policy persists (for example, at each annual renewal). If a policyholder opts not to renew, the reporting entity has no obligation to pay further commissions to the agent.

As written, interested parties believe this exposure would require the reporting entity to accrue these trail commissions at policy inception, which would be counter to the principles contained in SSAP No. 5R -

Liabilities, Contingencies and Impairment of Assets. These commissions are not liabilities until the policy persists, and, until that time, the transaction obligating the entity has not occurred. Language added to paragraph 2 is intended to distinguish the scope of the guidance in paragraphs 3-5 from these traditional trail commission arrangements.

Further, interested parties strongly disagree with the modifications to paragraph 7. Reporting entities have filed annual statements based on the current interpretation of SSAP No. 71 with unqualified opinions from their external auditors. Regulatory examinations have also been completed by various states of domicile insurance departments without adjustment. IP believe that if the proposed revisions are adopted and result in an accounting change, these should be reflected as a change in accounting principle. Per SSAP No. 3, "A change in accounting principle results from the adoption of an accepted accounting principle, or method of applying the principle, which differs from the principles or methods previously used for reporting purposes." Reporting entities that in good faith applied a particular method by following SSAP No. 71 and were not required to adjust statements as a result of audits or regulatory examinations, should not be considered to have made an **accounting error**. As such, interested parties disagree with the modifications in paragraph 7. As noted above, the proposed revisions to SSAP No. 71 substantially change the interpretation that has been followed for years, and therefore, the original text would apply for a reporting entity that must change its method of applying the revised SSAP No. 71.

In summary, we recommend that the NAIC consider the changes contained in the current Ref #2019-24 exposure be reclassified as **substantive, that an issue paper be drafted, and that this be re-exposed and processed accordingly.**

Ref #2019-34: Related Parties, Disclaimers of Affiliation and Variable Interest Entities

The Working Group exposed proposed changes to SSAP No. 25 as described below:

- Based on the comments from the Group Solvency Issues (E) Working Group, NAIC staff added a new disclosure that provides information on minority ownership interests, as well as significant relationships between minority owners and other U.S. domestic insurers/groups. This new disclosure is not intended to include passive fund owners, such as ETFs and mutual funds. This is in paragraph 22 in the exhibit to this agenda item.

- NAIC staff removed the direct references to U.S. GAAP and SEC guidance that was included in the initial draft revisions. It was not intended to incorporate by reference the guidance from these sources but was instead intended to show that the revisions were going to be more consistent with the U.S. GAAP and SEC guidance. The language that was added to the description of related parties in paragraph 4 in the original exposure draft are all language from either U.S. GAAP or from laws and regulations related to the SEC.

- With the proposed rejection of the U.S. GAAP VIE guidance for statutory accounting, our intention is to rely on SSAP No. 25, including the proposed revisions, to capture related parties for reporting. These updates are not intended to change reporting in Schedule BA or Schedule D for any investments.

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

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

Ref #2020-17: Updating the SCA Review Process

The Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities* to provide updated descriptive language regarding SCA reviews. Additionally, this agenda item proposes a more streamlined method for communicating SCA review results.

Interested parties offer the following comments:

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

Ref #2020-18: SSAP No. 97 Update

The Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*, removing the statement that guarantees or commitments from the insurance reporting entity to the SCA can result in a negative equity valuation of the SCA. This update reflects recently adopted guidance from agenda item 2018-27 which states that reported equity losses of an SCA shall not go negative (thus the reported basis will stop at zero), however to the extent there is a financial guarantee or commitment, that liability would be recognized in accordance with *SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets.*

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

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

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

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

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

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

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

- We agree that with respect to 8.b.ii entities, the statutory accounting guidance would require an insurer to report negative equity since 8.b.ii entities are considered an extension of the insurance company. 8.b.ii entities may own assets that would not be admitted if owned by the insurer, so it is reasonable to require the insurer to report negative equity in those subsidiaries to prevent such assets from becoming admissible simply because they are owned by an 8.b.ii subsidiary and not owned directly by the insurer.

- We, however, do not agree that the application of the paragraph 9 adjustments should ever result in the insurer's investment in a foreign insurance subsidiary being reported at an amount less than zero. Prior to applying the SSAP No. 97 paragraph 9 adjustments, the GAAP equity of a foreign insurance subsidiary is subject to the following recoverability and impairment tests on the net assets inherent in its GAAP equity:
  - ✓ GAAP loss recognition testing of DAC and reserves, for which additional liabilities would be established for expected future losses beyond recovery of any GAAP assets (including recoverability of deferred acquisition costs, or DTAs),
  - ✓ GAAP impairment testing of asset balances (e.g. – goodwill, DTA's, investment other-than-temporary losses)

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

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

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

Ref #2020-19: Clarification Edits - Mortgage Loan Participations

The Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to *SSAP No. 37—Mortgage Loans* to clarify that a participant's financial rights may include the right to take legal action against the borrower (or participate in the determination of legal action), but do not require that the participant have the right to solely initiate legal action, foreclosure, or under normal circumstances, require the ability to communicate directly with the borrower.

Interested parties support this proposal.

Ref #2020-20: Disclosure of Rolled Cash Equivalent Investments

The Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to *SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments* to require the identification/disclosure of cash equivalents and short-term investments, or substantially similar investments, which remain on the same reporting schedule for more than one consecutive reporting period. (This revision expands current disclosure requirements to include cash equivalent investments.) Additionally, the revisions clarify that the disclosure is satisfied through the use of the code on the investment schedules.

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

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

Ref #2020-21: SSAP No. 43R - Designation Categories for RMBS/CMBS Investments

The Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to *SSAP No. 43R—Loan-backed and Structured Securities*, to reflect the updated final designation guidance for RMBS/CMBS securities. This update will reflect the guidance recently adopted for the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P manual).

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

> "Step 3: Determine Final Designation – The final NAIC designation~~**, as determined by the modeled price range,**~~ is determined by comparing the carrying value (divided by remaining par amount) of a security (based on paragraph 27.a.ii.) to the NAIC CUSIP specific modeled breakpoint values assigned to the six (6) NAIC designations for each CUSIP. ***The final*** NAIC designations ***is*** mapped to ***an*** NAIC designation **category according to the instructions** in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office*~~**, along with instructions for tranches that have no expected loss under any of the selected modeling scenarios and instructions for non-modeled securities**~~. Th**e** final NAIC designation ~~**and NAIC designation category**~~ shall be applicable for statutory accounting and reporting purposes**, and the NAIC designation category will be used for** investment schedule reporting and establishing ~~**RBC and**~~ AVR charges. The final NAIC designation is not used for establishing the appropriate carrying value method in Step 2 (paragraph 27.a.ii.)."

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

Ref #2020-22: Accounting for Perpetual Bonds

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

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

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

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

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

- **Amortization of premiums and accretion of discounts:** The proposal notes that due to a lack of a maturity date, insurers do not accrete discounts or amortize premiums on perpetual bonds. However, many insurers in the interested parties group do have methodologies to amortize premiums and accrete discounts. Most often, companies amortize premiums to the call date for the bonds (i.e., apply yield to worst) and accrete discounts to a date that is far into the future (i.e., consistent with how Bloomberg treats such bonds when quoting market yields for the bonds). Investors believe this approach to estimating a yield is a reasonable depiction of the true yield expected to be earned on the investments.

- **Call date is a pseudo-maturity date:** The capital markets and investors (including insurers) consider the call date in the bonds to be a pseudo-maturity date. That is, it is expected that the perpetual bonds will be called on the call date. Oftentimes insurers price the bonds to the call date. Many times, the bonds have step-up coupon provisions at the call date, which provides an incentive for the issuer to call the bonds, or there are other reasons why there is a market compulsion for the issuer to call such bonds on the call date. The expectation that the bonds will be called is one of the key characteristics that results in many companies reporting such bonds as fixed income for US GAAP reporting purposes. In the rare cases where perpetual bonds do not have callability, all other characteristics are the same as those bonds with callability (e.g., capital markets consider them bonds, the trade like bonds, the investment objective is the same as bonds, etc.) and thus interested parties believe they should be reported the same as all other bonds.

- **How perpetual bonds trade in the market:** The market's view of the call provisions on perpetual bonds, as outlined above, is a key reason (among others) that perpetual bonds trade in the capital markets like bonds. As a result, these instruments are more sensitive to interest rate movements, are generally priced like bonds (inclusive of accrued interest) and are quantified and measured in terms of par value and not in terms of shares of stock.

- **US GAAP reporting:** Those insurers who invest in perpetual bonds generally report them as fixed income for US GAAP reporting purposes. Some companies evaluate the investment characteristics (per the guidance in Topic 815) to determine if the characteristics such as redemption rights, voting rights, conversion rights, dividend rights, and protective covenants are more debt like or equity like when determining the appropriate reporting. Additionally, companies consider how the investments are viewed in the capital markets. The analysis performed generally concludes that perpetual bonds are more bond like than equity like. When classified as bonds, they are evaluated for impairment like any other bond (e.g., insurers assess the ability for the issuer to pay interest and principal).

- **Investment strategy for perpetual bonds:** Insurers invest in perpetual bonds for their fixed cash flows (interest and expected return of principal when called by the issuer) and not for market appreciation. Like other bonds, the expected fixed cash flows are used for cash flow matching to insurance liabilities. Many perpetual bonds have a fixed coupon and if not called the coupon adjusts to a current floating rate plus a spread (e.g., that is stepped-up significantly from original issuance spreads). Also, when insurers manage their investment portfolios (e.g., investment allocations, assessing risks, etc.), perpetual bonds are classified as bonds and not equities.

- **Monetization of perpetual bonds:** A key reason equity securities are reported at fair value for Statutory reporting purposes is because there is no certainty in the cash flows they generate and return to the investor (return of principal and return on investment), which includes dividend payments. Additionally, the return of an investor's original investment can only be monetized by selling the equity security at fair value. As a result, fair value is an important measurement when considering the expected return to the investor. Regarding perpetual bonds, the opposite situation exists. The cash flows have a much higher level of certainty (interest to be paid for the life of the investment is contractual and does not require the issuer's board declaring a dividend like a preferred stock and the return of par at the call date) like any other bond. As a result, similar to other bonds, we do not believe fair value is a relevant measurement principle for such investments for Statutory reporting purposes.

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

Ref #2020-23: Update to Leasehold Improvements

The Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to *SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements* and *SSAP No. 73—Health Care Delivery Assets and Leasehold Improvements in Health Care Facilities*, to allow the amortization of leasehold improvements to match the associated lease term, which is guidance that agrees with U.S. GAAP, ASC Topic 842.

Interested parties support this proposal.

Ref #2020-24: Accounting and Reporting of Credit Tenant Loans

The Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed this agenda item with a request for comments on the two general options for the accounting treatment of credit tenant loans (CTL). Notification will also be sent to the Valuation of Securities (E) Task Force of this agenda item in response to their referral. With this notification, NAIC staff will request further confirmation that a SVO-Listing could be developed to capture the CTLs that meet the SVO's structural and legal analysis and possess bond characteristics.

Interested parties' response – please see separate letter

Ref #2020-25EP: Editorial and Maintenance Update

The Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed editorial revisions to *SSAP No. 5R—Liabilities, Contingencies and Impairments of Asset* and *SSAP No. 62R—Property and Casualty Reinsurance*.

Interested parties have no comments on this item.

Ref #2020-26: ***ASU 2015-10, Technical Corrections & Improvements***

The Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to *Appendix D—Nonapplicable GAAP Pronouncements* to reject *ASU 2015-10, Technical Corrections & Improvements* as not applicable to statutory accounting.

Interested parties have no comments on this item.

Ref #2020-27: ***ASU 2019-09, Financial Services – Insurance; Effective Date***

The Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to *Appendix D—Nonapplicable GAAP Pronouncements* to reject *ASU 2019-09—Financial Services – Insurance* as not applicable to statutory accounting.

Interested parties have no comments on this item.

Ref #2020-28: ***ASU 2020-01, Investments—Equity Securities (Topic 321), Investments—Equity Method and Joint Ventures (Topic 323), and Derivatives and Hedging (Topic 815), Clarifying the Interactions between Topic 321, Topic 323, and Topic 815***

The Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to reject *ASU 2020-01, Investments—Equity Securities (Topic 321), Investments—Equity Method and Joint Ventures (Topic 323), and Derivatives and Hedging (Topic 815), Clarifying the Interactions between Topic 321, Topic 323, and Topic 815* for statutory accounting. The revisions note rejection are proposed to *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*, *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities* and *SSAP No. 86—Derivatives*.

Interested parties have no comments on this item.

Ref #2020-29: ***ASU 2020-05—Effective Dates for Certain Entities***

The Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to *Appendix D—Nonapplicable GAAP Pronouncements* to reject *ASU 2020-05, Revenue from Contracts with Customers (Topic 606) and Leases (Topic 842), Effective Dates for Certain Entities* as not applicable to statutory accounting.

Interested parties have no comments on this item.

Ref #2020-30: Premium Refunds and Other Adjustments

The Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed the agenda item with a request for comments/input on the issues described in the proposal. NAIC staff was also directed to draft guidance to address premium refunds and other policy adjustments for both property and casualty and accident and health lines of business.

Comments were requested on the following:

1. NAIC Staff's preliminary recommendation is that the proposed guidance should follow the existing principles of adjustable premium and shall be recognized as adjustments to premium based on experience to date.

2. Examples of existing products that have premium adjustments for reasons other than the existing guidance or how the existing guidance can be expanded.

3. If accounting treatment that is being applied is different from premium adjustments, please provide overview of key attributes.

Interested parties offer the following comments:

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

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

   Suggested revisions to Paragraph 4 of SSAP No. 54-R:

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

   a. For refunds or reductions in premiums under the terms of the policyholder or group contract refer to:
      1. Contracts Subject to Redetermination – Paragraphs 27-32 below
      2. Retrospectively Rated Contracts - SSAP No. 66

b. For voluntary refunds or reductions in premiums that are not specified by the terms of the policyholder or group contract, the timing of the recognition of the payment (or credit to gross billed premiums) is based on when the corresponding gross premium is or has been earned. To illustrate (not intended to be an exhaustive list):
   1. For premium reductions pertaining to previous or expired periods of coverage, the full amount of the reduction is recognized immediately.
   2. For premium reductions that relate to the current month's coverage, the reduction is recognized in the current month.
   3. For reductions that relate to subsequent months' coverage, the reduction will be recognized in the month to which it pertains so as to match the recognition of the reduction with that of the gross premium and coverage period to which it pertains.

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

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

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

Interested parties offer our assistance in developing additional guidance or in providing feedback on draft guidance.

Ref #2020-31: Early application of *SSAP No. 32R—Preferred Stock*

The Working Group voted by e-vote to move this item to the active listing, categorized as nonsubstantive, and exposed edits to *SSAP No. 32R—Preferred Stock* as detailed above. This item has a comment period deadline ending September 18, 2020.

Interested parties have no comments on this item.

Thank you for considering interested parties' comments. If you have any questions in the interim, please do not hesitate to contact us.

Sincerely,

D. Keith Bell Rose Albrizio
cc: NAIC staff and Interested parties

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July 31, 2020

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

RE: Ref #2019-21, SSAP No. 43R

Dear Mr. Bruggeman:

Interested parties would like to thank the Statutory Accounting Principles Working Group (SAPWG) for the opportunity to comment on the exposed issue paper in Reference #2019-21 – SSAP No. 43R, Loan-Backed and Structured Securities (the "Issue Paper" or "Exposure"). Interested parties have been challenged by the complexity and difficulty of the issues involved. Investment professionals who are accustomed to thinking of asset-backed securities as a discrete set of investments, were also concerned to find proposed changes to underlying accounting definitions that have the potential for wide-ranging consequences affecting fixed income securities more generally.

Interested parties have provided comments directly on each question included within the various sections of the Issue Paper. However, because Interested parties were challenged by much of what was proposed in sections 5a through 5e and have struggled to unravel all of the disparate threads woven throughout the Issue Paper, we have also summarized many of those comments immediately following the below table of contents. The table of contents coincides with the various sections of the Exposure and helps facilitate navigation for the reader.

Preamble – Interested Party Summary Comments

1) First and foremost, the proposed re-write of SSAP No. 43R with a new anchoring definition, is a very technical and nuanced process with the potential to drastically change the type of securities within the scope of both SSAP No. 26R and SSAP No. 43R that are currently afforded bond accounting treatment and reporting on Schedule D.

   Since the proposed anchoring definition is generally only used from the perspective of an issuing entity, most insurance companies' accountants, attorneys or front office investment personnel are not familiar with the definition and supporting body of work. When insurance companies do utilize the definition, for example when sponsoring asset-backed securities (ABS), their interaction with the definition is very narrow and with assistance of outside legal counsel. This fact raised many questions; as a result, industry needed and sought assistance from outside legal counsel to inform our response to the Exposure.

   After several Interested Party discussions with outside counsel, and analysis of both interested parties' investment portfolios and many areas of the Issue Paper, we became aware of some significant potential challenges associated with using the proposed anchoring definition. We question whether any benefits of using the proposed anchoring definition, outweigh the potential challenges, and expand upon those potential challenges below. Interested parties also believe developing independent principles beyond those included within the Issue Paper, and in lieu of the proposed anchoring definition, should strongly be considered.

   In light of this, interested parties ask the SAPWG to take time to carefully and thoroughly consider the recommendations included in this letter. Our objective is to ensure both proper clarity and proper accounting for each security type currently or newly proposed as a bond under SSAP No. 43R. Arriving at the appropriate revisions takes precedence over timeliness of completion. It is in the best interest of both insurers and regulators, and ultimately policyholders, to not emplace statutory accounting principles that are detrimental to insurers engaging in sound investment principles.

2) Importantly, the Exposure includes two definitions of ABS – 1) the Securities Exchange Act of 1934 definition (paragraph 19 – hereafter referred to as the "1934 Act Definition") and the definition set forth in 17 CFR Section 229.1191(c) (paragraph 20 – hereafter referred to as the "1933 Act Definition"). Each definition has been subject to regulatory and judicial interpretations, each includes single obligor ABS, and each exists for a different purpose.

   The 1934 Act Definition was enacted by Congress as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank). The purpose of the definition is to encompass a wide range of securities commonly viewed as ABS in the context of Dodd-Frank's risk retention requirements.

   The 1933 Act Definition was promulgated by the Securities and Exchange Commission (SEC) in 2006 and thus predates the 1934 Act Definition. The 1933 Act Definition is narrower in scope (e.g., does not include certain collateralized loan obligations "CLOs", for example) and is not relevant for 144A securities and private placement debt securities. The purpose of the 1933 Act Definition was to identify which types of ABS are eligible for the short form registration statement. In 2006, the S-3 was the only short-form registration statement; now there is an SF-3 registration form designed for ABS. That the 1933 Act Definition now exists solely for the SF-3 form illustrates its narrow scope.

   Interested parties believe the 1934 Act Definition is the more appropriate starting point to define ABS for statutory accounting, as this definition was most recently evaluated and utilized by Congress to subject a wide range of instruments to risk retention rules. Even the 1934 Act Definition, however, does not cover many securities commonly viewed by the market as ABS. This is because the 1934 Act Definition requires that the underlying assets of an ABS be self-liquidating, and thereby excludes a range of assets with predictable cash flows, but that are not self-liquidating (e.g., royalties and cell towers).

The "Four Principles", as proposed in paragraph 33 of the Exposure, likewise reference self-liquidating assets, and thus would need to be revised to better reflect ABS. Interested parties believe that it may be better to define, with interested parties, a revised set of principles, while potentially maintaining the 1934 Act Definition as a "safe harbor" to facilitate classification of ABS. A further brief timeline of the development of the 1933 Act and 1934 Act Definitions is included in Appendix I to this letter. As shown in that timeline, these definitions were not intended to capture the entire ABS market, but rather were targeted to specific regulatory and legislative goals.

Interested parties understand that NAIC staff chose the 1933 Act Definition, versus the 1934 Act Definition, because NAIC staff believed certain regulators wanted to limit the definition to ABS that could be rated only by Nationally Recognized Statistical Ratings Organizations (NRSROs) "approved" by the SEC to rate ABS.

As a technical clarification[1] any NRSRO can assign a rating to any ABS, regardless of whether the ABS meets the 1933 Act Definition. Every NRSRO is registered with the SEC to rate at least one asset class. Registration indicates that the NRSRO has special expertise in rating securities of a certain type (such as ABS) or issued by certain entities (such insurance companies). The NRSRO must submit to annual SEC examinations to maintain such registration. At present, six of the nine NRSROs are registered to rate ABS (each, an "NRSRO Registered for ABS").

It is entirely up to the NRSRO whether it wants to apply to be registered to rate multiple asset classes. For example, Japan Credit Rating Agency is registered for insurance company securities, but not for ABS. In those instances where federal law requires that securities held by federally regulated institutions be rated, only a rating from an NRSRO registered for securities of that type qualifies as a rating letter. Japan Credit Rating Agency is free to assign ratings to ABS as defined in the 1933 Act Definition, and the federally regulated institution is free to subscribe to or otherwise receive and review the Japan Credit Rating Agency rating; however, the rating is just another credit opinion and does not count toward the particular requirement of federal law.

Since the financial crisis of 2008-2009, many references in federal law to ratings have been removed. As a result, the concept of registered NRSRO now has less legal consequence. Nonetheless, the status of being a registered NRSRO does provide market credibility to NRSROs, which is why NRSROs go through the cost and effort of maintaining such status.

Regulators might ask – which NRSRO ratings should entitle an insurance company holder of ABS to filing exemption? Putting aside the confusion arising from federal law, paragraph 35 of the Issue Paper indicates that NAIC staff prefer that only rating letters from an NRSRO Registered for ABS should be counted as valid ratings for ABS meeting either the 1933 Act Definition or the Four Principles.

If the 1934 Act Definition is adopted as the cornerstone of SSAP No. 43R, which interested parties believe is more appropriate than the 1933 Act Definition, interested parties are open to applying the NRSRO Registered for ABS limitation to the 1934 Act Definition (i.e., if state regulators want to mirror what few remaining provisions of federal law do for ABS securities). Interested parties would also be open to discussing the extension of such concept to the Four Principles, when and if they are finalized.

The NRSRO Registered for ABS limitation should by definition apply only to ABS. The limitation should not apply to debt issued by closed end funds registered under the Investment Company Act of 1940 (CEF Debt), project finance bonds, certain "issuer obligation" municipal bonds (e.g., certain toll road municipal bonds), credit tenant loans (CTLs), ground lease financings (GLFs), equipment trust certificates (ETCs), enhanced

[1] The Exposure Draft's focus on NRSRO ratings in relation to the definitions is somewhat unclear. The SEC eliminated the requirement that securities registered on Form SF-3 have an investment grade rating from an NRSRO a number of years ago. Most other federal regulations also have eliminated NRSRO rating requirements and references, as required under the Dodd-Frank, although we do see them used, for instance, in TALF 2.0. NRSROs do register with respect to certain asset classes, but that does not mean that they are not allowed to rate non-registered transactions. The questions about ratings in general seem tied to the SVO process rather than the classification of the securities for purposes of the SSAPs.

equipment trust certificates (EETCs), and any other security issued from a Trust or special purpose vehicle (SPV), that is not an ABS but which NAIC staff and SAPWG move to SSAP No. 43R, only by virtue of their issuance from a Trust or SPV. Such securities will need explicit mention within the scope of SSAP No. 43R, beyond any refinement of the Four Principles, likely with separate reference to the specific asset classes themselves.

If SAPWG decides to proceed in this fashion, after defining such securities within the scope of SSAP No. 43R, interested parties would support special code identifiers on Schedule D to identify any specific asset class for which regulators feel they would benefit.

Lastly, with respect to using any SEC definition as a cornerstone, two other issues also would need to be addressed.

First, does the definition used incorporate both existing and future SEC interpretations as to whether a security-type meets the definition? Without incorporating existing and future interpretations, additional clarification would be needed for statutory accounting purposes, even if further principles are developed. Regulators and industry would otherwise be left with significant uncertainty as to scope. At a minimum, the NAIC would need to develop similar interpretative guidance which would likely be both voluminous and require continual update to keep pace with market evolution.

Second, the 1934 Act Definition, by its design, encompasses both registered and unregistered securities. The 1933 Act Definition is technically for securities that are registered with the SEC. Many 144A securities or private placement debt securities would meet this definition, but are not registered with the SEC. Therefore, any such scope utilizing the 1933 Act Definition, would need to ensure this distinction is made; that is, any security, whether registered with the SEC or not, is within the scope of SSAP No. 43R if it meets this definition. However, interested parties reiterate that the 1934 Act Definition is more appropriate for statutory accounting if a SEC cornerstone is to be adopted.

3) Today, there are essentially two accounting paradigms for bonds – SSAP No. 26R ("regular" amortized cost) and SSAP No. 43R ("modified" amortized cost that is adjusted periodically for changes in prepayment assumptions). Today, the scope of SSAP No. 26R includes all bonds with a specific carve-out for securities that qualify for the scope of SSAP No. 43R. The Exposure generally proposes to keep this distinction but clarifies that SSAP No. 43R includes all securities issued from a Trust or SPV even if they do not have prepayment or extension risk (which was the impetus for the modified amortized cost accounting in SSAP No. 43R). This is an important point; SSAP No. 43R securities (e.g., loan backed and structured securities), many of which are issued from a Trust or SPV, have this different accounting due to prepayment and extension risk and not because they are issued from a Trust or SPV.

   Interested parties unequivocally believe that many of the securities issued from a Trust or SPV should continue to follow the regular amortized cost accounting within SSAP No. 26R, as they do not have prepayment or extension risk. Therefore the modified amortized cost within SSAP No. 43R is not appropriate, as there is no need to update prepayment and extension assumptions as required under SSAP No. 43R. Examples include but are not limited to 1) where there is a direct guarantee from a corporate or government entity (e.g., certain Issuer Obligation Municipal Bonds), even if the security is issued from a Trust or SPV for legal or other reasons (i.e., an otherwise qualifying SSAP No. 26R security, with the exception of being issued from a Trust or SPV) or 2) project finance investments which are typically issued from an SPV. Many insurance companies currently report these securities as SSAP No. 26R investments. Interested parties and many others as well (industry, regulators, SVO, and NAIC staff) believe these are Schedule D bonds where regular amortized cost accounting is appropriate.

   Indeed, interested parties continue to question whether the presence of a Trust or SPV should form any part of an accounting classification. In many deals the trust nomenclature may appear, when in fact there is no separate trust entity. The term SPV is even more ambiguous, as there is no commonly accepted definition. There are many regulated businesses, non-for-profit corporations, and other entities that by law, regulation or charter are established and exist for a single purpose. Are these SPVs? There is no easy answer.

Any use of the terms Trust or SPV, to segregate for purposes of accounting or scoping, would require that they be defined with sufficient clarity to both reflect the substance of these terms and ensure that any such new standard is operational, including the appropriate accounting treatment with no unintended consequences.

Even if Trust and SPV can be defined with some precision, business entities will continue to evolve. In Section 5 of the Issue Paper, it is suggested that reporting entities should know to classify CEF Debt within the scope of SSAP No. 43R "due to the presence of the trust structure". However, most closed end funds are corporations, and there has been no reason to classify their debt as anything other than within the scope of SSAP No. 26R (e.g., there is no prepayment or extension risk). This example highlights the difficulty of making the type of issuing entity a decisive factor for accounting classification.

Ultimately, if the SAPWG determines all securities issued from a Trust or SPV should be included within the scope of SSAP No. 43R, it is imperative that both sufficient scope clarity be developed and all bonds with no prepayment or extension risk, even if issued from a Trust or SPV, receive the appropriate accounting (i.e., "regular" amortized cost accounting). It is therefore premature for the Issue Paper to suggest any class of security should utilize lower of amortized cost or market accounting, based on whether it meets some components of a somewhat arbitrary or ambiguous definition, without providing an appropriate rationale for doing so.

4) The NAIC Policy Statement on Coordination of the Accounting Practices and Procedures Manual and the Purposes and Procedures Manual of the NAIC Investment Analysis Office includes the following:

> *"The assessment of credit risk for an obligation or asset, as specified in the P&P Manual, is a separate and distinct process from the determination of statutory accounting or reporting under the AP&P Manual. The manner in which an NAIC designation is used within statutory accounting guidance is limited to that, if any, specified in a statement of statutory accounting principle (SSAP) and cannot be derived or implied by language in the P&P Manual. Obtaining an NAIC designation does not change an investment's applicable SSAP, annual or quarterly statement reporting schedule, or override other SSAP guidance required for the investment to be an admitted asset. There are limited instances in which a SSAP specifically identifies, within its scope, the inclusion of specific SVO-identified investments. The SVO review required for an investment to be included on a SVO listing is a separate evaluation process that focuses on the structure of the investment. This process is distinct from the SVO's assessment of an investment's credit risk, which results in a NAIC designation. As stated in the Statutory Hierarchy, Section V of the Preamble, the AP&P Manual is the highest level of authoritative guidance."*

Interested parties agree with the substance of this policy statement and believe SAPWG's effort should focus on the scope of bonds, and their appropriate accounting, and should not overlap with the SVO's mission of credit quality assessment of securities owned by insurance companies, in support of the Valuation of Securities Task Force (VOSTF) mission to establish and maintain the NAIC's credit assessment process. That is not to say interested parties believe NAIC staff and SAPWG should not work together with the SVO and VOSTF.

In fact, we encourage a high degree of interaction and cooperation between the two groups to ensure the overall framework is cohesive as the SVO works on Bespoke Securities (for example, certain Collateralized Fund Obligations "CFOs" or other bespoke transactions that the SVO believes to be abusive), which we understand is a main impetus of this project. Interested parties believe that each group's work product, SSAPs and Purposes and Procedures Manual (P&P Manual), respectively, should reflect only what is directly related to its specific mission and NAIC policy.

The SVO's mandate should continue to be limited to assessment of credit risk; scope determination should continue to be the mandate of SAPWG, unless a structural analysis has been delegated to the SVO where SAPWG has already determined scope (i.e., as with CTLs where the SVO determines if the security meets the SAPWG determined scope requirement). In this circumstance the SVO is enforcing a SAPWG decision as to scope but not determining scope. SAPWG should determine scope and the SVO should be limited to compliance with the defined scope.

An additional area where such interaction would be beneficial, and that interested parties would like to specifically address, is related to affiliated transactions. This seems to be an area of shared concern for regulators, the SVO, and NAIC staff. Interested parties agree that such concerns should be addressed. However, many sections of the Issue Paper, where scope requirements are proposed, instead appear to be addressing affiliated transaction concerns - i.e., 1) single obligor asset backed securities or whether it is "common" or "broadly syndicated" and 2) transactions where Schedule BA assets are converted to Schedule D Bonds, mostly in the context of certain CFO-type transactions, but do not meet sale criteria and could result in RBC arbitrage. This makes the proposed principles unworkable and appears to be inadvertently pejorative toward all CFO-type transactions (e.g., CEF Debt and similar structures) that interested parties believe, and we understand many regulators believe, are unequivocally investments that should be accounted for as bonds and reported on Schedule D.

Rather than commingling affiliated transaction concerns with scope, interested parties believe these concerns are already addressed (or will be addressed) as follows:

a) Part III of Section 17 of the P&P Manual already requires the filing of all investments in Subsidiary, Controlled and Affiliated (SCA) entities – "SCA investments are transactions between insurance company affiliates (called related parties) that are subject to special regulatory considerations identified in *SSAP No. 25—Affiliates and Other Related Parties*. This Manual specifies that such transactions are not subject to filing exemption and can only be assigned an NAIC Designation if the SVO has first concluded that the transaction is like those the SVO typically assesses for credit risk." This determination should be (and is) being done with cooperation of the SVO, the insurance company, and the applicable regulator.

   If this part of the P&P Manual does not include all types of affiliated transactions that are of concern (i.e., affiliated transactions are a subset of related parties), interested parties believe this should be addressed separately, rather than commingling the concern in SSAP No. 43R's scope determination. More specifically, interested parties note that the SVO's concurrently exposed project on Bespoke Securities also raises concerns on affiliated and related party transactions.

   Interested parties also believe certain additional clarifications are warranted. For example, per the guidance in Reference No. 2019-03, many interested parties believe SCA transactions do not cover securities, where an insurer or one of its subsidiaries sponsors a securitization and the insurer purchases some of the tranches of that securitization, and where the securitized assets are non-affiliated assets. Interested parties agree with this interpretation but a definitive clarifying determination may be needed.

   Lastly, both the 1933 Act Definition and the 1934 Act Definition include single obligor ABS within their scope, so there is no need to single them out in the exposure if the concerns are related to affiliated transactions as affiliated transactions already need to be filed with the SVO.

b) As noted in Section 2 of this letter, interested parties have provided clarifying guidance in our October 2019 comment letter that prohibits moving assets from one schedule to another (e.g., from schedule BA to Schedule D), which could result in RBC arbitrage, if the transaction does not meet sale criteria.

Our conversations with NAIC staff suggest they agreed with these clarifications and that they would eliminate such perceived abuses.

c) Further, in response to "equity-related" structure concerns, we have suggested further safeguards to ensure only regulator supported CFOs such as CEF Debt, and similar CFO-type structures, are afforded bond accounting and Schedule D reporting. The full details can be found in Sections 5c and 5d of this letter.

If the above do not fully address the NAIC concerns, interested parties request such additional concerns be more fully articulated so interested parties can help address them. There are many valid reasons for affiliated transactions that benefit both insurance companies and policyholders and therefore regulators as well. That said, interested parties understand the unique nature of affiliation transactions and regulators' concerns that they can be subject to abuse; so, interested parties welcome further transparency on affiliated transactions.

5) Similar to the assistance rendered by interested parties regarding Principal Protected Notes ("PPNs"), we again would like to help eliminate any potential statutory accounting abuses relative to SSAP 43R. However, to do so, there are some issues that interested parties need to more fully understand. For example, related to CFO-type investments, we agree that 1) instruments where the amount of principal or interest payable contractually varies based on the appreciation and/or depreciation of underlying equities warrant a different accounting treatment and therefore different reporting treatment than the bond section of Schedule D and 2) instruments that create RBC "arbitrage" (i.e., by moving Schedule BA assets to Schedule D without meeting sale criteria in SSAP No. 103R) should be prohibited.

However, any proposed scope clarifications should only address the perceived abuses and not have detrimental consequences to a broader range of CFO investments which are appropriate and beneficial for insurance companies' investment portfolios. For example, there are many CFO-type investments with a fixed coupon and fixed principal, that have adequate structural features such as overcollateralization and/or liquidity facilities, such that equity appreciation is not required in order to service debt obligations, and in fact, the value of the underlying equity investments can fall substantially, without jeopardizing debt repayments as scheduled (e.g., CEF Debt and other similar structures). Interested parties believe these structures are bonds, appropriate for schedule D reporting, and should be eligible for filing exemption.

The Exposure states that NAIC staff believes regulators do not believe any equity-backed investments should be reported as bonds on Schedule D. This is not consistent with our discussion with some regulators, who view that the aforementioned- types of securities with overcollateralization and fixed coupon rates and maturities are bonds and should be accounted for as bonds and reported on Schedule D. We would appreciate if regulators that share NAIC staffs' expressed view or have concerns would provide written comments on their specific concerns so we can help address them. We would welcome the opportunity to provide education on CEF Debt and other CFO structures that interested parties (and the SEC) unequivocally view as debt.

In general, we believe the Issue Paper too often wants to "look through" to the underlying assets to determine whether or not the security is a bond. We understand the rationale for this view is where the underlying collateral is a tangible asset not capable of generating cash flows, as is the case with certain collateral loans, defined in SSAP No. 21 (e.g., putting a piece of artwork or the "company airplane" in a Trust or SPV that issues debt). However, interested parties believe the Issue Paper conflates this concept with all other kinds of securities, including CFOs, that are generally recognized as bonds, by the SEC, the FASB and even certain members of the NAIC. The Internal Revenue Service also recognizes such securities as debt.

In addition to CFOs (see sections 5c & 5d), interested parties highlight many such instances throughout this letter where we believe solely "looking through" to the underlying assets is not appropriate, and that other characteristics of the specific investments should be considered. See also section 5f, where airplanes, rail cars or other physical assets, which are typically non-admitted assets, are cash generating through leases and are widely accepted as bonds even where there is re-leasing and/or related residual asset risk (i.e., reliance on the cash generating ability of the underlying asset). Similarly, royalty securitizations, municipal bonds contingent upon proceeds from tobacco settlements, etc. are also widely accepted as bonds. There are many more examples of such cash generating "non-admitted' assets where bond accounting is appropriate.

6) If the end product of this project results in significant changes to bond accounting and of Schedule D reporting, interested parties strongly believe any new scope requirements should be applied prospectively, so as to not penalize insurance companies who have complied with the rules prior to any such scope change. With that said, interested parties would agree to exceptions to this general principle if, as a result of the scope changes, transactions are identified that were deemed abusive by regulators.

7) Interested parties also believe it is imperative that any security-types where the scope or accounting is proposed to be changed, get adequate due process before SAPWG, and not get approved with a pass/fail vote on the broader proposed new standard. As noted above, this is a very complicated and technical area, and it serves both insurance companies and regulators to spend the requisite time to address affected asset classes individually. Further, drastic changes to scope of bonds could have a significant impact to certain areas of the capital markets or insurance company balance sheets. For example, even now, many insurance companies have stopped investing in CFO debt type securities given the regulatory uncertainty associated with their acceptability at the NAIC. Likewise, the CTL market is also challenged with regulatory uncertainty and their potential classification as Schedule BA assets. These are very good asset classes, with a track record of success, and such uncertainty is not healthy for insurance companies, regulators and ultimately policyholders, especially while already being challenged by the extended low interest rate environment.

8) Lastly, we appreciate NAIC staff's acknowledgement and support of industry's efforts to clarify the fundamentals that will help address some of the perceived abuses and develop a revised standard.

   Quite possibly, the most important part of the interested parties' response to the Exposure, is the Appendix II included at the end of our letter as well as discussed in section 2 of this letter. Appendix II highlights a preliminary list of securities (e.g., any security issued from a Trust or SPV, inclusive of existing SSAP No. 26R securities) many of which interested parties do not believe meet the scope of either the 1933 Act Definition or the 1934 Act Definition. It is important to note that this is only an initial attempt at identifying securities by interested parties after a "deep dive" into insurers' investment portfolios. As this was a very significant effort, it illustrates how complex, time-consuming, and difficult it is to evaluate investments issued by a Trust or SPV to determine if they meet the 1933 Act Definition or the 1934 Act Definition. Much of the analysis involved an individual asset-by-asset assessment that took a significant amount of time for insurers to perform. Many more hours of analysis would be required to identify all investments issued by a Trust or SPV to determine classification in accordance with the Exposure. Even after interested parties' efforts, there is still significant uncertainty about what asset classes qualify, and often the answer is "it depends." In order to determine appropriate principles for ABS beyond those included within these definitions, it is imperative all the above issues be addressed. Interested parties attempted to summarize these points as follows:

   1) Clarify whether regulators intend that any security issued from a Trust or SPV, fall in the scope of SSAP No. 43R, even those without prepayment/extension risk.
   2) If any security, issued from a Trust or SPV, is desired to be within the scope of SSAP No. 43R, it is imperative to appropriately define the terms Trust and SPV to ensure an operational standard (i.e., provide sufficient clarity so that both industry and regulators apply the terms consistently) with no unintended consequences (e.g., the requirement to apply modified amortized cost accounting when there is no prepayment or extension risk).

3) Have regulators confirm that securities identified in Appendix II are appropriately accounted for as bonds and reported on Schedule D. As already mentioned, more work may be needed in this area, to ensure all security types are identified.
4) If the investments are not to be reported as bonds on Schedule D, determine an appropriate accounting home.
5) If the investments are to be accounted for as bonds and reported as Schedule D, determine whether those securities are going to be specifically referenced in SSAP No. 43R by definition (i.e., as is currently done today with CTLs, ETCs, EETCs) or expanded for other securities that would now be in the scope of SSAP No. 43R (e.g., project finance, CEF Debt and similar CFO-type securities, and issuer obligation municipal bonds, etc.) that regulators and interested parties all believe are appropriate to be accounted for as bonds and reported on Schedule D, but are not ABS.
6) Definitively determine the appropriate Securities Act Definition (or not) with the appropriate clarifications as to 1) whether the definition applies to 144A, private placements, and CLOs if the 1933 Act Definition is used and 2) in any case, whether the SEC's interpretative guidance applies and, if not, how similar interpretative guidance will be developed.
7) Ensure that proper coordination with the SVO has occurred and appropriate determinations are made, for example, with regards to affiliated transactions.

Upon completion of the above, only then would it be appropriate to develop the principles to ensure they capture the intended ABS. For example, are they intended to capture royalty securitizations, or is that asset class going to be specifically defined within the scope of SSAP No. 43R and thus not needed to be captured under the principles?

We continue to stand ready to help NAIC staff and regulators in this effort.

<u>Section 1 – Summary of Issue (Includes History / Benefits / Concepts / Key Issues)</u>

<u>Overview of Key Concepts:</u>

- This section details the overall issue, history of development and key concepts and issues that provide the background for the overall discussion / project.

<u>Questions / Comments:</u>

- Is there additional information that should be captured to provide more information on the overall issue or discussion?

Much of the history and development of key concepts in this section is useful and accurate. However, in some ways it appears to be used in a way that does not present a complete and accurate accounting of such history and development.

For example, we note the following from paragraph 4:

> *"Although most of the guidance between the original SSAP No. 26 and SSAP No. 43 was the same, the guidance in SSAP No. 43 recognized the need to review (at least quarterly) the prepayment assumptions and resulting cash flows of the underlying loans, as changes in assumptions would necessitate a recalculation of the effective yield."*

Interested parties agree with this characterization and it should not be forgotten. Today, there are essentially two accounting paradigms for bonds – SSAP No. 26R (regular amortized cost) and SSAP No. 43R (modified amortized cost that is adjusted periodically for changes in prepayment assumptions).

SSAP No. 26R scope includes all bonds with a specific carve-out for securities that qualify for scope of SSAP No. 43R. Judging from the staff note in paragraph 9, the Exposure generally proposes to keep this distinction but clarifies that SSAP No. 43R includes all securities issued from a Trust or SPV even if they do not have prepayment or extension risk (which was the impetus for the modified bond accounting in SSAP No. 43R):

> *"Staff Note: With the revisions adopted in 2010, NAIC staff is under the impression that all securities issued from an SPV/trust structure were intended to be in scope of SSAP No. 43R. This provision is expected to be discussed and clarified in accordance with this issue paper."*

The different accounting paradigms is an important point – SSAP No. 43R securities (e.g., loan backed and structured securities), while issued from a Trust or SPV, have this different accounting due to prepayment and extension risk, not because they are issued from a Trust or SPV.

Further, interested parties believe NAIC staff's impression that all securities issued from a Trust or SPV structure were intended to be in scope of SSAP No. 43R is not wholly accurate for the following reasons:

1) Not all securities have prepayment/extension risk which renders the accounting of SSAP No. 43R moot,
2) Nowhere, as a result of the revisions adopted in 2010, did it change the scope of SSAP No. 43R to explicitly state all securities issued from a Trust or SPV are included,
3) Industry continues to hold multiple billions of dollars of securities issued from a Trust or SPV reported under SSAP No. 26 and neither regulators nor auditors have taken exception to this, and
4) Industry does not believe this was the intent of Matti Peltonen, at the time a member of the New York State Department of Financial Services, who was the impetus behind the 2010 changes. For example, after the 2010 changes were adopted, there were many open working calls with interested parties and Mr. Peltonen, where attempts were made to determine which securities within a Trust or SPV were ABS in accordance with SSAP No. 43R. Further, in a 2010 presentation to the North American Securities Valuation Association (NASVA), which we are happy to share with SAPWG, Mr. Peltonen concluded with the following observations:

    > *"The preceding pages are not meant to be definite guidance on how to report municipal bonds: some are clearly Issuer Obligations, some are clearly LBaSS – and there are probably some that are clearly in between."*
    >
    > *"The definite determination on how to report, if in doubt, needs to be done by studying a security's prospectus, and comparing the terms with the annual statement guidance, and SSAP26 and 43R."*

    Mr. Peltonen's focus was not on whether a security was issued from a Trust or SPV, but rather if a security was clearly an Issuer Obligation or a Loan-Backed (or Asset Backed) security with attributes of a proportional payments, as noted in paragraph 2 of SSAP No. 43R:

    > *"Loan-backed securities are defined as securitized assets not included in structured securities, as defined below, for which the payment of interest and/or principal is directly proportional to the payments received by the issuer from the underlying assets, including but not limited to pass-through securities, lease-backed securities, and equipment trust certificates.'*

    Examples of municipal bonds sometimes issued from a Trust or SPV, and often reported under SSAP No. 26R today, are special revenue bonds including toll roads or bridges, water and wastewater (sewer) utilities, prisons, and electrical generation facilities, among potentially many other similar "businesses". As Mr. Peltonen noted in his presentation:

"*When a municipal agency (that operates as a business) issues bonds they are issuer Obligations"*

"When a municipal agency puts assets in a blind trust that are the sole collateral for the issued bonds, they are LBaSS"

Some examples of securities potentially issued from a Trust or SPV that are generally accounted for under SSAP No. 26R are as follows:

- Issuer Obligation Municipal Securities,
- Project Finance Debt,
- CEF Debt and similar CFOs with proper collateralization,
- Sports Deals (e.g., MLB, NBA, NFL),
- And various others.

Interested parties unequivocally believe that many of the securities issued from a Trust or SPV should continue to follow the regular amortized cost accounting within SSAP No. 26R, as they do not have prepayment or extension risk. Therefore, the modified amortized cost within SSAP No. 43R is not appropriate, as there is no need to update prepayment and extension assumptions as required under SSAP No. 43R. Examples include but are not limited to 1) where there is a direct guarantee from a corporate or government entity (e.g., certain Issuer Obligation Municipal Bonds), even if the security is issued from a Trust or SPV for legal or other reasons (i.e., an otherwise qualifying SSAP No. 26R security, with the exception of being issued from a Trust or SPV) or 2) project finance investments which are typically issued from an SPV. Many insurance companies currently report these securities as SSAP No. 26R investments. Interested parties and many others as well (industry, regulators, SVO, and NAIC staff) believe these are Schedule D bonds where regular amortized cost accounting is appropriate.

Indeed, interested parties continue to question whether the presence of a Trust or SPV should form any part of an accounting classification. In many deals the trust nomenclature may appear, when in fact there is no separate trust entity. The term SPV is even more ambiguous, as there is no commonly accepted definition. There are many regulated businesses, non-for-profit corporations, and other entities that by law, regulation or charter are established and exist for a single purpose. Are these SPVs? There is no easy answer.

Any use of the terms Trust or SPV, to segregate for purposes of accounting or scoping, would require that they be defined with sufficient clarity to both reflect the substance of these terms and ensure that any such new standard is operational, including the appropriate accounting treatment with no unintended consequences.

Even if Trust and SPV can be defined with some precision, business entities will continue to evolve. In Section 5 of the Issue Paper, it is suggested that reporting entities should know to classify CEF Debt within the scope of SSAP No. 43R "due to the presence of the trust structure". However, most closed end funds are corporations, and there has been no reason to classify their debt as anything other than within the scope of SSAP No. 26R (e.g., there is no prepayment or extension risk). This example highlights the difficulty of making the type of issuing entity a decisive factor for accounting classification.

Ultimately, if the SAPWG determines all securities issued from a Trust or SPV should be included within the scope of SSAP No. 43R, it is imperative that both sufficient scope clarity be developed and all bonds with no prepayment or extension risk, even if issued from a Trust or SPV, receive the appropriate accounting (i.e., regular amortized cost accounting). It is therefore premature for the Issue Paper to suggest any class of security should utilize lower of amortized cost or market accounting, based on whether it meets some components of a somewhat arbitrary or ambiguous definition, without providing an appropriate rationale for doing so.

Section 2 – Defining Asset Backed Security

Overview of Key Concepts:

- The issue paper proposes use of the CFR definition for asset-backed securities as a general principle concept for determining scope of SSAP No. 43R. Securities that do not meet the CFR ABS definition will be required to be separately discussed and scoped into the Statement (as applicable).

- Use of the CFR ABS definition clarifies that the general premise of an ABS security is one that is satisfied primarily through receivables and financial assets held in trust that, by the terms of those assets, convert to cash over a finite time period. This definition prevents use of this classification as a means to convert equity instruments into debt instruments, as equity instruments could not be captured in a trust and used as the primary source of repayment for an issued "debt" security as it would not meet the requirements of the ABS definition.

Questions / Comments:

- Are there concerns with the use of the CFR ABS definition as the general principle concept for SSAP No. 43?

- It is expected that PPNs, CFOs and other instruments where the cash flows used to pay the ABS security are not fully contingent on interest and principal payments on assets held in trust would not be considered CFR ABS securities. Comments are requested on whether this assessment is correct, or if these items could qualify as CFR ABS securities.

- Comments are requested on the securities that have historically been captured within scope of SSAP No. 43R that will not meet the CFR ABS definition that should be considered for inclusion in scope of SSAP No. 43R. (Principle concepts for these securities are requested.)

Interested parties' comments on this section of the Exposure are as follows:

As discussed in the preamble to this letter, interested parties believe all bonds should be reported on Schedule D while applying either SSAP No. 26R or 43R accounting, as appropriate. Investors, the capital markets, and US GAAP define bonds regardless of how the underlying cash flows are generated to pay the principal and interest (e.g., CFOs with underlying equity, leases, EETC/ETC bonds, cash flows that may vary based on volume, etc.). When determining which SSAP to apply, interested parties believe SSAP No. 43R should be applied if the instrument is an ABS that has prepayment and/or extension risk; otherwise SSAP No. 26R should be applied. Although an approach such as using the 1933 Act Definition (or, alternatively, the 1934 Act Definition as proposed in our letter) along with a set of principles as the anchors for the scope of assets in SSAP 43R may be reasonable, we believe there is a simpler way to meet the objective of reasonably identifying ABS. For example, instead of using the 1933 Act Definition or 1934 Act Definition, it might be less complicated, and would avoid the drawbacks inherent in those definitions, if SAPWG developed a cohesive set of principles for ABS (independent of the securities law definitions). These principles would be less difficult and onerous for insures to apply than either of the securities law definitions. It would also simplify matters considerably if inclusion within the scope of SSAP No. 43R did not depend in any way on whether the security was issued from a Trust or SPV.

Interested parties believe that the scope of SSAP No. 43R should follow the original design for modified cost accounting and aim to include securities with prepayment or extension risk. In addition, another consideration for inclusion in scope of SSAP No. 43R may be if the investor has recourse only to the underlying collateral (i.e., is not a business) and has prepayment and/or extension risk. If a bond is issued and supported by a business, and does not have prepayment and extension risk, consideration should be given to accounting and reporting the bond under SSAP No. 26. The use of simplified principles would be less difficult to apply than the SEC definitions as discussed further below. However, should SAPWG elect to use either the 1933 Act Definition or the 1934 Act Definition, in conjunction with principles, we provide the comments and feedback below.

Question 1 above: Are there concerns with the use of the CFR ABS definition as the general principle concept for SSAP No. 43?

To answer this question, interested parties worked with two law firms to better understand what types of ABS are included in the 1933 Act Definition. Interested parties also performed an initial analysis ("deep dive") into our investment portfolios to begin identifying the types of investments reported as and accounted for as SSAP No. 43R investments as well as investments issued by a Trust or SPV that are reported as and accounted for as SSAP No. 26R investments. The analysis was performed by seven insurance companies with large investment portfolios. The analysis only "touched the surface" of identifying types of investments that must be considered as the rescoping of SSAP No. 43R moves forward (starting with this Exposure). Appendix II to this letter includes only the types of assets identified thus far and helps illustrate how complex the assets are, how many variations exist for the asset types, how difficult it is to determine if each asset meets the 1933 Act Definition or 1934 Act Definition and the amount of judgment involved in the analysis. While any scope determination will require an analysis at an individual asset level, with a significant amount of analysis related to each asset's own set of facts and circumstances, the newness of these definitions, combined with their shortfalls, has resulted in an incomplete analysis at this time.

As a result of the analysis with the law firms and the initial deep dive efforts, interested parties have the following observations:

1) If an SEC definition is to be used as an anchor for ABS within SSAP No. 43R, we do not recommend that the 1933 Act Definition be used; rather, the 1934 Act Definition should be used. We believe this is a more appropriate definition for the following key reasons as also discussed in the preamble to this letter:
    a. The intended use of the 1933 Act Definition was to determine the manner in which an ABS may be offered to potential investors and the amount of information provided to investors (e.g., registered through a more simplified S-3 registration form versus a longer S-1 registration). It was not intended to identify the entire population of investments that investors and the capital markets consider to be ABS.
    b. The more widely used definition of an ABS is contained in the 1934 Act Definition and was relied upon by Congress for the Dodd-Frank Act to determine which ABS issuances must comply with the risk retention rules. That means the 1934 Act Definition was more recently evaluated, versus the 1933 Act Definition, and determined to be an appropriate definition of ABS.
    c. The key types of ABS that are included in the 1934 Act Definition and not in the 1933 Act Definition include the following, which are considered by investors in the capital markets to be ABS securities:
        i. CLOs that do not have a static pool of assets (i.e., the underlying loans are managed), which is a very significantly sized asset class in the ABS market. Those CLOs where the underlying loans are set at inception (i.e., new assets are not purchased during the life of the CLO) are in scope of the 1933 Act Definition.
        ii. ABS offered in private placements or 144A offerings, for which the 1933 Act Definition has no relevance, as it applies in the context of registration requirements.

   iii. ABS registered for public offer using the SF-1 or S-1 (because the assets being securitized do not satisfy the asset-type limitations set forth in the 1933 Act Definition).

d. Interested parties note that residual asset risk is discussed in both the 1933 Act Definition and 1934 Act Definition and both allow for a similar degree of residual asset risk. Residual asset risk is discussed further in section 5f of this letter.

2) However, if the 1934 Act Definition were to be used as the anchor, we would recommend one modification to the 1934 Act Definition. The 1934 Act Definition has verbiage in it that an asset is in scope only if some of the tranches issued by the securitization are owned by a third-party unrelated to the issuing entity. We understand that the purpose of this verbiage was to clarify that, in the situation where a securitization is sponsored by a company and the tranches issued by the securitization were 100% owned by the company and its related parties, the risk retention rules were not required to be applied. This seems appropriate as risk retention would not be applicable in that situation given all securities issued by the securitization were retained by the sponsoring entity and its related parties. Because this language was solely related to risk retention rules, it is not relevant if the 1934 Act Definition is used to determine the scope of SSAP No. 43R investments and should not be included in any final revised SSAP.

3) As noted, if SAPWG's ultimate decision is that an SEC-related definition must be used, then we believe the 1934 Act Definition of an ABS should be used to identify those ABS that would qualify for SSAP No. 43R reporting and accounting. The focus of the 1933 Act Definition is on which types of ABS are eligible to use the SF-3 registration form. Whether a security is in scope of SSAP No. 43R should not hinge on what registration statement a publicly offered security can use. To apply such a rule to a security issued in a private placement or pursuant to Rule 144A, one could ask the hypothetical question – would the security have been eligible to use the SF-3 registration form? Having the scope of a security under SSAP No. 43R dependent on the answer to such a question makes little sense to interested parties. Among the advantages of the 1934 Act Definition is that it was intended to apply to registered and unregistered securities alike. As a result, any investment that meets the 1934 Act Definition should be in scope of SSAP No. 43R regardless of whether it is registered with the SEC for public offering. Also, we are aware of certain ABS investments issued in loan form that would in all other respects conform to the 1934 Act Definition. Interested parties believe these should also be in scope of SSAP No. 43R.

4) In discussions with NAIC Staff, interested parties understand that one of the objectives of anchoring the SSAP No. 43R scope on the 1933 Act Definition of an ABS is to ensure that only NRSROs Registered for ABS are eligible to issue ratings for ABS purchased by reporting entities. If so, then this reflects a misunderstanding of the SEC's regulation of NRSROs. Rating agencies need ongoing approval from the SEC to maintain NRSRO status. However, no NRSRO needs the SEC's *approval* to rate any type of ABS, CFR or otherwise. The SEC makes available to NRSROs a voluntary system of registration, under which NRSROs can be recognized as having specific expertise to rate bonds of certain types (such as corporate bonds or ABS) or issued by certain types of entities (such as insurance companies or government organizations). Why do some NRSROs go through the arduous process of obtaining and maintaining this registration? First, there is a perceived marketing advantage. Second, in those instances of federal law that require ratings, the rating letter is usable by the holder only if issued by the NRSRO with the corresponding registration. An NRSRO without the registration is free to rate the deal, but for federal law purposes, the NRSRO's work product is just a credit opinion. In practice, NRSROs that are not registered with the SEC to rate ABS are typically not chosen by issuers to rate widely syndicated, publicly registered offerings of plain vanilla ABS. But issuers of any other ABS, such as ABS issued in 144A offerings, may well choose any NRSRO, particularly if the targeted purchasing base does not need any rating benefit under federal law.

Thus, narrowing the definition of ABS cannot be relied upon to shut out NRSROs that are not NRSROs Registered for ABS. Instead, the insurance regulations would need to state that only ratings from NRSROs Registered for ABS are usable by reporting entities.

Therefore, interested parties do not believe that there is a strong argument to limit the SSAP No. 43R scope definition to only the 1933 Act Definition due to its linkage to NRSRO registration status. The scope could be expanded to the 1934 Act Definition without any consequence regarding NRSROs.

Interested parties would be open to discussing the possibility of limiting Filing Exemption (limiting Filing Exemption is discussed in paragraph 35 of the Exposure) for securities that meet the 1934 Act Definition and/or the Four Principles (Four Principles are listed in paragraph 33 of the Exposure) to only those ABS that are rated by an NRSRO Registered for ABS, if SAPWG believes that only ABS that are rated by an NRSRO Registered for ABS should get such designation. If an investment ends up in scope of SSAP No. 43R only because it has been issued by a Trust or SPV, its Filing Exempt status should not be impacted by whether the CRP rating is from an NRSRO registered for ABS. The requirement that a rating be from an NRSRO Registered for ABS should only be applied to ABS.

Question 2 above: It is expected that PPNs, CFOs and other instruments where the cash flows used to pay the ABS security are not fully contingent on interest and principal payments on assets held in trust would not be considered CFR ABS securities. Comments are requested on whether this assessment is correct, or if these items could qualify as CFR ABS securities.

Interested parties have included in Section 5e of this letter, comments related to PPNs.

Regarding debt tranches of CFOs, Interested parties believe such investments should be reported on Schedule D as bonds and be afforded regular amortized cost under SSAP No. 26R accounting when the debt tranches issued from a CFO have adequate protection such as overcollateralization, significant diversification, reserves, liquidity facilities, etc. to ensure they perform like debt, as discussed in more detail in Sections 5c and 5d of this letter.

Some CFOs are originated through self-securitizations on the part of insurers (e.g., Schedule BA assets securitized with tranches from the securitization being sold to unrelated third parties and/or to affiliates of the insurer, including those affiliates that are not in the ownership stack of the insurer, and/or with some tranches retained by the insurer that initiated the securitization). As discussed in our 2019 interested parties comment letter, we believe if the sale criteria in SSAP No. 103R are met and the transaction is compliant with SSAP No 25, sale accounting should be applied. That is, the original Schedule BA assets would be removed from the insurer's financial statements and the debt tranches issued from the Trust or SPV would be reported and accounted for as Schedule D bonds by any debt tranche investor. Our 2019 interested parties comment letter also discussed that these types of transactions, and other self-securitizations, are used by insurers for important business reasons (e.g., provides the ability to change the risk profile, economics and cash flows in its insurance and non-insurance companies; prevents the need for insurers to sell assets to unrelated third parties in an inefficient private market; enhances liquidity for the underlying pool of assets, etc.). When an insurer purchases some of the tranches from a self-securitization, that insurer has changed the risk profile and the expected cash flows significantly from the original Schedule BA assets. Therefore, the newly issued debt tranches from the self-securitization should be accounted for and reported as if the insurer purchased the tranches in the secondary markets (i.e., Schedule D reporting and bond accounting).

Interested parties note that the term "RBC arbitrage" has been used when referring to some self-securitization transactions, which some view as having a negative connotation. Interested parties believe that when sale accounting is achieved in compliance with SSAP No. 103R and the transaction is compliant with SSAP No. 25, the transaction should be considered acceptable and any change in the related RBC risk should be considered appropriate. As a result, we believe that though such acceptable transactions result in "RBC optimization" (i.e., compliant with SSAPs 103R and 25; the risk and cash flows have been changed from the original Schedule BA

Assets), they are legitimate transactions for legitimate business purposes. Interested parties view RBC arbitrage to be a situation where the transaction is not compliant with SSAP No. 103R or SSAP No. 25, yet the insurer reports and accounts for the transaction as if it were compliant. We provide a more detailed explanation and examples of self-securitizations in our 2019 letter.

Interested parties have included in Appendix II a list of investments that have traditionally been included in either the scope of SSAP No. 26R or SSAP No. 43R that may or may not meet the definition of an ABS either under the 1933 Act Definition or the 1934 Act Definition. It is very important to note that, when working with the two law firms, we experienced first-hand how difficult it is to apply the 1933 Act Definition and the 1934 Act Definition and how time consuming both initially and on-going it would be to identify assets in or out of scope. In many cases, whether an asset meets either definitions involves a significant amount of judgment (no bright line tests exist) and detailed analysis of each asset's own set of facts and circumstances. We found it not uncommon for one prominent law firm to conclude that a bond is in scope of one of the definitions, while another leading law firm concludes that the bond is not in scope (inconsistent conclusions). The 1933 Act Definition and 1934 Act Definition have been interpreted for many years by legal firms and the SEC, and there is significant judicial interpretation related to scope. We also found that the analysis required to determine if an asset is in scope would likely not be simple for an insurer to perform without the assistance of outside counsel. This list was the result of an initial deep dive we performed on our investment portfolios. In all cases, we believe the asset types listed should be reported and accounted for as bonds on Schedule D because they are considered bonds in the capital markets, by investors and by the FASB (under the Uniform Commercial Code definition). We believe more work would be needed to evaluate our investment portfolios to identify additional asset types, especially if any security issued from a Trust or SPV is to be included in SSAP No. 43R. We recommend SAPWG and industry work closely together to determine how simplified principles, if this path is chosen, may be developed to include such investments in Appendix II. Other investments will also need to be analyzed as appropriate decisions will need to be made on whether such securities get SSAP No. 43R accounting or SSAP No. 26R accounting if they do not have prepayment or extension risk. As noted in the first paragraph of this section of our letter, we believe an even more simplified approach to identify the scope of SSAP No. 43R assets could be used to accomplish the same key objectives in the Exposure

Question 3 above: Comments are requested on the securities that have historically been captured within scope of SSAP No. 43R that will not meet the CFR ABS definition that should be considered for inclusion in scope of SSAP No. 43R. (Principle concepts for these securities are requested.)

See comments already provided above.

Section 3 – Accounting and Reporting for Asset Backed Securities

Overview of Key Concepts:

- All CFR ABS (as defined) will be addressed in SSAP No. 43R.
- Each ABS rated debt tranche shall be separately reported for accounting and RBC. (This requires bifurcation of combination notes or other structures where ABS tranches have been combined to form a new security.)
- Tranches reflecting residual tranches / equity classes will be addressed in SSAP No. 43R, but the guidance will require reporting of these tranches on Schedule BA at the lower of amortized cost or fair value. Guidance is proposed to clarify the subsequent reporting of this tranche, particularly for OTTI, investment income, and return of investment.

Questions / Comments:

- Are there concerns with including all CFR ABS (as defined) in scope of SSAP No. 43R and allowing for the rated debt tranches of these instruments to generally follow historical accounting / reporting guidance? This guidance determines measurement method based on CRP rating (as permitted by the P&P Manual) translated to the equivocal NAIC designation.

- Should there be guidance that provides differing accounting and reporting treatment based on whether the CFR ABS is a "common" or "broadly syndicated" structure? Is the current collateral codes sufficient to identify new categories of SSAP No. 43R securities?

- From preliminary information received, all insurer-holders of combination notes should have the information necessary to bifurcate and separately report individual tranches. (As this is necessary to properly assess cash flows under the existing requirements of SSAP No. 43R.) However, specific investments details are requested if this is a concerning element.

- Are there concerns with guidance specifying that the residual / equity tranches shall be reported on Schedule BA, on a dedicated reporting line, with a lower of amortized cost or fair value measurement method?

Interested parties' response to 19-14 Section 3 questions below:

Question: Are there concerns with including all CFR ABS (as defined) in scope of SSAP No. 43R and allowing for the rated debt tranches of these instruments to generally follow historical accounting / reporting guidance? This guidance determines measurement method based on CRP rating (as permitted by the P&P Manual) translated to the equivalent NAIC designation.

Yes. We agree that ABS meeting the 1933 Act Definition of ABS should be included in the scope of SSAP No. 43R. However, as detailed in our responses to the questions in Section 2, the definition of ABS used in the 1933 Act is very narrow and would only capture a subset of investments that should be included in the scope of SSAP No. 43R. Therefore, if SAPWG concludes that a securities law definition must be used, we recommend the 1934 Act Definition of ABS be used in place of the 1933 Act Definition. However, we believe broad principles that capture what the marketplace generally considers to be ABS to be more appropriate.

Question: Should there be guidance that provides differing accounting and reporting treatment based on whether the CFR ABS is a "common" or "broadly syndicated" structure? Is the current collateral codes sufficient to identify new categories of SSAP No. 43R securities?

Without clearly knowing the definition of "common" and "broadly syndicated," it is difficult to completely answer this question. That is, are these terms referring to the underlying assets held in a Trust or SPV for the ABS or do they refer to the ABS itself (i.e., investors in the issued ABS)? In the context of this Exposure, we assume that it related to the underlying assets of an ABS. However, broadly syndicated usually means that the ABS itself has been marketed to a wide range of potential investors. We recommend these terms be clearly defined. Or, as mentioned in the preamble of this letter, are these terms being used to differentiate between affiliated and nonaffiliated transactions?

Assuming these terms relate to the underlying assets in the Trust or SPV of the ABS, if the structure meets the definition of an ABS, we do not believe the accounting and reporting treatment should be different. That is a look-through approach to the underlying assets in the ABS, as discussed in other sections of this letter, is generally not appropriate.

Assuming these terms relate to the ABS debt issued by a Trust or SPV, for securities that meet the relevant definition of ABS, we do not believe the accounting and reporting treatment should be different based on whether they are "common" or "broadly syndicated". Interested parties note that accounting methods are not determined, in either U.S. GAAP or elsewhere in Statutory Accounting, based on whether an investment is "common" or "broadly syndicated".

Regarding whether the current collateral codes are sufficient to identify new categories of SSAP No. 43R securities, we believe we are too early in this process to properly assess whether those collateral codes are sufficient. As we progress further through this process, we will be able to provide more clarity on our views as to whether additional collateral codes will be necessary.

Question: From preliminary information received, all insurer-holders of combination notes should have the information necessary to bifurcate and separately report individual tranches. (As this is necessary to properly assess cash flows under the existing requirements of SSAP No. 43R.) However, specific investments details are requested if this is a concerning element.

Paragraph 29 of the Exposure requires the various underlying tranches of a combo note (or other structure) to be separately reported with the NAIC designation that is attributed to the rating for the specific tranche (not the rating for the overall combined instrument). We have concerns with what may be included in the undefined "other structure." Footnote 7 of this paragraph appears to suggest that combo notes and other ABS structures, like ABS squared, are similar. This is not true. A combo note combines various tranches of a one or more ABS and issues a single tranche. Whereas an ABS squared is an ABS that has underlying debt tranches of ABS as the underlying assets in the Trust or SPV, from which the Trust or SPV then issues multiple debt tranches.

While we do not think it would be difficult to obtain information necessary to bifurcate and separately report individual tranches of a combo note, it most likely would be a manual process, which creates unnecessary operational burden for insurers. However, for securitizations, such as collateralized debt obligations (CDOs), which utilize tranches of other ABS to create a new CDO (e.g., CDO squared), we believe it would be inappropriate for the CDO, or similar securitizations, to be bifurcated as the securitization is a new securitization for which it would be impossible to unwind.

Question: Are there concerns with guidance specifying that the residual / equity tranches shall be reported on Schedule BA, on a dedicated reporting line, with a lower of amortized cost or fair value measurement method?

Most reporting entities interpret the U.S. GAAP accounting guidance to require most residual interests of securitizations be reported as bonds. We would not want to create an unnecessary GAAP to Statutory difference by classifying residual debt tranches as equity. Currently there is diversity in practice how insurers report residual tranches. Some insurers report residual tranches on Schedule D, while others report these on Schedule BA. However, the general consensus is that residual tranches of an ABS are bonds and accounted for in accordance with SSAP No. 43R. Interested parties would not object to reporting the residual tranche of an ABS in a dedicated section of Schedule BA-Bonds provided that the accounting remains consistent with SSAP No. 43R, the assets are deemed admitted assets to the extent they conform to the requirements within the statement, and the RBC is the same as reporting the investments on Schedule D (for both Life and P&C companies). Additionally, availability of audited financial statements should not impact admissibility of residual tranches of an ABS.

Section 4 – Accounting and Reporting for Non-CFR ABS (Traditional Securitizations)

Overview of Key Concepts:

- This proposes four principle concepts to identify securities that are principally similar to CFR ABS securities. If the four principles are met, this guidance proposes to have the securities treated in SSAP No. 43R as if they were CFR ABS.

- The proposed guidance suggests restricting CRP ratings to these securities to the NRSROs that are SEC registered for CFR ABS. *(This change would have to be addressed by the VOSTF and captured in the P&P Manual.)*

- Similar to the CFR ABS, each rated debt tranche shall be separately reported for accounting and RBC. (This requires bifurcation of combination notes or other structures where ABS tranches have been combined to form a new security.)

- Also, similar to CFR ABS, the residual tranche / equity class will be addressed in SSAP No. 43R, but the guidance will require reporting of this tranche on Schedule BA at the lower of amortized cost or fair value. Guidance will be drafted to clarify the subsequent reporting of this tranche, particularly in the recognition of OTTI, investment income, and return of investment.

Questions / Comments:

- Are there comments with the four proposed principles and whether they will successfully identify securitizations that are principally similar to CFR ABS?

- Will these principles capture a significant majority of the non-CFR ABS that reflect traditional securitizations? If not, what elements would disqualify those securities?

- Will these principles include securities that go beyond the intent for "traditional securitizations" and if so, what aspects would permit these securities?

Interested parties have the following comments related to the Four Principles ("Principles"). The following is intended to provide comments related to the three questions posed above in the Exposure.

In summary, we would like to work closely with SAPWG in further developing the Principles and believe more simplified principles may be developed and used instead of a combination of the Principles and one of the securities law definitions (i.e., 1933 Act Definition or 1934 Act Definition). As noted in Section 2 of our letter and as illustrated in Appendix II, we believe the many different types of debt investments should be reported as bonds and accounted for under either SSAP No. 43R or SSAP No. 26R. That is, all would be reported for and accounted for as Schedule D bonds; however, the SSAP would determine if they qualify for regular amortized cost or modified amortized cost accounting based on whether they are ABS subject to prepayments or extensions.

The Exposure sets forth the Principles that may be leveraged to identify investments in scope of SSAP No. 43R. Those Principles include investments issued by a bankruptcy remote entity, where the underlying collateral is self-liquidating (has contractual cash flows), the underlying collateral has more than a single obligor, and the securitization provides periodic performance reports to investors. The Exposure proposes that although some investments may not meet either the 1933 Act Definition or the 1934 Act Definition, they would still be in scope of SSAP No. 43R and be filing exempt, if they meet the Principles. As noted above and in the following paragraph, we believe that the Principles should be revised, if they are used in a final SSAP, to include a broader range of assets with predictable cash flows.

Interested parties believe that the 1934 Act Definition is a better starting point than the 1933 Act Definition, although we note that some investments falling outside the 1934 Act Definition are widely and properly viewed as ABS (e.g., are considered ABS by investors and the capital markets). We believe the use of Principles to capture and identify such investments (paragraph 33 of the Exposure) may be a reasonable approach. However, as currently proposed, the Principles are too limiting in that they would unintentionally exclude various types of assets, which should be considered ABS, that are discussed below. We recommend SAPWG and interested parties work closely together to develop the appropriate Principles; however, we offer a few recommendations thus far (not necessarily all inclusive as more work is needed to appropriately define the Principles) to more closely align the Principles with the definition of an ABS as follows:

a. Interested parties note that both the 1933 Act Definition and the 1934 Act Definition include securities whose underlying collateral is backed by a single obligor. As a result, interested parties recommend the Principle requiring more than one obligor be removed to align the Principles more closely with the 1933 Act Definition and the 1934 Act Definition. Interested parties note that at least half of all commercial mortgage-backed securities ("CMBS") issued today have underlying collateral (a commercial mortgage loan) from only a single obligor. All of these single-asset CMBS deals are ABS that meet the 1933 Act Definition and 1934 Act Definition. To require more than one obligor in the Principles would be inconsistent with this. Interested parties also believe single obligor transactions in ABS markets may grow in the future (e.g., Property Assessed Clean Energy; PACE bonds).

b. The 1934 Act Definition requires that the underlying assets be self-liquidating. Certain assets with variable future cash flows (i.e., future flow assets), such as royalties (e.g., where the cash flow generated is a function of volume and/or sales price) may be perpetual in nature and hence not self-liquidating. Our interested parties comment letter would recommend that these be considered ABS under SSAP No. 43R, because the capital markets consider them to be ABS, which are debt, and they are reported as debt for US GAAP. If they are not in scope of SSAP No. 43R (e.g., no prepayment/extension risk), then they should be in the scope of SSAP No. 26R bonds. They also provide various forms of protection (such as over collateralization ranging from 50-60%), resulting in them being debt-like.

c. ETCs/EETCs were not considered when the SEC defined ABS under the 1933 Act Definition or when Congress defined ABS under the 1934 Act Definition. As a result, they do not fall in scope of either Act. Interested parties believe such investments should be reported as Schedule D bonds as discussed throughout our letter.

d. Regarding debt tranches of CFOs, as mentioned in Section 2 of our letter, we believe they should be reported as Schedule D bonds and apply "regular" amortized cost accounting. They are debt in that they have fixed return of principal, are considered debt in US GAAP, and are considered debt by investors and capital markets.

e. Both the 1933 Act Definition and the 1934 Act Definition include assets with re-leasing risk. As a result, we believe the Principles should be modified to clarify that this is permissible. This concept is more thoroughly explored in Section 5f of our letter.

f. Regarding residual asset risk, also more thoroughly explored in Section 5f or our letter, we believe this should not be relevant when determining the classification of bonds.

Section 5 – Accounting and Reporting for Non-CFR ABS and Non-Traditional Securitizations

Overview of Key Concepts:

- This section attempts to identify the types of structures that have been reported in scope of SSAP No. 43R.

Questions / Comments:

- Are there additional structures that are not captured in the noted categories?

As noted in section 2, interested parties are currently in the process of identifying securities issued from a Trust or SPV that do not meet the definition of either the 1933 Act Definition or 1934 Act Definition. This is a daunting task as the volume of SSAP No. 43R securities that need to be analyzed is substantial. Further, because the Issue Paper implies that anything issued from a Trust or SPV is proposed to be within scope of SSAP No. 43R, this analysis needs to be extended to a substantial amount of securities currently accounted for and reported under SSAP No. 26R.

Further, whether the 1933 Act Definition or 1934 Act Definition is utilized as the cornerstone of a new SSAP No. 43R, each definition has hundreds of pages of judicial interpretations, etc. that need to be sorted through. With that said, while the identification of such securities is discussed in our response in Section 2, there are often differences in how companies report such securities. For example, most companies report project financing securities and CFO-like securities under SSAP No. 26R while some report under SSAP No. 43R.

Quite possibly, the most important part of the interested parties' response to the Exposure, is the Appendix II included at the end of our letter as well as discussed in section 2 of this letter. Appendix II highlights a preliminary list of securities (e.g., any security issued from a Trust or SPV, inclusive of existing SSAP No. 26R securities) many of which interested parties do not believe meet the scope of either the 1933 Act Definition or the 1934 Act Definition. It is important to note that this is only an initial attempt at identifying securities by interested parties after a deep dive into insurers' investment portfolios. As this was a very significant effort, it illustrates how complex, time-consuming, and difficult it is to evaluate investments issued by a Trust or SPV to determine if they meet the 1933 Act Definition or the 1934 Act Definition. Much of the analysis involved an individual asset-by-asset assessment that took a significant amount of time for insurers to perform. Many more hours of analysis would be required to identify all investments issued by a Trust or SPV to determine classification in accordance with the Exposure. Even after interested parties' efforts, there is still significant uncertainty about what asset classes qualify, and often the answer is "it depends."

In order to determine appropriate principles for ABS beyond those included within these definitions, it is imperative that many issues be addressed before attempting to develop principles to capture within scope any securities issued from a Trust or SPV. These issues and the necessary steps are summarized at the beginning of this letter.

With respect to using any SEC definition as a cornerstone, two other issues will need to be addressed.

First, does the definition used incorporate both existing and future SEC interpretations as to whether a security-type meets the definition? Without incorporating existing and future interpretations, additional clarification would be needed for statutory accounting purposes, even if further principles are developed. Regulators and industry would otherwise be left with significant uncertainty as to scope. At a minimum, the NAIC would need to develop similar interpretative guidance which would likely be both voluminous and require continual update to keep pace with market evolution.

Second, the 1934 Act Definition, by its design, encompasses both registered and unregistered securities. The 1933 Act Definition is technically for securities that are registered with the SEC. Many 144A securities or private placement debt securities would meet this definition, but are not registered with the SEC. Therefore, any such scope utilizing the 1933 Act Definition, would need to ensure this distinction is made; that is, any security, whether registered with the SEC or not, is within the scope of SSAP No. 43R if it meets this definition. However, interested parties reiterate that the 1934 Act Definition is more appropriate for statutory accounting if a SEC cornerstone is to be adopted.

Section 5a – Accounting and Reporting for Non-CFR ABS and Non-Traditional Securitizations – One Underlying Obligor

Overview of Key Concepts:

- This section addresses items that are issued through a trust / SPV but that are collateralized by a single obligor.
- If the underlying investment held in trust would qualify as a bond if held directly, the proposed guidance would retain historical accounting and reporting guidance.
- If the underlying investment would not qualify as a bond if held directly, the guidance proposes to require the underlying investment to be reported under the applicable SSAP. With this guidance, use of a trust / SPV could not be used to capture non-qualifying items on the bond schedule (such as structured notes or collateral loans).
- Pursuant to comments received, some entities may consider investments from trusts / SPV that would be captured in Section 5c or 5d of this issues paper (impacted by performance of equity investments held in trust) as bonds. These items are not intended to be captured within this "one obligor" guidance and shall be captured in Section 5c or 5d.

Questions / Comments:

- Are there comments with the proposed guidance / scope of section?
- Is the guidance in paragraph 39a sufficient to exclude investments that rely on the performance of underlying equity investments (e.g., CFOs and other structures) from the scope of the "one-obligor" provisions?

Interested parties have the following comments and observations regarding single obligor transactions issued from a Trust or SPV:

a) The beginning of Section 5a, paragraph 37 states that "the general concept of a securitization is that the security is collateralized by contractual obligations from many diverse payers. If the structure … has only one underlying obligor … then the structure does not fit the criteria for a traditional securitization."

   The original concept of securitization was the transformation of financial assets – not in themselves securities – into securities. The transformation was accomplished by transferring ownership of financial assets to a discrete entity, which would issue securities backed by the assets it owned. In this way receivables, loans, leases, mortgages and other financial assets with contractual cash flows were "securitized".

Even in the early years of securitizations, however, there were deals involving single underlying obligors. There were also deals where a single asset (usually a receivable) was the subject of a securitization. These deals made sense because it was possible for the purchaser to perform its own underwriting on the credit of the underlying obligor.

SEC guidance on the 1933 Act Definition and the 1934 Act Definition indicates that each definition recognizes single obligor deals as ABS. A brief look at the current CMBS market illustrates this: approximately half of recent issuance in the CMBS markets consists of deals with a single commercial mortgage as the underlying collateral.

Interested parties do not understand the apparent discomfort with single obligor ABS deals. In particular, we see no reason why these particular transactions merit the treatment indicated in paragraph 41, in which potential eligibility for Filing Exemption would be determined by reference to the P & P Manual.

b) In addition to ABS transactions that involve a single underlying obligor, there are many other transactions involving both (i) issuance from a Trust or SPV and (ii) a single obligor.

Notable examples include ETCs, EETCs and conforming CTLs, where debt is serviced via a pass-through of contractual lease payments made by the lessee for use of either real property or equipment. In these structures, all debt service payments enjoy a contractual claim to a corporate payor (via a lease or similar obligation). Unlike traditional ABS structures, there is no uncertainty around the timing of debt cash flow repayment. Since there is no prepayment or extension risk associated with these structures, reporting requirements are usually just corporate financial reporting requirements with no "servicer reports" to track performance as typically provided in most ABS structures. Therefore, these transactions behave like corporate bonds that also have an additional benefit of being secured by valuable collateral (equipment and/or real property), and we believe they should be accounted for as such in SSAP No. 26. However, if SAPWG elects not to move these transactions back to SSAP No. 26R, then these securities will need to be addressed separately in SSAP No. 43R, as they do not necessarily meet either the 1933 Act Definition or the 1934 Act Definition; nor do they meet all of the Four Principles, as set forth in the Issue Paper.

In short, both ABS and non-ABS transactions often involve (i) issuance from a Trust or SPV and (ii) a single obligor (collectively, "Single-Payor Securitizations"). Interested parties do not believe that Single-Payor Securitizations need to be subject to special rules or guidance from the P&P Manual in order to be Filing Exempt. Rather, we believe the following types of asset classes, which have historically enjoyed Filing Exempt status, should continue to retain Filing Exempt status. Such Single-Payor Securitizations include, but are not limited to, ETCs, EETCs, Project Finance, and certain Issuer Obligation Municipal Securities, as well as ABS under both the 1933 Act Definition and the 1934 Act Definition.

While no explicit rationale was offered up in Section 5a on why Single-Payor Securitizations should not be filing exempt, other than a premise in paragraph 37 which interested parties believe is inaccurate, Interested parties understand that NAIC staff concerns potentially stem from affiliated transactions that fail to meet true sale criteria and could result in RBC arbitrage if the proper accounting is not followed, especially as they relate to "equity-related" structures. We believe these concerns are already addressed (or will be addressed) as follows:

1. Part III of Section 17 already requires the filing of all investments in SCA entities – "SCA investments are transactions between insurance company affiliates (called related parties) that are subject to special regulatory considerations identified in *SSAP No. 25—Affiliates and Other Related Parties*. This Manual specifies that such transactions are not subject to filing exemption and can only be assigned an NAIC Designation if the SVO has first concluded that the transaction is like

those the SVO typically assesses for credit risk." This determination should be (and is) being done with cooperation of the SVO, the insurance company, and the applicable regulator.

If this part of the P&P Manual does not include all types of affiliated transactions that are of concern (i.e., affiliated transactions are a subset of related parties), interested parties believe this should be addressed separately, rather than commingling the concern in SSAP No. 43R's scope determination. More specifically, interested parties note that the SVO's concurrently exposed project on Bespoke Securities also raises concerns on affiliated and related party transactions.

Interested parties also believe certain additional clarifications are warranted. For example, per the guidance in Reference No. 2019-03, many interested parties believe SCA transactions do not cover securities, where an insurer or one of its subsidiaries sponsors a securitization and the insurer purchases some of the tranches of that securitization, and where the securitized assets are non-affiliated assets. Interested parties agree with this interpretation but a definitive clarifying determination may be needed.

Lastly, both the 1933 Act Definition and the 1934 Act Definition include single obligor ABS within their scope, so there is no need to single them out in the exposure if the concerns are related to affiliated transactions as affiliated transactions already need to be filed with the SVO.

2. As noted in Section 2 of this letter, interested parties have provided clarifying guidance in our October 2019 comment letter that prohibits moving assets from one schedule to another (e.g., from Schedule BA to Schedule D), which could result in RBC arbitrage, if the transaction does not meet sale criteria. Our conversations with NAIC staff suggest they agreed with these clarifications and that they would eliminate such perceived abuses.

3. Further, in response to "equity-related" structure concerns, we have suggested further safeguards to ensure only regulator supported CFOs such as CEF Debt, and similar CFO-type structures, are afforded bond accounting and Schedule D reporting. The full details can be found in Sections 5c and 5d of this letter.

If the above do not fully address the NAIC concerns, interested parties request such additional concerns be more fully articulated so interested parties can help address them. There are many valid reasons for affiliated transactions that benefit both insurance companies and policyholders and therefore regulators as well. With that said, interested parties understand the unique nature of affiliated transactions and regulators' concerns that they can be subject to abuse; so, interested parties welcome further transparency on affiliated transactions.

c) Interested parties agree with the principle that the mere presence of a Trust or SPV, as issuer of a security, should have no bearing on whether the security itself is classified as a bond. We acknowledge that regulators are trying to be helpful in suggesting that historical accounting policy would apply if "the underlying investment held in trust would qualify as a bond if held directly".

By its premise, this key concept jumps forward to a time when the type of assets used in ABS structures has expanded far beyond the original set of financial assets that were not themselves securities. Originally, the items in trust (credit card receivables, motor vehicle leases) often were not even commonly viewed as investments, let alone securities. The ABS markets were, however, quick to innovate and expand upon basic securitization structures. One of the earliest and most notable examples would be commercial mortgages, the securitization of which has evolved into its own industry. Putting aside CMBS, only a subset of today's ABS issuance features underlying assets that insurers would commonly acquire as investments. The most notable example is CLOs, which are backed by loans rather bonds.

The look-through concept, however, has limited usefulness. If one were to look through the entities that issue single asset CMBS, an insurer might be required to account for the underlying commercial mortgage on Schedule B. Another example is “whole business securitization,” a widespread new type of ABS in which the securities issued are backed by key operating assets of a business. If one were to look through the structure to the underlying assets, under what SSAP could those assets be reported? As a separate example, the power produced by hydroelectric plants is often sold on a merchant (not contracted) basis. If a project finance deal for a hydroelectric facility were subject to the “look-through” analysis proposed in the Issue Paper, where would that facility sit on the insurer’s schedules? Taken to extremes, one can see where this approach calls into question the reporting status of billions of dollars of insurer’s assets, much of which has been considered a mainstay of insurers’ investment portfolios for decades.

Interested parties also note that the FASB generally does not look through to the underlying assets of a security. For example, FASB does not look through to the underlying assets in ABS structures.

d) In the Issue Paper, staff asked whether Section 39a is sufficient guidance to exclude investments that rely on performance from underlying equity investments from the single-payor category. Interested parties found the guidance to be confusing. Should staff wish to exclude CFOs and similar equity-supported structures from SSAP No. 43R, it would be better to reference such structures specifically, rather than referring to “the requirements of a bond” and thereby excluding ABS backed by contractual payment obligations, such as receivables of a single underlying obligor.

That said, interested parties believe that certain types of debt issued from a Trust or SPV that owns equity investments should, in fact, qualify as bonds, particularly those structures with significant overcollateralization. We would refer staff and SAPWG to Sections 5c and 5d of this response letter for more detail on that issue.

<u>Section 5b – Accounting and Reporting for Non-CFR ABS and Non-Traditional Securitizations – Collateral Not Owed by Many Payers</u>

<u>Overview of Key Concepts:</u>

- This section addresses items that do not qualify as a securitization due to the number of underlying payers. The key concern with these structures is that the use of a trust / SPV masks the underlying risk exposure. This is because the reduction of risk, which would generally be expected in a securitization with many payers, is not obtained.

- The proposed guidance would continue to permit the issued securities as debt instruments (if they qualify) in scope of SSAP No. 43R, but would require a lower of amortized cost or fair value measurement method regardless of the NAIC designation. Also, the guidance proposes to require the SVO involvement in determining the appropriate NAIC designation. (It also includes an alternative to permit only CRP ratings from NRSROs that are SEC approved to provide designations on asset-backed securities.)

<u>Questions / Comments:</u>

- The guidance proposed in this section is for all debt instrument securities that do not meet the “many” payee threshold. Are there securities that would not meet the “many” threshold, but would have more than a “limited” number of payees? Explicit examples of securities that would be characteristic of this dynamic are requested.

- Should amortized cost (and not LCOM) be permitted for certain investments that are captured in this section? Explicit examples and principle concepts to differentiate these securities are requested.

Interested parties share the following comments and observations regarding securitizations involving more than one, but fewer than many, payors:

a) We do not agree that the use of a Trust or SPV structure "masks the underlying risk exposure" of a security. The Trust or SPV structures used in the early types of securitizations have evolved and have become widespread in the financial markets. Trusts and SPVs are used so widely in finance, and indeed in business generally, that SAPWG should not place much, if any, weight on the presence of these vehicles. A Trust or SPV format is often used, as the owner of assets and issuer of securities, solely to enable the issuer to grant a security interest in the assets to debt investors ***on a bankruptcy-remote basis***. The bankruptcy remote position is viewed by debt investors as a benefit. This is the rationale behind the more recent iteration of "whole business securitizations".

   Nor do interested parties agree that structures with many payors are "preferred" for securitizations. As stated previously, the CMBS market demonstrates this. Approximately half of recent issuance in the CMBS markets consists of deals with a single commercial mortgage as collateral. These deals, often referred to as single asset CMBS, have the advantage (from an investor standpoint) of allowing the investor to scrutinize and assess the underlying asset in detail. The other half of CMBS issuance consists of diverse pools of commercial mortgages. These CMBS deals offer the benefits of asset diversification, offset in some cases by exposure to asset types that the purchaser of CMBS views as more of a detriment than a positive. Some investors invest in both types of CMBS; some invest in neither; some invest in one type but not the other. It is not possible to conclude that either type is "preferred".

b) The Issue Paper specifically asks if there are types of securities (other than affiliated transactions or RBC-arbitraging transactions) that are issued from a Trust or SPV which have more than one, but fewer than many, payors. Interested parties are aware of such transactions, but for the most part they have been executed in the bank markets. The typical transaction features a company that is not a strong credit, but which sells products or services to highly rated customers. The receivables generated from the company's sales of products or services are placed in a Trust or SPV structure, which in turn issues loans or securities. Only certain receivables are eligible. In practice, the bulk of the receivables might be payable by a small handful of key customers, often of higher credit quality. The structure gives the lender exposure to the better credits (the customers) while providing some insulation from a possible bankruptcy of the company. Our expectation is that only a subset of insurance companies will invest in these transactions; but we see no reason to exclude them in advance.

   We are also aware of at least one EETC transaction that would fit this description. It was the Air 2 US transaction, sponsored by Airbus, which had a mix of aircraft collateral in the SPV, some on lease to United Airlines, and some on lease to American Airlines. Airbus had previously provided financing support to those airlines, in order to facilitate the purchase of Airbus aircraft, and the manufacturer decided to exit its financing interests using an EETC structure. For all practical purposes, that deal behaved like a traditional EETC; however, it happened to have aircraft with two different airline obligors as opposed to one. This deal was a market-clearing capital markets transaction that had nothing to do with affiliated transactions or with arbitraging RBC requirements.

   Interested parties expect that transactions featuring just a few obligors will remain a relatively small universe going forward. We should note, however, that if the look-through approach is applied widely, many commonplace deals are subject to being recharacterized as having a few underlying obligors. For example, a deal issued by a sports league (which itself may be an unincorporated association) might have, as its primary underlying source of revenue, payments made under contracts with two national broadcasting networks.

c) The Issue Paper specifically asks whether amortized cost accounting (and not lower of cost or fair value) should be permitted for certain investments captured in this section. Interested parties note that it is difficult to generalize about the investments captured in this section. For most of these investments, interested parties believe that amortized cost accounting is appropriate. Rather than using the number of obligors to determine accounting treatment, interested parties believe that the nature of the investment (specifically, whether there is extension/prepayment risk, and whether the debt cash flows are likely to be serviced as contractually promised) should determine accounting treatment.

d) The Issue Paper proposes "to require the SVO involvement in determining the appropriate NAIC designation." Interested parties see no reason to deny Filing Exemption to these investments. As stated in other contexts, eligibility for Filing Exemption should be presumed, so long as the transactions are non-affiliated and are not designed for the purpose of RBC arbitrage (i.e., where sale criteria in SSAP No. 103R has not been met). As a practical matter, it would be very difficult to craft a definition that provides clear boundaries for "more than one, but fewer than many".

   The Issue Paper also contemplates an alternative option, where these transactions could be Filing Exempt, if they are rated by a CRP that is an NRSRO Registered for ABS. Interested parties are open to this alternative approach. Indeed, interested parties advocate defining ABS in a manner reflective of the wide range of ABS transactions in the market, and are open to discussing the possibility of limiting eligibility for Filing Exemption to ABS rated by a CRP that is a NRSRO Registered for ABS.

Section 5c – Accounting and Reporting for Non-CFR ABS and Non-Traditional Securitizations – Security Partially Impacted by Equity Collateral

Overview of Key Concepts:

- This section addresses items where the coupon payments, principal repayment and whether default occurs, is partially determined based on the performance of equity assets held in trust.
- Guidance identifies that these may be desirable investments, but are not debt instruments.
- The proposed guidance suggests alternative accounting and reporting treatment for these securities, suggesting new guidance in SSAP No. 48 or in a new SSAP.
- The information identifies that RBC may be the driving factor in reporting these investments on Schedule D-1.

Questions / Comments:

- Comments are requested on the different types of structures that would be captured within this category and if there are characteristics that are reflected in some structures that would support different accounting and reporting treatment from other structures in this category.
- Is there a different accounting / reporting approach that should be taken for these securities?

- If these items are excluded from Schedule D-1, what factors (e.g., asset coverage / over-collateralization, etc.,) could be considered in determining an appropriate RBC?

Regarding the following bullet points, as they relate to CFOs and similar structures;

- Comments are requested on the different types of structures that would be captured within this category and if there are characteristics that are reflected in some structures that would support different accounting and reporting treatment from other structures in this category.

Is it the intent to have the rule relate only to assets "held in trust", or is it more broadly related to debt backed by equity instruments? Interested parties do not understand why a definition of whether an instrument constitutes debt should depend on the type of business entity issuing the instrument. The staff note following paragraph 53 inadvertently highlights the pitfalls of this approach. There is a discussion of Closed-end Fund debt, some of which is issued by funds owning only equity securities. It is noted that some reporting entities classify these as bonds in SSAP No. 26R. Then a comment is made that NAIC Staff had expected such instruments to be captured in SSAP No. 43R "due to the presence of a trust structure". However, there is no trust structure as most closed end funds are corporations.

The regulatory concerns stated in Section 5c and 5d seem to have migrated from an understandable concern over instruments where the investor's contractual entitlement under the instrument directly depends on the performance of an equity security or index, to a much more sweeping concern over debt securities where the investor's practical ability to collect principal and interest is impacted in some general way by the "performance" of equity assets held by the issuer of the instrument. Interested parties understand the concerns over the former category, in which the instrument resembles, in some ways, a variable annuity. The latter category, however, could encompass a wide array of securities, particularly if the aspect of a Trust is discarded, and the rule is written to apply to instruments issued by any type of business entity. The following paragraphs will attempt to illustrate this.

Debt securities whose repayment is dependent upon equity ownership interests are common and have trillions of dollars of issuance outstanding. Debt securities whose repayment is dependent upon equity ownership are viewed by the SEC, capital markets, rating agencies, and accounting standards organizations (FASB and IFRS) as bonds. Examples of debt issued by corporations, limited liability companies, partnerships, trusts and other business entities whose performance is wholly, or partially based on the performance of equity instruments include:

<u>Holding Companies</u>: Holding company debt is prevalent. There are thousands of holding company debt issuers worldwide, including well known corporations such as Berkshire Hathaway, Alphabet, utility holding companies (e.g. DTE Energy or Alinta) or banks (e.g. JP Morgan or Barclays). These holding companies do not have operating businesses, but instead have ownership interests in subsidiaries, which can take the form of equity shares or partnership interests.

Often, debt issued by a holding company is not guaranteed by the holding company's subsidiaries. Instead, holding companies look to the equity of their subsidiaries to meet all holding company obligations. Subsidiaries can pay dividends to the holding company so the holding company can service its debt, for example. Alternatively, a holding company can sell equity interests in its subsidiaries and use the proceeds from the sales to service holding company debt. The SEC, capital markets, rating agencies and accounting standards organizations (FASB and IFRS) all view obligations for borrowed money at holding companies as debt. The Internal Revenue Service also recognizes such obligations as debt. (Indeed, insurers who purchase such obligations are often required to furnish a Form W-9, which is designed to give the IRS the practical ability to double check whether the insurer is accurately reporting the receipt of interest income on its federal tax return.). The fact that the assets of the holding company are equity does not cause debt obligations to be recast as equity. Obligations for borrowed money are debt, notwithstanding the fact that dividends made by a subsidiary to a holding company can only be paid to the holding company if the subsidiary is solvent. Dividends from subsidiaries are further restricted by financial covenants imposed by lenders to the subsidiary and by corporate law limiting dividend payments to those payable out of surplus. Holding companies issue both amortizing debt and bullet maturity debt (where the holding company is taking refinancing risk). Debt is repaid from dividends, equity sales or refinancing.

Business Development Corporations ("BDCs"): BDCs are authorized by the 1940 Act. BDCs invest in the debt and the equity of underlying portfolio companies that they finance. BDCs rely upon income from, and the continued harvesting of, such investments to service debt issued by the BDC. Borrowed money issued by BDCs is considered debt by the SEC, capital markets, rating agencies and accounting standards organizations (FASB and IFRS). BDC obligations for borrowed money are not re-characterized as equity, even though the assets of the BDC are not operating assets, but instead financial instruments held by the BDC.

Real Estate Investment Trusts ("REITS") and Master Limited Partnerships ("MLPs"): Under U.S. Federal income tax law, a REIT is "any corporation, trust or association that acts as an investment agent specializing in real estate…". The early REITs focused on the ownership of mortgages. Today, most REITs focus on owning real estate equities.

The Omnibus Budget Reconciliation Act of 1987 (also known as the Revenue Act of 1987) delineated that an MLP must earn at least 90% of its gross income from qualifying sources, which were defined as the transportation, processing, storage, and production of natural resources and minerals. MLPs typically do not own the operating assets directly, but instead like REITs, they focus on owning the equity of entities that own assets that generate qualifying income.

The underlying REIT and MLP assets that generate earnings and cashflows are not owned directly, but rather in an array of subsidiaries that may be partnerships, limited liability companies or other vehicles. REITs and MLPs rely upon cash flow paid from equity interests, and often the sale of equities, to service debt issued by the MLP or REIT. In that sense, the practical ability of the holder of REIT or MLP debt to collect depends on the "performance" of the equities owned by the REIT or MLP. The SEC, capital markets, rating agencies and accounting standards organizations (FASB and IFRS) characterize obligations for borrowed money issued by MLPs or REITs as debt. These obligations are not recast as equity.

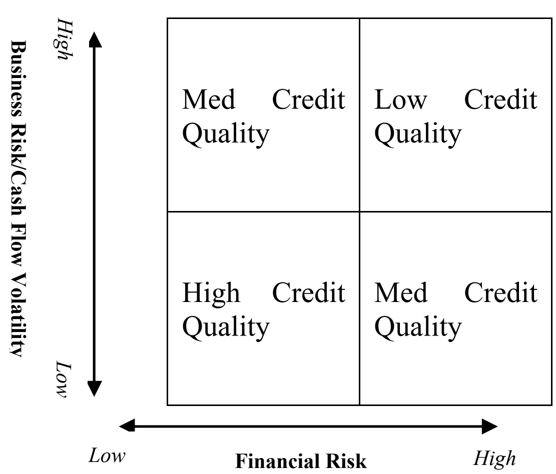
Closed-end Funds ("CEFs"): Debt issued by listed 1940 Act vehicles that invest in equity or debt securities are another example of debt securities that, in many instances, are backed by equity holdings. These funds often issue debt and/or preferred stock (both of which are regulated as leverage under the 1940 Act) to enhance the expected returns for shareholders in the funds. The debt issued by the CEFs is serviced from dividend and interest income generated by portfolio holdings. CEFs, in effect, use debt as a margin financing. Indeed, in some instance holders of CEF debt must make filing under margin lending rules. The 1940 Act reflects this reality with certain built in protections for lenders, and lenders to CEFs often impose additional limits on the use of leverage. For instance, covenants in debt instruments often require the CEF to repay its borrowed money, if the market value of its portfolio does not exceed the value of its debt by a specified coverage level. The SEC, capital markets, rating agencies and accounting standards organizations (FASB and IFRS) do not consider borrowed money issued by CEFs as anything but debt, even though the assets of many CEFs consist solely of equity shares whose market values change constantly. CEFs pay debt service through dividends received from equity shares held by the CEF, or by sale of shares owned by the CEF, as well as by refinancing.

Collateralized Fund Obligations ("CFOs"): CFOs are similar to Closed-end Funds in that they typically invest in equity securities (main difference is the CFOs invest in partnership stakes in private equity funds or in privately held companies, while CEFs typically invest in public stock or debt). The underlying funds do not guarantee the debt issued by a CFO, but the debt issued by a CFO benefits from significant overcollateralization and, in some cases, reserve accounts and/or liquidity facilities that ensure the contractual debt payments can be made under a variety of market conditions. Private equity firms have accumulated business holdings that rival, and in some case exceed, the total amount of operating company assets controlled by major corporations. The portfolio holdings of private equity funds contain many individual companies and often are more diverse in their industry and economic cycle exposure than corporations that sell a single product or service. CFOs service their debt from dividends received from portfolio companies, sale of portfolio holdings or refinancing, and in that sense, are no different than debt issued by holding companies, BDCs, MLPs and REITs or CEFs.

CFOs are structured with protections for the investors who provide borrowed money or debt to the CFO. As with CEFs, lenders benefit from covenants that limit leverage, typically with respect to the market value of the assets in the CFO. The leverage limits for CFOs tend to have greater structural features than Closed-end Funds to protect lenders to CFOs, because CFOs invest in pools that hold illiquid assets lacking observable market values. Because CFOs own less liquid investments, the value of these investments often is not directly observable by a quotation on an exchange, but instead is determined by a valuation process that compares the less liquid valuation to liquid assets, adjusted for an illiquidity charge. Debt issued by CFOs is recognized by the SEC, capital markets, rating agencies and accounting standards organizations (FASB and IFRS) to be debt or borrowed money, just as borrowed money for holding companies, which rely upon ownership interests, have their borrowed money classified as debt.

Investors, lenders and rating agencies assess the risk of the debt issued by a CFO using the same fundamental principle used by a lender to a holding company, BDC, MLP and REIT, or CEF: evaluation of the stability/predictably of the cash flows received from the underlying assets, combined with the level of overcollateralization. In all cases, no matter the legal form of the borrower, be it a holding company or otherwise, the amount of debt permitted for a given risk level, or rating of the probability of payment interruption, is sized based upon the certainty and predictability of the cash flow of, and/or salability of, the assets held. The more stable and predictable the cash flows, the greater leverage allowed. Sizing of debt backed by the equity interests in the investment grade markets is done to ensure that, under a variety of market conditions, the debt can be serviced by the cash flows received from the underlying investments.

If overcollateralization levels decline, the assigned ratings on the debt security decline as well. In addition, if the cashflows are insufficient to service the contractual debt payments, the debt security issued by the CFO will be impaired to reflect this.



Under Sections 5c and 5d, interested parties would like to note the descriptions that the exposure uses (namely, "partially" and "solely") to separate the securities addressed between the two sections (in Section 5c "items where the coupon payments, principal repayment…is partially determined based on the performance of equity assets held in trust", and in Section 5d "items that are solely contingent on derivative or equity collateral and references to equity index performance"). Because the word "partially" can refer to a wide range of variabilities, as currently worded in Section 5c of the Exposure, a wide array of securities may fall within the scope and securities whose repayment is partially determined by the performance of equity assets on one end of the spectrum would be treated the same as those securities on the other end of the spectrum. This may not appear to lead to improved accounting or reporting. Thus, interested parties would like to seek clarification of the Exposure's intent in this regard. Please see comments under Section 5d for interested parties' view on "solely".

- Is there a different accounting / reporting approach that should be taken for these securities?

In analyzing debt securities backed by equity interests, rating agencies and investors attempt to understand the level of subordination, volatility of the cash flows and sensitivity to underlying asset price volatility. The ratings vary based on changes in these factors. These securities do not vary from the principle used in the insurance industry to capture investment risk for all Schedule D Assets: ratings issued by a CRP are accepted by the SVO, or if no CRP rating exists, a designation from the SVO is applied. SSAP No. 26R recognizes this fundamental accounting hierarchy in insurance regulation as applied by the P&P Manual of the SVO. In all cases, if the risk increases, the designation will decline to a higher capital charge designation, ensuring that the insurance company holds appropriate capital for the investment risk held. Industry acknowledges that the Regulators may want Schedule D to provide more disclosure as to the investment type and are willing to accommodate, if helpful. Industry also affirms that reporting classification is independent of the fundamental principle of investment risk, which is, as risk increases, the designation is accordingly recognized with a higher SVO classification on the scale from 1-6. At the same time, industry strongly believes that these forms of borrowed money are debt, no different from any other debt instrument recognized by SSAP No. 26R. Therefore, industry believes regular amortized cost accounting is appropriate for these securities

- If these items are excluded from Schedule D-1, what factors (e.g., asset coverage / over-collateralization, etc.,) could be considered in determining an appropriate RBC?

Rating agencies have established criteria where they assign ratings that consider a variety of factors, including the volatility of cash flow, the degree of overcollateralization or excess of value of the assets relative to the debt outstanding, the liquidity of the entity that must service the debt relative to the frequency of scheduled debt payments, structural and legal protections including bankruptcy-remote entities that ring fence assets, and covenants giving the lender of the borrowed money rights to force asset liquidation and other remedies, if risk rises to trigger threshold metrics. The preceding is a fundamental process of assessing investment risk ratings. Interested parties believe that risk ratings assigned by either CRPs or the SVO (if filed for a designation) should drive RBC charges.

Section 5d – Accounting and Reporting for Non-CFR ABS and Non-Traditional Securitizations – Security is Solely Impacted by Equity Collateral / Equity Index

Overview of Key Concepts:

- This section addresses those items that are solely contingent on derivative or equity collateral and references to equity index performance. The proposed guidance would exclude these securities fully from SSAP No. 43R.

- NAIC staff believes the treatment is in line with the interested parties' comment letter, and clarification has been included to reflect what is considered an "equity" instrument.

Questions / Comments:

- Is the guidance clear as to what should be considered an equity instrument and excluded from the scope of SSAP No. 43R?

- Are there structures that would be captured within this guidance that would reflect an unintended consequence of what is intended?

- Comments are requested on whether these structures would include differing types of investments (combinations of equity / derivative instruments) and if specific guidance requiring bifurcation should be captured.

Regarding the following questions, as they relate to debt backed by equity or other risk assets, that is dependent on risk asset performance to service debt:

- Is the guidance clear as to what should be considered an equity instrument and excluded from the scope of SSAP No. 43R?

Interested parties agree that an instrument that is solely contingent upon derivative equity (a contingent right) or solely contingent upon equity index return has the characteristics of equity. However, interested parties do not agree that an instrument that is solely backed by equity can never be debt. Holding companies often own nothing but equity in subsidiaries. Loans made to holding companies are debt and recognized as such by the SEC, the IRS, commercial contract law, recognized accounting standards, and rating agencies, even though the entity that issues the debt solely owns equity interests. In addition to holding companies, there are other legal entities that issue debt, including limited liability companies, trusts, partnerships and other legal entities which also indirectly own assets, and whose form is chosen for tax treatment reasons. The problem with the above characterization in the "Overview of Key Concepts" is that the premise proposed for SSAP No. 43R conflates the form of an instrument to its risk and return characterization narrowly because the proposal appears to exclude considerations for the structural enhancements (e.g. requiring that equity value to exceed the debt, reserve accounts and other features designed to provide downside protection) that exist to make the security a marketable debt instrument. Debt results when an instrument has sufficient cash flow resources (including assets that can be converted to cash) and structure to reduce the payment risk to the point where the instrument can support a stated coupon and maturity. Debt is distinct from equity, but the element that makes a debt instrument is not the legal form, per se, of what backs that instrument. Instead, it is the elements where the debt instrument has sufficient cash flow, and assets that can be converted to cash, or refinanced based on their value, that allow that instrument to have sufficient certainty of payment. Debt repayment is less volatile than equity, and as the certainty of debt repayment increases, the credit quality of the debt rises, but equity alone can still underpin a debt instrument.

- Are there structures that would be captured within this guidance that would reflect an unintended consequence of what is intended?

Interested parties would like to clarify the term "solely," as there are debt securities that are backed by equity interests that have materially different risk profile than the equity assets backing the debt. This different risk profile is mainly due to significant overcollateralization and structural enhancements (e.g. covenants and reserve accounts) that work to preserve bond like characteristics under a variety of market conditions. Hence, while the "sole" assets backing the debt may be equities, the debt does have a materially different risk profile. The sole assets backing a REIT's unsecured public bonds is typically equity interests in real estate, but that does not mean that the unsecured REIT debt is itself an equity. The unsecured REIT debt has a very different risk profile versus equity interests. Further, interested parties would like to state that corporations, partnerships and other entities all can own assets, but the type of entity used to own an asset or assets, and then issue a debt instrument, does not impact whether the borrowed money is debt.

The legal form of the issuer is, in some cases, selected to obtain specific tax treatment of income from the issuer, and in some other cases, to legally isolate the transferred financial assets, to give a few examples. But in of itself, the legal form of an issuer holds no bearing on what constitutes the core of borrowed money or debt.

- Comments are requested on whether these structures would include differing types of investments (combinations of equity / derivative instruments) and if specific guidance requiring bifurcation should be captured.

Look through treatment can be appropriate in narrowly defined circumstances as is the case with combo notes. In many other contexts, however, look through treatment can lead to philosophical abstractions that, in practical application, end up transforming a REITs debt "backed" by a real estate equity, into equity itself. Bifurcation may also be appropriate if the underlying assets are a combination of equity and debt securities and all returns are directly passed through to investors. Interested parties suggest that the look through concept or bifurcation approach be applied only on a case-by-case basis, as an aid to analysis rather than a binding rule.

In conclusion, related to CFO investments, we agree that 1) instruments where the amount of principal or interest payable contractually varies based on the appreciation and/or depreciation of underlying equities warrant a different accounting treatment and therefore different reporting treatment than the bond section of Schedule D and 2) instruments that create RBC "arbitrage" (i.e., by moving Schedule BA assets to Schedule D without meeting sale criteria in SSAP No. 103R) should be prohibited.

However, any proposed scope clarifications should only address the perceived abuses and not have detrimental consequences to a broader range of CFO investments which are appropriate and beneficial for insurance companies' investment portfolios. For example, there are many CFO-type investments with a fixed coupon and fixed principal, that have adequate structural features such as overcollateralization and/or liquidity facilities, such that equity appreciation is not required in order to service debt obligations, and in fact, the value of the underlying equity investments can fall substantially, without jeopardizing debt repayments as scheduled (e.g., CEF Debt and other similar structures). Interested parties believe these structures are bonds, appropriate for schedule D reporting, and should be eligible for filing exemption.

The Exposure states that NAIC staff believes regulators do not believe any equity-backed investments should be reported as bonds on Schedule D. This is not consistent with our discussion with some regulators, who view that the aforementioned- types of securities with overcollateralization and fixed coupon rates and maturities are bonds and should be accounted for as bonds and reported on Schedule D. We would appreciate if regulators that share NAIC staffs' expressed view or have concerns would provide written comments on their specific concerns so we can help address them. We would welcome the opportunity to provide education on CEF Debt and other CFO structures that interested parties (and the SEC) unequivocally view as debt.

For the benefit of NAIC staff and regulators, included in Appendix III of this letter, is an overview of typical non-abusive CFO issued debt, which interested parties believe should be accounted for as bonds and reported on Schedule D.

Section 5e – Accounting and Reporting for Non-CFR ABS and Non-Traditional Securitizations – Principal Protected Notes

Overview of Key Concepts:

- This section addresses principal-protected notes (or similar structures), in which only a portion of the assets held in trust ensures the repayment of principal at maturity.

- As detailed, the Valuation of Securities (E) Task Force is currently proposing to exclude these instruments from filing exempt, and require submission to the NAIC SVO in determining NAIC designations.

- In addition to the filing exempt exclusion, the issue paper proposes consideration of a lower of amortized cost or fair value measurement method, as well as restrictions in using the "intent and ability to hold guidance" in determining OTTI.

Questions / Comments:

- In addition to the PPNs, are there other instances in which SSAP No. 43R securities are issued with stated interest rates that would be substantially lower than if the debt instruments were held individually?

- Is the proposed lower of amortized cost or fair value measurement method and the OTTI provisions appropriate for PPNs?

- Should there be additional disclosures for PPNs in the financial statements?

PPNs, as described in the Issue Paper, present unique considerations due to structuring which creates a difference between the yield implied by the contractually promised fixed-schedule payments and the expected total yield at the time of investment. Contractually promised payments are satisfied by underlying bonds (which would, on a stand-alone basis, qualify as filing exempt debt instruments under SSAP Nos. 26R or 43R), but the structure offers other potential returns via the presence of other assets, a contractually promised yield well below market comparable credits, or a combination thereof. There is a substantial component to PPN structures that exhibits characteristics consistent with qualifying debt instruments (contractually promised fixed-schedule payments, contingent upon the credit risk of the underlying debt issuer(s)), but there is also a component that may either generate additional return on investment or alternatively erode the portion(s) of initial invested basis (acquisition price) associated with its unique expected future cash flow prospects.

PPNs are finite term investment vehicles with structured fixed-schedule payments covered by underlying monetary assets (by their terms converting to cash within a finite time period). Much of the specific performance measurement and valuation guidance already outlined within SSAP No. 43R, including the qualification of continuous monitoring of currently expected underlying cash flows, is already well suited to capturing the economic substance of PPN structures, including for impairment. Interested parties, however, would take no objection to restrictions in using the "intent and ability to hold guidance", in determining impairment, due to the "lower than market" yield often associated with such investments.

Interested parties further note that the VOSTF has now adopted finalized guidance to exclude these instruments from the filing exempt universe thus requiring their submission to the SVO for determining an NAIC designation. The analysis of cash flows employed by the SVO in executing their Weighted Average Ratings Factor ("WARF") methodology for designating credit and other non-payment risk on PPNs is meant to address the real risk associated with these investment (i.e., to obtain the appropriate RBC charge), and with the more strict impairment requirements noted previously, interested parties do not believe lower of cost or market accounting is necessary. We are open to considering whether the inherent diversity of Schedule BA might ultimately serve as the best fit; particularly given that it already has a classification grouping for investments with underlying characteristics of fixed income attended by a data field for NAIC Designations. Interested parties further take no objection to further disclosures surrounding such investments, if regulators feel such disclosure would be beneficial.

Section 5f – Accounting and Reporting for Non-CFR ABS and Non-Traditional Securitizations – Collateral is Not Cash Generating and Not Equity (e.g., artwork held in trust)

Overview of Key Concepts:

- This section addresses structures where the collateral held in trust is neither a cash-generating debt instrument nor an equity security.
- The guidance proposes to exclude these structures completely from SSAP No. 43R. It is identified that such structures may be designed to circumvent reporting if the underlying collateral had been held directly.

Questions / Comments:

- Is the guidance clear enough to ensure that this only captures non-cash generating assets and non-equity securities?
- Are there structures that would be captured within this guidance that would reflect an unintended consequence of what is intended?
- It is anticipated that these structures are not overly common, but information would be requested on the prevalence of these instances.

Interested parties offer the following comments and observations regarding structures taking asset risk:

a) First, it should be noted that the commentary in this section often strays far from most definitions of ABS, including the fairly narrow 1933 Act Definition. The 1933 Act Definition includes ABS backed by many types of underlying financial assets, not just ABS backed by debt instruments. It requires that the ABS be primarily serviced by the cash flows from the underlying financial assets, while allowing for some level of physical asset releasing/refinancing risk within the structure.

b) The 1933 Act Definition goes on to provide some definition around the word primarily. For securities backed by leases, the portion of the pool balance attributable to the residual value of the physical property may be as high as 50%; in the case of motor vehicle leases, as high as 65%. In short, the securities are backed partly by a financial asset (a lease) and partly by a physical asset. The physical asset would fall between the bookends of “neither a cash generating debt instrument nor an equity security”.

c) SAPWG rules should distinguish between (i) securities backed by non-admitted assets that, by their nature, are not cash generating (e.g., collector’s items or artwork) and (ii) securities backed by non-admitted assets that are capital assets, used and useful in commerce, such as ships, aircraft, railcars and power plants. An entity that owns capital assets can generate cash flow through the operation, lease or sale of the assets; and a lender to that entity can assess whether the cash flows likely to be generated will suffice to repay debt. Lease-backed debt instruments have been held by insurers since the nineteenth century. The most common type, for many decades, was debt instruments secured by locomotives and rail cars. Title to the rolling stock was held by an equipment trustee, and the rolling stock was on lease to a railroad. More recently, lease-backed debt instruments have been secured by ships and aircraft. From the standpoint of the insurer holding the debt instrument, it has always been of critical importance to have a valid security interest in the leased collateral, and the ability to repossess such collateral in the event of a default by the lessee. The security interest also affords protections, should the lessee go directly into bankruptcy. In the event of an outright liquidation of the lessee, however, or the rejection of a lease in bankruptcy, the debtholder can become the owner of the collateral. Therefore, it is important to understand that the investor views the collateral as an extra form of protection and a benefit, above and beyond the contractual obligation of the underlying equipment operator to pay for such equipment's use.

d) This has always been the case with lease-backed debt instruments. Investors need to understand that they might become the owners of the collateral, whether they want to or not. This is true, whether the collateral is motor vehicles, boats, aircraft, rail cars, industrial equipment, or otherwise. The taking of ownership occurs very infrequently, but it has happened in the past and will surely happen again. When lenders take ownership, the assets are almost never held directly. Entities are set up to hold the assets, in part to limit liability, and also to allow the issue of shares or other instruments reflecting percentage ownership where more than one lender is involved. Once a lender has become an owner, the lender's ownership interest may need to be impaired substantially, or even non-admitted. In fact, impairment would likely occur well before the lender becomes an actual owner. Notwithstanding these accounting consequences, insurers have been willing to take ownership of leased assets, in cases where the assets are still useful in commerce and capable of generating cash flows from potential unaffiliated users (unlike the examples cited in the Issue Paper). In contrast to bank regulators, who assign considerable positive value to collateral held by bank lenders, commentary in the Exposure seems intent on recognizing no benefit to insurance lenders for the potential to release, refinance or sell collateral in order to service or repay secured debt investments.

e) Industry is very surprised to see the NAIC look to promote the policy that, if the leased asset would be non-admitted if eventually owned by the insurer (following a lessee event of default, or following an SPV's inability to refinance a balloon debt maturity at lease expiry), then the debt instrument backed by the leases of such assets must be non-admitted as well. What would the result if this concept were applied to ABS backed by motor vehicle leases where there is releasing risk or relatedly residual asset risk? Would the answer be, if the motor vehicles could not be held as admitted assets, neither can the ABS? Other examples could be provided of lease backed securities might suddenly become non-admitted just because of releasing risk. Is this best for insurance companies, regulators and ultimately policyholders? We understand the regulatory concern with debt securities backed by physical assets that are very unlikely ever to generate cash flows (e.g. corporate art). To adopt the concept broadly across all physical assets as suggested above, however, would be to undermine the concept of secured lending altogether.

f) In addition, interested parties note that SAPWG's current concerns around releasing/refinancing risk for SSAP No. 43R structured securities directly conflicts with how debt is treated within SSAP No. 26R. A great many corporations and municipalities issue debt with bullet maturities. It is very often the case that such debt maturities are larger than the free cash flow expected to be generated by the underlying business or municipality in any given year. In such instances, investors in corporate and municipal debt are inherently taking refinancing risk. Should the corporation or municipality fail to refinance their debt maturities, debt investors pursue remedies. In the case of corporate debt, unsecured debt investors may convert their claims into equity of the insolvent corporation as part of a bankruptcy, and thereby gain control of the corporation's assets. A process identical in substance could take place with debt issued by a Trust or SPV that holds a leased asset, where the debt has a balloon maturity payment obligation. If the borrower is unable to refinance its balloon maturity debt obligation, investors may foreclose on the underlying collateral within the Trust or SPV and sell or re-lease the collateral in order to recoup their investment. In essence, this is the same outcome that occurs with the corporation unable to refinance its debt obligations. The risks are inherently the same, regardless of whether a security sits within SSAP No. 43R or SSAP No. 26R. Therefore, interested parties do not understand why the Issue Paper contends that Single-Payor Securitizations with residual value/refinancing risk should not be accounted for as bonds.

g) Refinancing risk is a fundamental part of any credit assessment process. The existence of refinancing risk should have no bearing on whether a security is classified as a bond. Instead, refinancing risk is one of many risks inherent in a security and is therefore relevant in determining the appropriate capital requirements for that security. Interested parties believe that SAPWG is better served to focus on the nature of the underlying collateral for SSAP No. 43R securities, rather than focusing on whether there is an element of refinancing risk. If the underlying collateral is used or useful in commerce and can be operated, re-leased or sold to generate cash flow (in the event that the debt cannot be refinanced at maturity), then the security should be granted bond accounting treatment. If the underlying collateral is, by its nature, not used or useful in commerce (for example, collectors' items), then debt backed by such assets is unlikely to merit bond accounting treatment.

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Thank you for considering interested parties' comments. Interested parties are committed to working with NAIC staff and SAPWG on this very complicated and important topic. If you have any questions in the interim, please do not hesitate to contact us or Mike Reis at michaelreis@northwesternmutual.com or 414-241-8293.

Sincerely,

D. Keith Bell Rose Albrizio

cc: Interested parties

Appendix I

History of SEC and Congressional Definitions of Asset-Backed Securities

In the early 1980s, Congress strongly supported enhanced liquidity in the mortgage loan markets to facilitate home ownership, and the government sponsored entities, Fannie Mae and Freddie Mac, along with Ginnie Mae, were key participants in developing residential mortgage-backed securities (RMBS). In 1984, Congress adopted the Secondary Mortgage Market Enhancement Act (SMMEA), which added a definition of "mortgage-related security" to the 1934 Act and preempted state law to allow insurance companies to purchase mortgage-related securities. When the SEC modified its procedures to facilitate quicker public securities issuance by large companies with an established reporting history, it added mortgage-related securities to the issuances that could use those procedures. The SEC—which has dual missions of investor protection and supporting capital formation—had recently adopted Rule 415, allowing securities to be issued on a delayed or continuous basis through shelf registration on Form S-3. Rule 415 was expanded to permit mortgage-related securities to use shelf registration, even without the reporting history.

In 1992, the SEC decided to expand shelf registration under Rule 415 to asset-backed securities, which had developed in the mid-1980s as the techniques used for RMBS created funding opportunities for other assets, like credit card receivables and equipment leases. In 1992, the SEC also adopted a rule under the Investment Company Act of 1940, Rule 3a-7, to clarify that the issuers of asset-backed were not investment companies required to register under the '40 Act. Both rules used the same definition for asset-backed securities, with the key principle being that shelf registration and the '40 Act exemption would be limited to offerings of securities backed by "a discrete pool of financial assets that by their terms convert into cash within a finite time period." There were a few goals here:

1. Limit the use of shelf registration for issuers without a reporting history to structures with an asset pool that investors could assess quickly
2. Maintain clear lines between an "asset-backed security" and an investment company that should be registered (in this case by requiring that the issuing entity not be actively managed, that it have a discrete pool of assets, and that the assets be self-liquidating (i.e., no equity securities))
3. Provide a safe harbor for sponsors of asset-backed securities under the '40 Act
4. Ensure that the securities offered were high quality by requiring them to be rated by a nationally recognized statistical rating organization (NRSRO)

ABS disclosure was a square peg in a round hole. The SEC issued a variety of no-action letters that explained to issuers which parts of the SEC disclosure requirements applied to ABS and which parts did not, and established an alternative reporting regime that relied on knowledge of guidance and lore more than formal rules. In 2004, the SEC consolidated its guidance into Regulation AB and adopted new, formal disclosure requirements focused on pool characteristics, parties and deal structure, while specifically exempting ABS prospectuses from requirements for audited financial statements, MD&A and other requirements that were relevant to operating companies but not to asset pools. Regulation AB moved the definition of "asset-backed security" into a rule, but did not change it significantly from that used to determine eligibility for Form S-3.

In 2007-08, the financial crisis hit, and Congressional focus turned to mortgage-backed securities—in particular, the assertion was that subprime mortgages were originated without adequate underwriting because the lenders knew they could offload all of the risk of the assets by securitizing them. The proposed solution was risk retention—requiring sponsors of securitizations (and in some cases loan originators) to retain a portion of the risk of securitized assets so that they would be more careful in their originations. Because there was concern that similar issues could arise from "originate to distribute" models in other asset classes, Congress decided to apply risk retention requirements to all securitizations of assets with credit risk—loans, leases, mortgages and receivables—to improve credit underwriting. The SEC had tried to have a narrow focus with its definition of ABS to restrict the securities that could achieve shelf eligibility and use different disclosure rules. Congress was much more concerned about capturing the portion of the securitization market that securitized debt, and Article IX of the Dodd-Frank Act imposes risk retention obligations on the sponsors of securities that depend primarily on the cash flows from self-liquidating financial assets—in other words, those that by their terms convert into cash in a finite time period. It does not try to capture all ABS.

Appendix II

Asset-Backed Security Definitional Review

Both transaction structure and asset pool composition may determine whether an investment is in scope of the definition of "asset backed security" under the 1934 Act or under the 1933 Act (Regulation AB). Key considerations include whether any securities are issued, whether such securities "depend primarily on the cash flow" from the asset pool, the type of financial assets comprising the pool, and the underlying collateral, if any, supporting the financial assets. Accordingly, interests in one structure may be in scope of the definitions, but interests in a different structure supported by the same asset type may be out of scope. Each issuance requires nuanced analysis, and different counsel (and different regulators) may reach different conclusions about a single structure and asset pool. Moreover, the characterization of any transaction depends on the time at which it is evaluated and the characteristics of the asset pool existing at that time. This document is intended to provide some general considerations in determining whether a transaction could be considered in scope of the 1934 Act Definition or the 1933 Act (Regulation AB) Definition, but a thorough analysis should be conducted with respect to any particular transaction to determine whether it would be in scope of the 1934 Act Definition or the 1933 Act (Regulation AB) Definition. We note that many of the securities that fall outside of both definitions are considered by the market to be asset-backed securities, especially those that have predictable cash flows and that legally isolate the assets.

Asset Class	Description	1933 Act (Regulation AB) analysis	1934 Act analysis
Residential Mortgage Backed Securities	Securities issued by a special purpose entity (SPE) that owns a pool of underlying residential mortgages (mortgage pass through security or collateralized mortgage obligation or CMO). The underlying mortgages can be prime (high credit quality) or subprime, they can be guaranteed by a federal agency or government-sponsored entity (collectively Agency RMBS) or not (non-Agency RMBS). The mortgage cash flows (and, if applicable, servicer advances and guarantee payments) are the source of repayments of interest and principal on the securities, and the security holders have a security interest and/or fractional undivided interest in the mortgages themselves. Investors in non-Agency RMBS typically benefit from various forms of credit enhancement such as (i) credit and prepayment tranching; (ii) shifting interest mechanism - whereby	Typically, yes, subject to compliance with the restrictions on pool and structure set forth in the Regulation AB definition	For non-agency RMBS, typically yes. For agency RMBS, a question remains as to whether payments on the securities depend primarily on the cash flows from the mortgage-loan pool or whether they depend primarily on the GSE payment obligation under the guarantee. This has not been tested, because agency RMBS is exempt from risk retention.

	payment to junior classes of debt holders can be skipped for a period of time to prevent the level of credit enhancement from deteriorating over time; (iii) over collateralization; and (iv) reserve accounts.		
Commercial Mortgage Backed Securities	Securities issued by an SPE that owns one or more commercial mortgages on income producing properties (e.g., multi-family properties, office buildings, industrial properties, shopping centers, hotels and healthcare facilities). The cashflows from the income-generating properties service and repay the securities, while security holders have a security interest and/or fractional undivided interest in the mortgages themselves. The debt is typically tranched into multiple categories of debt, with junior securities and equity supporting the senior class. Prepayment risk may be eliminated through call protection, but investors are typically exposed to extension risk due to balloon structures in the underlying collateral pool.	Depends on type of structure. Typically, yes, subject to compliance with the restrictions on pool and structure set forth in the Regulation AB definition	Depends on type of structure. Typically, yes as the mortgages are thought to be self-liquidating financial assets, assuming the underlying assets consist of mortgages rather than leases.
Asset Backed Securities—Credit Card Receivables	Securities issued by an SPE that owns a revolving pool of assets generating contractual cash flows, which can be paid at a required minimum level or in higher amounts, up to repayment in full, on any month, and typically have an open line of credit that permits additional borrowing. The cash flows from the underlying assets in the pool are used to reinvest in new receivables and to service and repay the securities. Credit card securitizations assume that there will be some level of defaults and are structured to have the ability to cover those defaults—typically through the yield on the assets, which is expected to cover interest, servicing and anticipated defaults with a cushion (excess spread) remaining. Prepayment risk largely only relates to a decline in the excess spread below zero and does not typically depend on principal repayment rate. Subordinated tranches and cash reserves often provide credit enhancement to more senior tranches.	Typically, yes, subject to compliance with the restrictions on pool and structure set forth in the Regulation AB definition	Typically, yes

Asset Backed Securities—Other (Student Loans, Auto Loans, Home Improvement Loans, RV Loans, Mobile Home Loans)	Securities issued by an SPE that typically owns a static pool of assets generating contractual cash flows. The cash flows from the underlying assets in the pool are used to service and repay the securities. Through the use of partitioning, the risk of default in the underlying collateral as well as prepayment risk is shared differently across different groups of debt holders (tranches) but uniformly within a tranche. Often early losses are reallocated to a junior tranche, which then serves as a form of credit protection for the senior tranche. Transactions typically have credit enhancement, which may be in the form of overcollateralization, subordinated securities, cash collateral or reserve accounts and/or priorities of payment that suspend payments to holders of subordinate interests if certain tests are not satisfied.	Typically, yes, subject to compliance with the restrictions on pool and structure set forth in the Regulation AB definition	Typically, yes. If the loan pool is not static (i.e., the deal is more of a future flow transaction), there could be an argument that it is not 1934 Act ABS.
Asset Backed Security—Structured Settlement	Securities issued by an SPE. The SPE owns a pool of court-approved structured settlements and/or annuities issued by insurance companies and may hold other assets to address early termination of annuities linked to the life of the original holder. Through the use of partitioning, the risk of defaults in the underlying collateral as well as prepayment risk is shared differently across different groups of debt holders (tranches) but uniformly within a tranche. Transactions typically have credit enhancement, which may be in the form of overcollateralization, subordinated securities, cash collateral or reserve accounts and/or priorities of payment that suspend payments to holders of subordinate interests if certain tests are not satisfied.	Depends on assets and structure. The court-approved structured settlements are likely to convert into cash in a finite time period. Depending on the terms of the annuities, those assets may or may not convert into cash in a finite time period. Whether a transaction qualifies as an asset-backed security under Regulation AB will depend on the particular asset pool.	Depends on assets and structure. The court-approved structured settlements are likely to be considered self-liquidating assets. Depending on the terms of the annuities, those assets may or may not be considered self-liquidating financial assets. Whether a transaction qualifies as an asset-backed security under the 1934 Act definition will depend on the particular asset pool.
Asset Backed Security—Consumer loans	Securities issued by an SPE that owns a pool of consumer loans (other than credit card, auto or student loans), either fixed or revolving, that generate contractual cash flows used to service and repay the securities.	Typically, yes, as the loans by their terms typically convert into cash within a finite time period, and serve as the primary cash flow to the holders of the	Typically, yes, as the loans are typically self-liquidating financial assets that serve as the primary cash flow to the holders of the securities, e.g., a pool of consumer loans. If

		securities, e.g., a pool of consumer loans, subject to compliance with the restrictions on pool and structure set forth in the Regulation AB definition.	the loan pool is not static (i.e., the deal is more of a future flow transaction), there could be an argument that it is not 1934 Act ABS. Securitizations that permit new borrowings under existing lines of credit are not considered future flow.
Asset Backed Security—Home equity loans and lines of credit	Securities issued by an SPE that owns a pool of home equity loans (static) or a pool of home equity lines of credit (revolving, sometimes using master trust technology) that generate contractual cash flows used to service and repay the securities.	Typically, yes, as the loans by their terms typically convert into cash within a finite time period and serve as the primary cash flow to the holders of the securities, e.g., a pool of home equity loans subject to compliance with the restrictions on pool and structure set forth in the Regulation AB definition.	Typically, yes, as the loans are typically self-liquidating financial assets that serve as the primary cash flow to the holders of the securities, e.g., a pool of home equity loans.
Asset Backed Security—Venture Capital Backed Loans	Securities issued by an SPE that owns a pool of venture capital loans.	Typically, yes, assuming the loans by their terms convert into cash, as opposed to equity interests (e.g., warrants or convertible debt)., subject to compliance with the restrictions on pool and structure set forth in the Regulation AB definition.	Typically, yes, assuming the loans are self-liquidating financial assets that by their terms convert into cash, as opposed to equity interests (e.g., warrants or convertible debt).
Asset Backed Security—Timeshare securitizations	Securities issued by an SPE that holds promissory notes secured by mortgages that generate contractual cash flows used to service and repay the securities. The mortgages represent the purchase price of a timeshare interest in vacation properties.	Depends on type of structure, typically yes assuming the underlying assets are promissory notes secured by mortgages, which typically by their	Depends on type of structure, typically yes assuming the underlying assets are promissory notes secured by mortgages, which are typically

		terms convert into cash within a finite time period.	self-liquidating financial assets.
Collateralized Loan Obligations (CLOs)	Debt securities issued by an SPE that holds a pool of bank loans. The capital structure of a CLO typically consists of a highly rated senior class, multiple subordinated classes (many of them still with an investment grade rating) and a junior class that receives all residual cash flow on the assets. The cash flows from the loans, as well as sale proceeds to the extent not reinvested in new assets, are allocated to investors based on tranche seniority. CLOs are typically actively managed by an investment manager (loans are actively purchased and sold during investment period).	Typically, no, unless the securities are backed by a static pool of loans (balance sheet CLOs). The active management of the asset pool in open market CLOs generally is inconsistent with the "discrete pool" requirement of Regulation AB.	Typically, yes, but depends on structure. If a CLO structure does not issue securities but instead enters into a credit agreement in which it borrows loans, then the loans may not constitute ABS under the 1934 Act definition.
Lease-Backed Securities—Auto Leases, Equipment Leases (health care, industrial/manu-facturing, computers/tech),	Securities issued by an SPE that owns a pool of leases on multiple assets. The cash flows from the underlying leases in the pool are used to service and repay the securities. Through the use of partitioning, the risk of defaults in the underlying collateral as well as prepayment risk is shared differently across different groups of debt holders (tranches) but uniformly within a tranche. Often early losses are reallocated to a junior tranche, which then serves as a form of credit protection for the senior tranche. Transactions typically have credit enhancement, which may be in the form of overcollateralization, subordinated securities, cash collateral or reserve accounts and/or priorities of payment that suspend payments to holders of subordinate interests if certain tests are not satisfied.	Depends on whether the residual value for automobiles exceeds the 65% threshold under the Regulation AB definition, and whether the residual value for other assets exceeds the 50% threshold (as well as satisfying the other pool and structuring characteristics required under Regulation AB)	Depends on whether the leases serve as the primary cash flow to the holders of the securities, rather than the re-leasing, selling or otherwise disposing of the automobiles or other equipment.
Lease-Backed Securities - Residential and commercial solar	Debt issued by an SPE that owns an equity interest in a number (usually 5-10 in each transaction) of limited liability company subsidiaries (the "LLCs") which own and lease solar panels on residential properties as well commercial industrial. Although the insurer's investment is directly in the SPE that owns the equity interest, the	Depends on structure. Although the leases convert to cash in a finite time period, the interposition of the LLCs may make Regulation AB unavailable.	Depends on structure. The leases are typically self-liquidating financial assets, and for purposes of satisfying the regulatory intention of the 1934 Act definition to require risk retention,

	cash flows are still contractual since the residential property owners/commercial borrower make lease payments on the solar payments based on contractual agreements. The underlying limited liability companies are typically established with shared ownership with a tax equity investor but are managed by an affiliate of the Issuer. The LLCs each have provisions in their organizational documents setting out application of expenses and sharing of revenue with the tax equity investor such that, effectively, the SPE issues debt directly backed by cash flows (and indirectly backed by solar panels and related customer agreements) that represent the profits of the LLCs. These transactions are typically tranched with different waterfall priorities.		regulators may look through intervening LLC structures. The market treats them as subject to risk retention.
Lease-Backed Securities - Aircraft	Securities issued from an SPE which typically owns some combination of aircraft, leases, loans, or equity interests in wholly owned subsidiaries that own such aircraft, leases or loans. Assets may be held in a variety of non-US entities to satisfy foreign licensing requirements or because retitling them in the US is cost prohibitive. The equipment is typically leased to multiple entities and is subject to significant re-leasing risk. The cash flows from the underlying leases and assets in the pool are used to service and repay the debt. Through the use of partitioning, the risk of defaults in the underlying collateral as well as prepayment risk is shared differently across different groups of debt holders (tranches) but uniformly within a tranche. Often early losses are reallocated to a junior tranche, which then serves as a form of credit protection for the senior tranche. Transactions typically have credit enhancement, which may be in the form of overcollateralization, subordinated securities, cash collateral or reserve accounts and/or priorities of payment	Depends on type of structure. Securitization of loans (SPV holds a portfolio of loans): Typically, yes, as the loans by their terms typically convert into cash within a finite time period and serve as the primary cash flow to the holders of the securities, subject to compliance with the restrictions on pool and structure set forth in the Regulation AB definition. Securitization of aircraft and leases (SPV holds a portfolio of aircraft and related leases): it depends on the structure. If the leases are short-term and do not serve as the primary cash flow to	Depends on type of structure. Securitization of loans (SPV holds a portfolio of loans): Typically, yes, as the loans are typically self-liquidating financial assets that serve as the primary cash flow to the holders of the securities. Securitization of aircraft and leases (SPV holds a portfolio of aircraft and related leases): it depends on the structure. If the leases are short-term and do not serve as the primary cash flow to the holders of the securities, but rather the cash flow primarily depends on re-leasing, selling or otherwise disposing of the

	that suspend payments to holders of subordinate interests if certain tests are not satisfied.	the holders of the securities, but rather the cash flow primarily depends on re-leasing, selling or otherwise disposing of the underlying aircraft, and the residual value of the aircrafts exceeds the 50% threshold under Regulation AB, and other aspects of the structure are inconsistent with Regulation AB, then typically no.	underlying aircraft, typically no. We note that aircraft securitizations backed by the full faith and credit of the United States may be less likely to be 1934 Act asset-backed securities, because they are less likely to depend for payment primarily on the cash flow from self-liquidating financial assets.
Lease-Backed Securities - Railcars	Securities issued from a special purpose entity which typically owns some combination of railcars and leases on such railcars. The equipment is leased to multiple entities and is subject to significant re-leasing risk. The cash flows from the underlying leases and assets in the pool are used to service and repay the debt. Through the use of partitioning, the risk of defaults in the underlying collateral as well as prepayment risk is shared differently across different groups of debt holders (tranches) but uniformly within a tranche. Often early losses are reallocated to a junior tranche, which then serves as a form of credit protection for the senior tranche. Transactions typically have credit enhancement, which may be in the form of overcollateralization, subordinated securities, cash collateral or reserve accounts and/or priorities of payment that suspend payments to holders of subordinate interests if certain tests are not satisfied. Securities may also be issued as a single tranche on a pass-through basis.	Depends on the terms of the leases and the maturity of the securities. Typically, yes, if the payments on the securities are tied to the expected cash flows on the existing lease portfolio at the time of securitization, subject to compliance with the restrictions on pool and structure set forth in the Regulation AB definition. Typically, no, if the leases are short-term and do not serve as the primary cash flow to the holders of the securities, but rather the cash flow primarily depends on re-leasing, selling or otherwise disposing of the rail cars.	Depends on the terms of the leases and the maturity of the securities. Typically, yes, if the payments on the securities are tied to the expected cash flows on the existing lease portfolio at the time of securitization. Typically, no, if the leases are short-term and do not serve as the primary cash flow to the holders of the securities, but rather the cash flow primarily depends on re-leasing, selling or otherwise disposing of the rail cars.
Lease-Backed Securities- Containers	Securities issued from a special purpose entity which typically owns some combination of containers, leases on	It depends. If the leases are short-term and do not serve as	It depends. If the leases are short-term and do not serve as the

	such containers and equity interests in wholly owned subsidiaries that own such containers. The equipment is leased to multiple entities and is subject to significant releasing risk. The cash flows from the underlying leases and assets in the pool are used to service and repay the debt. Through the use of partitioning, the risk of defaults in the underlying collateral as well as prepayment risk is shared differently across different groups of debt holders (tranches) but uniformly within a tranche. Often early losses are reallocated to a junior tranche, which then serves as a form of credit protection for the senior tranche. Transactions typically have credit enhancement, which may be in the form of overcollateralization, subordinated securities, cash collateral or reserve accounts and/or priorities of payment that suspend payments to holders of subordinate interests if certain tests are not satisfied.	the primary cash flow to the holders of the securities, but rather the cash flow primarily depends on re-leasing, selling or otherwise disposing of the containers, typically no. If the residual value of the physical assets does not exceed the 50% threshold of the Regulation AB definition, then may be in scope.	primary cash flow to the holders of the securities, but rather the cash flow primarily depends on re-leasing, selling or otherwise disposing of the containers, typically no.
Lease-Backed Securities -Triple net leases	Securities are issued by an SPE that holds property interests and a pool of triple net leases. Similar to CMBS, but with leases, rather than a mortgage loan, on the property constituting the primary financial asset.	Depends on the transaction. Transactions may have long-term leases that serve as the primary cash flow to the holders of the securities, rather than the cash flow depending primarily on re-leasing, selling or otherwise disposing of the underlying real estate, so may be considered in scope. If the transaction has short-term leases that do not serve as the primary cash flow, then it may not be considered in scope. In addition, depends on whether the residual value of the underlying real	Depends on the transaction. Transactions may have long-term leases that serve as the primary cash flow to the holders of the securities, rather than the cash flow depending primarily on re-leasing, selling or otherwise disposing of the underlying real estate, so may be considered in scope. If the transaction has short-term leases that do not serve as the primary cash flow, then it may not be considered in scope. Securitization of leases only and not the underlying real estate: Yes, assuming the

		estate exceeds the 50% threshold under the Regulation AB definition and other collateral and structural conditions are satisfied. Securitization of leases only and not the underlying real estate: Yes, assuming the leases serve as the primary cash flow to the holders of the securities, subject to compliance with the restrictions on pool and structure set forth in the Regulation AB definition.	leases serve as the primary cash flow to the holders of the securities.
Lease-Backed Securities -Single family rental	Securities issued from an SPE that typically owns mortgage loan receivables from owners of single family residential rental properties which are, in turn, secured by an assignment of rents. This asset class combines certain aspects of RMBS (underlying asset is mortgage loans on residential properties) with certain aspects of CMBS (small number of obligors and income-generating property). The cash flows from the underlying leases in the pool are used to service and repay the debt.	Typically, yes, subject to compliance with the restrictions on pool and structure set forth in the Regulation AB definition	Typically, yes
Lease-Backed Securities -Cell towers, data centers	Securities issued by a special purpose entity that holds a portfolio of cell towers or data centers and related leases. The cash flows from the underlying leases and assets in the pool are used to service and repay the debt.	Depends on type of structure and assets. If the leases are short-term and do not serve as the primary cash flow to the holders of the securities, but rather the cash flow primarily depends on re-leasing, selling or otherwise disposing of the cell towers (i.e., the residual value of the property exceeds the 50%	Depends on type of structure and assets. If the leases are short-term and do not serve as the primary cash flow to the holders of the securities, but rather the cash flow primarily depends on re-leasing, selling or otherwise disposing of the cell towers, then these are unlikely to be securities the payments on which depend

		threshold), then these are unlikely to be Regulation AB asset-backed securities. If the transaction has long-term leases that serve as the primary source of cash flow, then it may be considered in scope, subject to compliance with the restrictions on pool and structure set forth in the Regulation AB definition	primarily on the cash flow from self-liquidating financial assets. If the transaction has long-term leases that serve as the primary source of cash flow, then it may be considered in scope.
Lease-Backed Securities -Rental cars	Vehicles are transferred to a special purpose subsidiary (the "SPV") that issues debt in various series, typically on a shared collateral basis, to both capital markets investors in term note transactions and bank lenders in variable funding note transactions. The SPV leases the entire pool of vehicles to the operating company pursuant to a single operating lease. The rental payments under the operating lease are sized to meet the debt service obligations of the SPV together with a profit component. The vehicles are titled in the name of the SPV and pledged to the noteholders through a collateral agency arrangement. In some transactions, a two-tier structure exists (originally intended to facilitate like-kind exchanges) whereby one SPV owns the vehicles and leases to the operating company and finances the vehicles through and intercompany loan to a second SPV. The second SPV issues third party debt secured by the intercompany loan and, indirectly, the vehicles. Rental car structures typically also have credit support in the form of reserve of letters of credit covering interest payment obligations and certain other amounts.	Typically, no. Because of the shared collateral pool, these are unlikely to be viewed as supported by a discrete pool of assets.	Typically, yes.

Other Lease Backed Securities—Equipment Based (aircraft, ships, etc.)	Debt issued by a pass-through trust ("Trust") that either owns equipment on long-term lease to a Credit Entity or holds a debt instrument secured by a mortgage against equipment owned by a Credit Entity. The Trust issues certificates representing an undivided interest in the assets of the Trust. The lease or debt payments from the Credit Entity are passed through to the holders of the certificates and represent the right to obtain interest and principal calculated based on the face amount of the certificates. The structures, however, are not fully contractually obligated to a Credit Entity; either because the lease expires before the associated debt matures, or because there is a balloon payment due at maturity that is not part of the lease obligation. This refinancing and residual asset risk is mitigated by low leverage at maturity or point of refinancing.	Depends on type of structure. Securitization of loans (SPV holds a portfolio of loans): Typically, yes, as the loans by their terms typically convert into cash within a finite time period and serve as the primary cash flow to the holders of the securities, subject to compliance with the restrictions on pool and structure set forth in the Regulation AB definition. Securitization of equipment and leases (SPV holds a portfolio of equipment and related leases): it depends on the structure. If the leases are short-term and do not serve as the primary cash flow to the holders of the securities, but rather the cash flow primarily depends on re-leasing, selling or otherwise disposing of the underlying equipment, and the residual value of the equipment exceeds the 50% threshold under Regulation AB, and other aspects of the structure are inconsistent with Regulation AB, then typically no.	Depends on type of structure. Securitization of loans (SPV holds a portfolio of loans): Typically, yes, as the loans are typically self-liquidating financial assets that serve as the primary cash flow to the holders of the securities. Securitization of equipment and leases (SPV holds a portfolio of equipment and related leases): it depends on the structure. If the leases are short-term and do not serve as the primary cash flow to the holders of the securities, but rather the cash flow primarily depends on re-leasing, selling or otherwise disposing of the underlying equipment, typically no.

Equipment Trust Certificate ("ETC")—backed by equipment, aircraft, aircraft engines, rail cars, rail locomotives, ships	Debt issued by a pass-through trust ("Trust") that either owns equipment on lease to a Credit Entity or holds a debt instrument secured by a mortgage against equipment owned by a Credit Entity. The Trust issues certificates representing an undivided interest in the assets of the Trust. The lease or debt payments from the Credit Entity are passed through to the holders of the certificates and represent the right to obtain interest and principal calculated based on the face amount of the certificates. This differs from the item above under Other Lease-Backed Security - Equipment Based) as this type does not have refinancing/residual risk with the balloon payment at the end of the debt. The certificate holders (through their interest in the assets held by the Trust) also enjoy the benefits of an unsecured claim to the corporation in a bankruptcy scenario, in addition to hard asset collateral. Therefore, if the underlying obligor defaults on its lease or debt obligations, investors can foreclose (or direct the Trust to foreclose) on the underlying equipment as an additional protection to the claim on the Credit Entity in the bankruptcy. Equipment could be a range of collateral types.	An ETC is effectively a security structure to provide financing for a specific piece or pieces of equipment. These deals are typically not considered asset-backed securities under these regulations, but they are considered debt securities.	An ETC is effectively a security structure to provide financing for a specific piece or pieces of equipment. These deals are typically not considered asset-backed securities under these regulations, but they are considered debt securities.
Enhanced Equipment Trust Certificate ("EETC")	An ETC that has been "enhanced" through division into multiple tranches, each representing a different claim in priority within the SPE's capital structure (1st Loss, 2nd Loss, Last Loss, etc.) and also some additional enhanced features. As with an ETC, investors enjoy an unsecured claim to a credit entity plus the benefits of collateral. Since EETC's relate to aircraft equipment owned by airlines, investors have the benefit of Section 1110 of the bankruptcy code and because EETCs typically are cross-collateralized and cross-defaulted to the lease or mortgage, the related underlying obligor is strongly incentivized to perform under Section 1110 for the entire pool of equipment securing the certificates with	The securities are viewed as direct obligations of the sponsor and not as asset-backed securities under these regulations, but they are considered debt securities.	The securities are viewed as direct obligations of the sponsor and not as asset-backed securities under these regulations, but they are considered debt securities.

	respect to a transaction. EETCs also typically contain either a liquidity facility to service interest payments, or a Paid-in-Kind feature to accrue additional principal, in the event of a bankruptcy/payment		
Credit Tenant Loan ("CTL")	Debt issued from an SPE which owns real property net leased to a single credit tenant (a Credit Entity). Lease payments are used to pay debt service on the transaction, which is an obligation of the SPE that owns the property. Collateral consists of a first lien priority assignment of the lease, including all rent due thereunder which is paid directly to the CTL debt investors, and a mortgage on the property. The debt issued by the SPE is either nearly fully amortizing, or amortizing down to a 5% maximum principal balloon due at maturity (as permitted under the CTL guidelines in Statutory accounting) or, amortizes down to an amount which is fully insured with RVI insurance, or amortizes down to a payment obligation of the Credit Entity tenant or other credit enhancement. Therefore, the holders of the debt are not subject to any repayment risk in excess of 5% of the original principal amount and are fully secured. CTLs are not rated by a CRP and are not FE.	CTLs do not meet the definition of “ABS” as set forth in the 1933 Act. CTLs are viewed as debt securities that are obligations of a Credit Entity (the tenant).	CTLs do not meet the definition of “ABS” as set forth in the 1933 Act. CTLs are viewed as debt securities that are obligations of a Credit Entity (the tenant).
Ground Lease Financing (“GLF”)	Debt issued from an SPE that owns and leases (as Ground Lessor) the underlying land of a property where ownership and financing of the land and improvements are bifurcated. The deal is structured exactly like a CTL, except that the owner of the improvement (the Ground Lessee) which leases the land from the Ground Lessor is not an operating company like CVS or IBM, but instead is an SPE that owns and operates the improvements (which can be either single or multi-tenanted) under a long-term Ground Lease (typically 99 years) entered into with the Ground Lessor. The rent from the Ground Lessee is paid directly to the GLF debt investors as debt service -	GLFs do not meet the definition of “ABS” as set forth in the 1933 Act. GLFs are viewed as debt securities that are obligations of an SPE owned by a sponsor.	GLFs do not meet the definition of “ABS” as set forth in the 1933 Act. GLFs are viewed as debt securities that are obligations of an SPE owned by a sponsor.

	like in a CTL - with the same collateral (first priority assignment of lease and all rent due thereunder, and a mortgage on land and on the Ground Lessor's reversionary interest in the improvements). The Ground Lease payments are sufficient to service debt over the term of the financing, which is typically 30-35 years, and is fully amortizing or with a 5% balloon due at maturity (as permitted under the CTL guidelines in Statutory accounting). Given the foregoing structure, investors in Ground Leases are in a "last loss" position and have a reversionary interest in the improvements should a default occur. Like a CTL, there is no refinancing or residual risk. Ground lease transactions are typically rated by a CRP but are not FE.		
Other Rated Lease-Backed Financings ("ORLB")	Same structure as a CTL, except an ORLB does not fully comply with CTL guidelines in either one or both of the following areas: 1) a balloon payment due at maturity is in excess of 5% (as permitted under CTL guidelines in Statutory accounting) and is not insured with RVI or other credit enhancement; 2) the primary term of the lease expires on or before the maturity date so investors are relying on lease renewal by Credit Entity tenant. Therefore, the structure is subject to an element of refinancing or residual asset value risk, which is mitigated by low leverage at maturity, and a strong likelihood of lease renewal by the Credit Entity tenant. ORLBs are rated by a CRP but are not expected to be FE.	ORLBs do not meet the definition of "ABS" as set forth in the 1933 Act. Similar to GLFs, ORLBs are viewed as debt securities that are direct obligations of an SPE owned by a sponsor.	ORLBs do not meet the definition of "ABS" as set forth in the 1933 Act. Similar to GLFs, ORLBs are viewed as debt securities that are direct obligations of an SPE owned by a sponsor.
Royalty Payment Streams—intellectual property, movie rights, drug rights	Occurs when a corporation or individual wishes to monetize future fixed payment streams that are usually already legally set forth in the contract. An SPE is established, and debt issued to buyout the original recipient of future royalty payments. The right to receive royalty payments is then assigned to the SPE; and cash flows received from the royalty payments are usually sufficient to fully cover debt service.	No, these generally do not convert into cash in a finite time period. However, royalty securitizations are viewed as asset backed securities in the financial markets due to use of bankruptcy remote entities and	No, these generally are not self-liquidating financial assets. However, royalty securitizations are viewed as asset backed securities in the financial markets due to use of bankruptcy remote entities and predictable cash flows.

		predictable cash flows.	
Future Flow Receivables	Future flow securitizations are those where at the time of the securitization, the pre-set receivables backing the securitization are not of equivalent or higher value than the debt that was issued by the SPV. For example, the receivables may increase or decrease due to volume or usage (e.g. tollway usage). Other examples are whole business securitizations of franchises where the franchisor securitizes its right to receive fees from franchisees for providing contractual services to the franchisee.	Typically, no. However, future flow receivable securitizations are viewed as asset backed securities in the financial markets due to use of bankruptcy remote entities and predictable cash flows.	Typically, no. Some future flow receivables transactions may be 1934 Act asset-backed securities if (i) the amount of receivables at issuance is high enough that payments on the securities depend primarily on the cash flows on the existing receivables, rather than on the generation of new receivables, (ii) the contract under which new receivables arise is itself a self-liquidating financial asset, or (iii) the securitization includes additional self-liquidating assets in the pool, such as a sponsor note secured by existing and future receivables. Future flow receivables deals are viewed as asset backed securities in the financial markets due to use of bankruptcy remote entities and predictable cash flows.
Collateralized Fund Obligation with Firm Schedule of CF Repayment	Debt is issued from an SPE that owns a seasoned pool of LP interests in PE funds diversified across vintage, strategy and manager. Cash distributions from the underlying funds over time are used to pay interest and principal of the notes, with the remainder going to the equity. The debt is tranched into one or more categories, with junior debt and equity supporting the senior class. Prepayment risk is addressed through call protection, although investors are exposed to extension risk due to the distribution	Typically, no. PE funds generally do not convert into cash in a finite time period. Although probably not asset backed securities under these regulations, these are debt securities similar to corporate debt.	Typically, no. PE funds generally are not self-liquidating financial assets. Although probably not asset backed securities under these regulations, these are debt securities similar to corporate debt.

	characteristics of the underlying PE funds holdings. Most have liquidity facility to cover cash flow timing differences.		
Other examples of debt issued by CFO-like structures but are not viewed as SPVs. Most are Closed-end Funds ("CEFs"), Holding Companies (e.g. Utilities, Berkshire Hathaway), Business Development Corporations	CEFs are listed 1940 Act vehicles that invest in equity or debt securities, are another example of securities that in many instances are backed by equity holdings. These funds often use borrowed money, or debt to enhance the expected returns for shareholders in the funds. The debt issued by the CEFs is serviced from dividend and interest income generated by portfolio holdings. CEFs in effect use debt as margin financing. The 1940 Act reflects this reality with certain built in protections for lenders, and lenders to CEFs often impose additional limits on the use of leverage, such as debt covenants. The other examples such as Holding companies and business development corporations, which own equity interest in other entities.	Typically, no. Although probably not asset backed securities, these are debt securities similar to corporate debt.	Typically, no. Although probably not asset backed securities, these are debt securities similar to corporate debt.
Project Finance Debt	Long term debt issued by an SPE or limited liability corp. to fund a stand-alone capital investment. The SPE/LLC will own the project assets, and the cash flows generated from operating the project are the source of debt repayment. In this sense, the project can be viewed as a small, standalone Credit Entity. Debtholders have a pledge of collateral in the project cash flows, any contingency reserve accounts and often the project asset itself (often through step-in or cure rights).	No, the project assets are not assets that by their terms convert into cash in a finite time period. Although probably not asset backed securities, these are debt securities similar to corporate debt.	No, the project assets are not self-liquidating financial assets. Although probably not asset backed securities, these are debt securities similar to corporate debt.
Special Revenue Municipal Bonds	Issuer Obligation - Backed by "special" revenue generating activity of the municipality AND operates as a business - Toll Roads and Bridges, Water and Wastewater, Airports, Seaports, and Transportation Hubs, Power Plants and Electrical Generation Facilities. The bond is issued by a division of the municipality and may or may not be issued by an SPV.	Depends on type of structure, typically not considered to convert by their terms into cash within a finite time period if the fee requires some future action, such as performing a service, which typically would not be considered a financial asset that converts by	Depends on type of structure, typically not considered self-liquidating financial assets if the fee requires some future action, such as performing a service, which typically would not be considered self-liquidating financial assets. If the fees are already earned due to

		its terms into cash. If the fees are already earned due to prior service and the fee is simply deferred, then it may be considered a financial asset that converts by its terms into cash.	prior service and the fee is simply deferred, then it may be considered self-liquidating financial assets.
Special Revenue Municipal Bonds	LBASS - Backed by "special" revenue generating activity of the municipality AND does not operate as a business and assets in blind trust - Student loan bonds, Tobacco Settlement Bonds (based on contractually set cash flows either for legal fees or payments to be received by states), some Housing bonds.	Depends on the underlying asset and the rights conveyed. Tobacco settlement bonds are typically comparable to other structured settlement securitizations; other special revenue municipal bonds are unlikely to be supported by self-liquidating financial assets or assets that by their terms convert into cash in a finite time period.	Depends on the underlying asset and the rights conveyed. Tobacco settlement bonds are typically comparable to other structured settlement securitizations; other special revenue municipal bonds are unlikely to be supported by self-liquidating financial assets or assets that by their terms convert into cash in a finite time period.
NFL/NBA/MLB/ NHL Bonds	An almost infinite variety of deals [League Deals Backed By Media Revenue, League Deals Backed By General Revenue, Team Deals, Stadium Deals] held by a majority of life insurance companies. There is usually a separate SPV that pledges revenue (from the different sources listed under Collateral Type) to the entity to service the debt issued. Debt obligations can be serviced by sources of revenue (often contractual in nature) such as: -Television revenues, -Team franchise rights, - Member Club Assessments, -Ticket Sales/ticketing fees - Participating Club Assets, - Naming rights - Sponsorships/advertising - Suite fees and premiums - Concessions	Depends on the nature of the underlying assets. If the issuing entity holds secured debt from the club or league, that is likely an asset that converts to cash in a finite time period. Media rights do not so convert, whereas a committed payment stream under an advertising contract might, depending on the contingencies affecting payments. The right to ticket sale proceeds likely does not qualify. Stadium bonds probably do not	Depends on the nature of the underlying assets. If the issuing entity holds secured debt from the club or league, that is likely a self-liquidating financial asset. Media rights are not self-liquidating, whereas a committed payment stream under an advertising contract might be, depending on the contingencies affecting payments. The right to ticket sale proceeds likely does not qualify. Stadium bonds probably do not qualify, in the same way that other project finance does not. For

	- Parking -Non-TeamCo events -Team rent payments -Premium seat licenses	qualify, in the same way that other project finance does not. For the types of structures that may not fit in the scope of this regulation, they would typically be viewed as debt securities similar to corporate debt.	the types of structures that may not fit in the scope of this regulation, they would typically be viewed as debt securities similar to corporate debt.
Global Funding Investments	An insurance company creates a special purpose vehicle to issue a single series of notes. The insurance company enters into a funding agreement with the special purpose vehicle. Cash flows from the funding agreement are used to make principal and interest payments on the notes. The transaction has the following characteristics: The funding agreement is an insurance product and the direct liability of the insurance company. Payments on the funding agreement are backed by the general account of the insurance company. The terms of the notes exactly match the terms of the underlying funding agreement. There are no other credit enhancements for the notes, and only a nominal residual interest in the special purpose vehicle is created for purposes of complying with formation requirements of local law. Only one series of notes is created with the backing of a particular funding agreement. While the special purpose vehicle may issue multiple series of notes, each series will be backed by one distinct funding agreement.	No. The SEC says that it would look through the funding agreement to the general account of the insurance company. Therefore, these are usually treated as corporate debt of an insurance company.	No. The SEC says that it would look through the funding agreement to the general account of the insurance company. Therefore, these are usually treated as corporate debt of an insurance company.
Stranded Cost Utility Securitizations	Stranded costs are the costs of obsolete assets or system restoration by energy companies, and the right to recover such costs through rates charged to specified customers are created by action of state legislatures. Such rights to charge	Typically, no. Although probably not asset backed securities, these are	Typically, no. Although probably not asset backed securities, these are debt securities

	customers are transferred to an SPE that issue bonds backed by such future charges.	debt securities similar to corporate debt.	similar to corporate debt.
Real Estate Investment Trusts ("REITS") and Master Limited Partnerships ("MLPs")	Under U.S. Federal income tax law, a REIT is "any corporation, trust or association that acts as an investment agent specializing in real estate…". The early REITs focused on the ownership of mortgages. Today, most REITs focus on owning real estate equities. The 1987 Tax Act delineated that an MLP must earn at least 90% of its gross income from qualifying sources, which were strictly defined as the transportation, processing, storage, and production of natural resources and minerals. MLPs typically do not own the operating assets directly, but instead like REITs, they focus on owning the equity of entities that own assets that generate qualifying income. These equities held by REITs and MLPs are not owned directly, but rather in an array of subsidiaries that may be partnerships, limited liability companies or other vehicles. REITs and MLPs rely upon cash flow paid from equity interests, and often the sale of equities, to service debt issued. In that sense the practical ability of the holder of REIT/MLP debt to collect does depend on the "performance" of the equities owned by the REIT/MLP. The SEC, capital markets, rating agencies and accounting standards organizations (FASB and IFRS) characterize obligations for borrowed money issued by REITs/MLPs as debt. These obligations are not recast as equity.	Securities issued by REITs and MLPs would not be viewed as asset-backed securities for purposes of the Regulation AB definition. They do not hold a discrete pool of assets that by their terms convert into cash into a finite time period. REITs do sponsor securitizations—typically RMBS and CMBS—but the REIT itself is not the issuer of those securities.	Typically, no. Securities issued by REITs and MLPs would not be viewed as asset backed securities for purposes of 1934 Act definition. The securities do not typically depend for payment primarily on the cash flows from self-liquidating financial assets. REITs do sponsor securitizations—typically RMBS and CMBS—but the REIT itself is not the issuer of those securities.
STACR	STACR REMIC or STACR Debt - Bonds issued directly by Fannie Mae and Freddie Mac or issued from a trust set up by Fannie and Freddie whose principal and interest payments are linked to a referenced set of mortgages STACR Trust - issues notes out of a third-party trust. Freddie Mac pays a credit premium payment to the trust and benefits from the credit risk transfer through a reduction in note balances for	The credit risk transfer securities that were issued directly by Fannie Mae and Freddie Mac would not meet the Regulation AB definition for asset-backed security, since those securities are unsecured debt of the GSEs—there is a	The credit risk transfer securities that were issued directly by Fannie Mae and Freddie Mac would not meet the 1934 Act definition for asset-backed security, since those securities are unsecured debt of the GSEs—there is a

	defined credit events on the reference pool. The trust makes periodic payments of interest and principal to noteholders. Freddie Mac receives payments from the trust that otherwise would have been made to the noteholders to the extent there are certain defined credit events on the mortgages in the related reference pool. Note, there are similar structures by FNMA & mortgage insurers	reference pool, but no genuine pool of assets. Note that credit risk transfer securities issued directly by Fannie and Freddie do not use a trust or SPV. Similarly, STACR Trusts and STACR REMICs are unlikely to be considered asset-backed securities, even though they hold a pool of assets, because the payments on the securities do not depend on the performance of the assets. In its Regulation AB adopting release, the SEC stated that "Payments on ABS must be based primarily on the performance of the financial assets in the pool." Moreover, the GSEs take the position that the risk retention rules do not apply to the STACR Trusts or STACR REMICs because the securities issued by them are not asset-backed securities under the 1934 Act or under Regulation AB.	reference pool, but no genuine pool of assets. The GSEs take the position that the risk retention rules do not apply to the STACR Trusts or STACR REMICs because the securities issued by them are not asset-backed securities under the 1934 Act or under Regulation AB.
ReRemic	REMICs (created by the Tax Reform Act of 1986) are essentially the securitization of mortgage pass through securities. A Re-REMIC takes one or more than one tranche of a REMIC and issues tranches (e.g. BRE issues tranches backed by tranches issued by a REMIC)	Typically, yes.	Typically, yes.

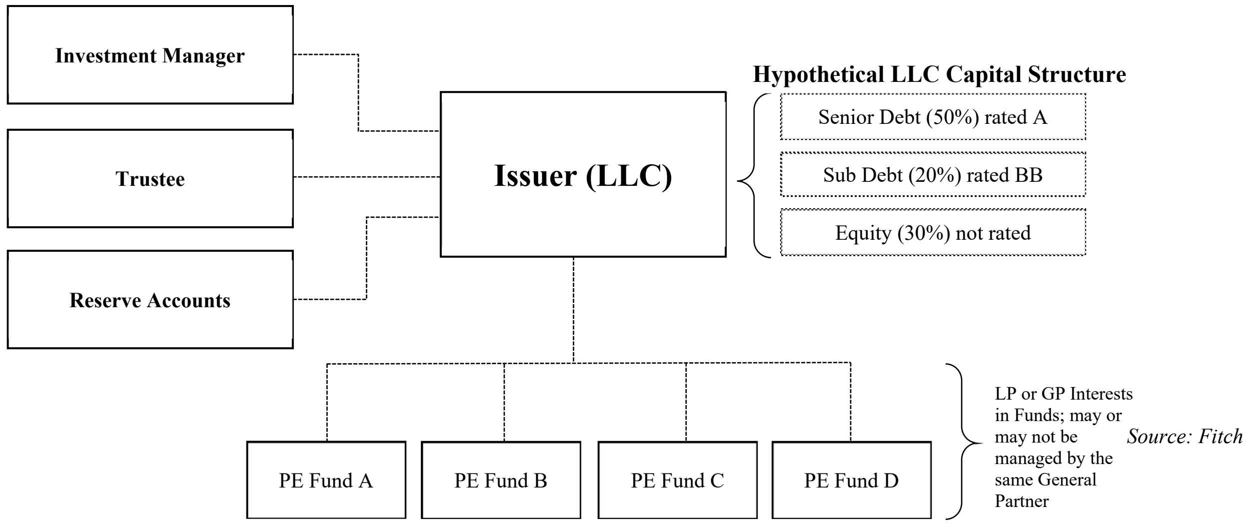
Structured Repos	SPV enters into a reverse repo (buys a security under agreement to resell); SPE issues bond backed by reverse repo.	This is unlikely to be considered ABS under Regulation AB. The SPV holds two assets—the reverse repo agreement itself and the securities sold under it. The repayment to security holders does not depend on the cash flows on the securities subject to the repo; it depends on payment being made under the repo. So the repo itself would have to be the financial asset that by its terms converts into cash in a finite time period. Although possible, it's unlikely the SEC would view it that way.	Probably not. A structured repo is more likely to be viewed as a self-liquidating financial asset under the '34 Act than under the '33 Act, but that requires the repurchase agreement to be treated as a self-liquidating financial asset. We have not seen a federal regulator give a definitive answer on this point, but industry participants have argued against the view that a repurchase agreement is a self-liquidating financing asset.

Appendix III

Collateralized Fund Obligations ("CFOs") Defined:

Summary Definition	Key Credit Variables/Considerations
Typically represents the financing of private equity partnership interests transferred to a Limited Liability Company ("LLC"). The LLC issues debt and equity securities that are sold to investors. Most often, the General Partner ("GP") of the underlying funds retains the equity tranche, but CFOs have been issued by Limited Partners ("LPs") to monetize or to alter the risk and return of their existing exposure by selling debt or equity/subordinated tranches. Creditors do not have direct recourse to the sponsor and are secured by the underlying limited partnership interests. The equity tranche (subordination) is sized to ensure that the LLC's solvency and contractual cashflows are maintained under a variety of market conditions. The LLC also establishes reserve accounts to support creditors in extreme market conditions. If cashflow coverage and overcollateralization requirements are not maintained, the equity holders of the structure are restricted from extracting economics from the LLC.	• Initial and ongoing required overcollateralization (or LTV) • Expected volatility of the value and cashflows of the underlying partnership interests • Nature of underlying risk (equity, debt, or combination) • Size of reserve accounts • Debt service coverage covenants • Ability for equity investors to receive excess cashflows • Performance track record of sponsor • Investment phase of underlying interests • Static or dynamic pool of underlying assets • Ratings based covenants/"triggers" • Integrity of asset valuations • Ability to add incremental debt • Sponsor obligations (e.g. keep well provisions) • Source of payment for future capital calls • Fee structure on partnership interests • Operational and other counterparty related risks

Basic Example:



Ratings Framework:
The primary focus for evaluating the credit risk of CFO issued debt securities is the level of equity (or subordination) and the expected volatility of the underlying assets. The level of subordination to achieve an investment grade rating is typically at least the size of the gross expected losses of the underlying assets (i.e. 15% expected gross losses require a 15% level of equity support). The size also varies based on expected volatility of the expected gross losses – a guiding principle used in almost all debt markets (i.e. more equity support is needed to support debt issued by entities with more volatility or underlying risk).

The expected cashflows generated by the underlying assets are also evaluated to: 1) assess risk, 2) ensure timely payment of interest and principal, and 3) establish the size of the reserve accounts.

Valuation, Covenants and Ongoing Ratings Assessment:
The values of the underlying partnership interests are established by the General Partner's pricing policies, which are agreed to in advance by the Limited Partners. They typically use an independent internal valuation committee and/or external advisers to review methodologies, inputs, and fair value estimates for reasonableness. These valuations and valuation procedures are also reviewed by the fund's auditors.

These valuations form the basis for the Loan to Value ("LTV") covenants and ongoing assessment of risk. The initial and ongoing expectation for a well-structured debt security issued by a CFO is that, at all times, the value of the underlying assets will exceed the value of the debt issued by the structure. In fact, most debt securities issued by CFOs benefit from covenants that require substantial excess cushion in the LTV, such that risk of principal loss is low. For an example, if the initial LTV of a CFO is 65%, the covenants will typically restrict the ability for the equity tranche to receive economics from the structure if the LTV exceeds 80% - this may also trigger rapid debt amortization or require additional reserves to be established.

The credit rating on debt issued by CFOs allows for some variation in the LTV; however, if persistently above the initial LTV (i.e. if initially set at 65% and it is persistently is above 70%), the credit rating on the CFO issued debt will likely be lowered. In addition, if the amount of subordination is smaller than the gross expected loss rate of the underlying assets, the credit rating will likely be lowered materially.

Sponsor Obligations:
While debt investors do not have direct recourse to the sponsor, in some GP sponsored CFOs, the GP is required to fund and contribute related capital calls into the LLC. If the LTV exceeds the initial LTV at the time of the capital call, the GP may be required to contribute the additional partnership interests into the LLC without incurring additional debt at the LLC level. Some CFOs also require the GP's stake in successor funds to be contributed as well. This requirement effectively provides a "keepwell" from the GP to ensure that the LTV does not increase above the LTV when the structure was established.

Key Risk Differential Between Debt Issued by CFOs and Principal Protected Notes ("PPNs"):

A PPN typically involves an issuance by an LLC that holds a combination of risk assets (e.g. private equity limited partnership interests) and assets with no credit risk (e.g. long dated zero-coupon Treasury bonds). The LLC will issue one security: a single PPN with no subordination. The amount of riskless assets in the structure is sized so that if an investor holds the PPN to maturity, the value accretion of the zero-coupon bond will ensure that the PPN's principal will be repaid with no dependence on the performance of the risk assets.

For the PPN, returns vary with asset performance, but if held to maturity, there is no risk of loss. However, the structure still holds a sizable amount of risk assets and assets with duration, such that at any given point in time, the value of the assets in the LLC may not exceed the value of the PPN.

While CFOs and PPNs both expose investors to risk assets, the CFO issued debt benefits from a sizable amount of subordination with contractual returns not expected to vary with asset performance. This subordination ensures that if the assets in the LLC were to be liquidated, at any time, the debt could be repaid with no risk of principal loss. This concept of continuous asset coverage only exists at issuance and at the stated maturity for a PPN.

CFO Issued Debt Within Scope of SSAP 26R:

Debt backed by equity instruments is common in the capital markets and universally viewed as having bond-like characteristics. Other examples of debt issued by CFO-like structures (or equity-reliant) include debt issued by Holding Companies (e.g. Utilities, Berkshire Hathaway), Business Development Corporations, Closed-end Funds, Master Limited Partnerships and Real Estate Investment Trusts.

For CFO issued debt to be within scope of SSAP 26r (or to get similar accounting and RBC treatment), there must be a fixed maturity, fixed coupon rate (not varying with asset performance), and a minimum level of asset overcollateralization of 133% (or inversely, an LTV of not more than 75%). The structure should also include covenants that work to maintain continuous asset coverage and have established reserve accounts to support the timely payment of interest and principal.

Reference Materials:

SSAP 43R IP Comment Letter 10/11/19; Fitch Special Report: *PE CFOs: Securitizing Private Equity Fund Interests* 10/10/19

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Ref #2020-31

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

Issue: Early application of *SSAP No. 32R—Preferred Stock*

Check (applicable entity):

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

Description of Issue: On July 30, the Working Group adopted *Issue Paper No. 164—Preferred Stock* and substantively revised *SSAP No. 32R—Preferred Stock.* As is traditionally the case with substantive revisions, the Working Group, as recommended by NAIC staff, implemented an effective date of Jan. 1, 2021.

While the adoption updated the definitions, measurement and impairment guidance for all preferred stock, the most significant change was noted for the balance sheet reporting of perpetual preferred stock. With adoption of SSAP No. 32R, all perpetual preferred stock is to be valued at fair value, not to exceed any currently effective call price. NAIC staff were supportive of this change in valuation requirements as reporting these assets at fair value, as opposed to historical costs, allows for a more accurate representation of the value of such assets as perpetual preferred stock is more comparable to equity securities.

At the request of industry representatives, this agenda item has been drafted to permit the early adoption of SSAP No. 32R. If adopted, the impact of substantive revisions could be reflected in the 2020 year-end financial statements. (When revising SSAP No. 32R, it was noted that fair value is already used for perpetual preferred stocks and is the more appropriate measurement method for these equity-like securities.)

Existing Authoritative Literature:
The entire substantively revised SSAP No. 32R is relevant, however only the paragraph below would be impacted by this agenda item.

Effective Date and Transition

> 21. On July 30, 2020, substantive revisions, as detailed in *Issue Paper No. 164—Preferred Stock* were adopted. These revisions, effective January 1, 2021, update definitions of preferred stock and reporting values based on characteristics of the preferred stock.

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

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

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

Staff Recommendation: NAIC staff recommend that the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to *SSAP No. 32R—Preferred Stock* to permit the early application of SSAP No. 32R.

Ref #2020-31

SSAP No. 32R—Preferred Stock

Effective Date and Transition

21. On July 30, 2020, substantive revisions, as detailed in *Issue Paper No. 164—Preferred Stock* were adopted. These revisions~~, effective January 1, 2021,~~ update definitions of preferred stock and reporting values based on characteristics of the preferred stock and are effective January 1, 2021, with early adoption permitted.

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

Status:
On August 17, 2020, the Statutory Accounting Principles (E) Working Group voted by e-vote to move this item to the active listing, categorized as nonsubstantive, and exposed edits to *SSAP No. 32R—Preferred Stock* as detailed above. This item has a comment period deadline ending September 18, 2020.

On October 13, 2020, the Statutory Accounting Principles (E) Working Group adopted, as final, the nonsubstantive revisions to *SSAP No. 32R—Preferred Stock* to permit early adoption of the substantively revised SSAP No. 32R.

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Ref #2020-26

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

Issue: ***ASU 2015-10, Technical Corrections & Improvements***

Check (applicable entity):

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

Description of Issue:
FASB issued *ASU 2015-10, Technical Corrections & Improvements* to update various FASB Accounting Standards Codification for minor corrections that were provided by stakeholders. FASB added a standing project to address feedback received from stakeholders on Codification and to make other incremental improvements to U.S. GAAP. This perpetual project will update Codification for technical corrections, clarifications and improvements.

Existing Authoritative Literature:
The table starting on page 2 summarizes the updates in this ASU, as well as defines the recommended actions for statutory accounting.

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

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

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

Staff Recommendation:
NAIC Staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to *Appendix D—Nonapplicable GAAP Pronouncements* to reject *ASU 2015-10, Technical Corrections & Improvements* as not applicable for statutory accounting.

Staff Review Completed by:
Jim Pinegar and Fatima Sediqzad - NAIC Staff - April 2020

Status:
On July 30, 2020, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to *Appendix D—Nonapplicable GAAP Pronouncements* to reject *ASU 2015-10, Technical Corrections & Improvements* as not applicable to statutory accounting.

On October 13, 2020, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed revisions to *Appendix D—Nonapplicable GAAP Pronouncements* to reject *ASU 2015-10, Technical Corrections & Improvements* as not applicable to statutory accounting.

The last column lists the status of the GAAP source literature for statutory accounting and the recommended action.

Topic	ASC Reference	Abbreviated Summary of Change	Related Paragraphs	SAP Status/Recommendation
	105-10-65-3	Transition related to ASU 2015-10	5	**This update is not applicable – no action required.**
Discontinued Operations	205-20-45-1D	If the one-year requirement in paragraph 205-20-45-1E(d) is met, a business or nonprofit activity shall be classified as held for sale as a discontinued operation at the acquisition date if the other criteria in paragraph 205-20-45-1E (effectively ready and being marketed for sale) are probable of being met within a short period following the acquisition (usually within three months).	6-7	Guidance for discontinued operations is in SSAP No. 24 – in that discontinued operations shall be reported with the entity's reporting of continuing operations. **This update is not applicable – no action required.**
Statements of Cashflows	230-10-45-20 255-10-55-2	Updates the term *market value* to *fair value.* Cash receipts and cash payments resulting from purchases and sales of other securities and other assets shall be classified as operating cash flows if those assets are acquired specifically for resale and are carried at fair value in a trading account.	8-11	Security classifications, trading, held to maturity, etc., are not utilized for statutory accounting purposes. However, SSAP Nos. 26R, 37, 43R, already reference fair value in lieu of market value. **This update is not applicable – no action required.**
Personal Financial Statements	274-10	The example provided was an error and did not correctly illustrate the demonstrated disclosure.	12-14	**This update is not applicable – no action required.**

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Topic	ASC Reference	Abbreviated Summary of Change	Related Paragraphs	SAP Status/Recommendation
Receivables – Overall	310-10-35 310-10-45	1. Heading changes to certain sections to ease of finding certain information 2. Removed additional explanatory language regarding impairment loss based on the fair value of collateral when a creditor determines foreclosure is probable. 3. Updates reference links to other applicable paragraphs	15-21	Bullets #1 and #3 are not applicable. Bullet #2 is referenced in SSAP No. 37 – which contains language regarding the impairment measurement based on the fair value of collateral less costs to obtain and sell. The additional explanatory language, which the FASB deemed may confuse readers, was not included in the SSAP. **This update is not applicable – no action required.**
Receivables – Nonrefundable Fees and Other Costs	310-20-35 310-20-50	Discusses the immediate expensing and related disclosures of certain origination costs associated with the issuance of a credit card that is not a private label credit card.	22-24	Private label credit cards are not addressed in statutory accounting. **This update is not applicable – no action required.**
Receivables – Loans and Debt Securities Acquired with Deteriorated Credit Quality	310-30-35-10	Sentence structure changes for ease of reading. The primary change was the location of the verbiage "based on current information," when determining impairment of certain loans.	25-26	*SSAP No. 26R—Bonds* & *SSAP No. 37—Mortgage Loans* most closely matches the topic covered. However existing language in the AP&P manual is deemed appropriate and does not warrant the change notated. **This update is not applicable – no action required.**
Investments – Debt and Equity Securities	320-10-15-7	Sentence structure to clarify that equity securities accounted for under the cost method	27-28	Update is not applicable – reporting of securities at an amortized cost of fair value is a function of

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Topic	ASC Reference	Abbreviated Summary of Change	Related Paragraphs	SAP Status/Recommendation
		are excluded fair value reporting.		NAIC designations *and* if the reporting entity maintains an asset valuation reserve. **This update is not applicable – no action required.**
Readily Determinable Fair Value	Master Glossary Term	Updates to the master glossary that the definition of readily determinable fair value may be applied to investments in a mutual fund or in a similar structure if the fair value per share is determined and published and is the basis for current transactions.	29-30	Fair value is more broadly defined in SSAP No. 100R and in addition, fair value reporting of equity securities (including mutual funds) is already required in SSAP No. 30R. **This update is not applicable – no action required.**
Recognition & Derecognition	320-10-25-20 & 320-10-40-3	Updates that state an investor shall account for two structured notes as a single until one is sold, at which time the notes shall be measured in the same way as a participating interest.	31-32	Update is not applicable – reporting of structured securities is defined in SSAP No. 43R, which utilizes NAIC designations *and* if the reporting entity maintains an asset valuation reserve for deterring the appropriate accounting and reported method. **This update is not applicable – no action required.**
Investments—Other—Beneficial Interests	325-40-55-1	Update discusses the treatment for accretion yield should an other-than-temporary impairment occur. Original guidance stated the accretion yield should be revised to 'market rate." Updated guidance	33-34	SSAP No. 43R details the treatment for accretion yield for beneficial interests after an OTTI has been recognized. AP&P guidance states an accretion adjustment shall be made for the remaining life of the beneficial interest – a

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Topic	ASC Reference	Abbreviated Summary of Change	Related Paragraphs	SAP Status/Recommendation
		states the yield is not changes as a result of recognizing OTTI. However, the yield may be changed prospectively for non-credit related factors.		position more conservative than in this ASU. As such, no changes are recommended. **This update is not applicable – no action required.**
Liabilities—Extinguishment of Liabilities	405-20-55-4	Paragraph wording update, removing the language, "under the financial components approach," which *may* have implied that an alternative approach was available when analyzing the liability extinguishment in certain in-substance defeasance transactions.	35-36	SSAP No. 103R does not contain such language. As such, the ambiguity of regarding an alternative approach for review for these types of transactions does not exist. **This update is not applicable – no action required.**
Asset Retirement and Environmental Obligations	410-30-35-7	Removal of inconsequential wording, *"Remediation technology is changing constantly, and, in many cases, new technologies have resulted in modified costs for environmental remediation."*	37-38	While remediation is notated in the AP&P manual, this specific verbiage was not included. **This update is not applicable – no action required.**
Guarantees – Overall	460-10-05-3	Removal of references to subordination agreements.	39-41	Subordination agreements are excluded from the definition of indemnifications or guarantees in statutory accounting. **This update is not applicable – no action required.**
Participating Mortgage Loans	470-30-35-4 470-30-35-4A	The GAAP codification condensed the accounting practices for two different types of	42-44	The accounting for loan-backed participating securities is not bifurcated depending on

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Topic	ASC Reference	Abbreviated Summary of Change	Related Paragraphs	SAP Status/Recommendation
		mortgage participations (those related to the results of the operations and those related to market value appreciation).		the type of participation. SSAP No. 43R defines the presentation, recognition, impairment, etc. for such activities. **This update is not applicable – no action required.**
Receivables for Issuance of Equity	505-10-45-2	The update removes non-guidance commentary and adds reference to another authoritative paragraph stating that generally notes received for the issuance of equity typically require a deduction of the receivable from equity.	45-46	SSAP No. 72, paragraph 4 details that notes or other receivables for the issuance of stock which have been approved by the domiciliary commissioner and met other criterion, are considered admitted assets. If not met, the note receivable is nonadmitted. **This update is not applicable – no action required.**
Revenue Recognition—Multiple Element Arrangements	605-25-15-3A	The update includes references to additional paragraphs relevant to an entity's determination of how to allocate arrangement consideration in accordance with the relative selling price method, from ASU 2009-13, Revenue Recognition: Multiple-Deliverable Revenue Arrangements.	47-48	Multiple-deliverable revenue arrangements are not applicable to statutory accounting. **This update is not applicable – no action required.**
Compensation—Retirement Benefits—Defined Benefit Plans—Pensions	715-30-55-63 715-80-50-5(e)	Removes an incorrect reference to nonpublic entities (instead of not-for-profit entities) and edits one sentence related to a NFP's	49-51	Specific guidance for NFP's is not applicable for SSAP. **This update is not applicable – no action required.**

Ref #2020-26

Topic	ASC Reference	Abbreviated Summary of Change	Related Paragraphs	SAP Status/Recommendation
		financial statement issuance.		
Compensation—Stock Compensation—Employee Stock Ownership Plans	718-40	Correction of the definition of fair value in the glossary for topic 718-40 (Stock Compensation) to effectively replace "could be" with "would be" in the following: The price that could be received to sell an asset or paid to transfer a liability…". Additional guidance is given related to a transition period for the update.	52-56	SSAP No. 104R details share-based payments and its definition of fair value does not contain the affected language in the ASU update. **This update is not applicable – no action required.**
Other Presentation Matters	718-740	Corrects a reference in the applicable Subtopic regarding measuring actual tax deductions as a result of excess tax benefits.	57-58	**This update is not applicable – no action required.**
Income Taxes – Overall	740-10	Replaces the term "uncertain tax positions" with the broader term "uncertainty in income taxes." Additional guidance is given regarding the scope to which entities the update applies.	59-62	Previous guidance regarding uncertain tax positions is still pending for statutory accounting. **This update is not applicable – no action required.**
Income Taxes—Other	740-30	Eliminates the term subsidiary from the glossary of Subtopic 740-30.	63-67	Statutory accounting has a separate definition for the term subsidiary. **This update is not applicable – no action required.**
Business Combinations—Overall	805-10	Moves a paragraph that is codified in the incorrect Subtopic to the correct Subtopic.	68-69	Previous guidance over an incomplete business combination has been rejected for statutory accounting.

Ref #2020-26

Topic	ASC Reference	Abbreviated Summary of Change	Related Paragraphs	SAP Status/Recommendation
				This update is not applicable – no action required.
Business Combinations—Identifiable Assets and Liabilities, and Any Noncontrolling Interest	805-20	Amend a paragraph and add a paragraph with no link to a transition paragraph.	70	Relevant paragraphs refer to business combinations, which are accounted for differently under statutory accounting. **This update is not applicable – no action required.**
Not-for-Profit Entities—Business Combinations	958-805	Updates a paragraph reference.	71	**This update is not applicable – no action required.**
Derivatives and Hedging—Overall	815-10	Replaces the word “available” with the word “obtainable” to make this paragraph consistent with terminology in Topic 860.	72-73	*SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* already utilizes the term obtainable. **This update is not applicable – no action required.**
Derivatives and Hedging—Hedging—General	815-20	Changes an incorrect reference in paragraph 815-20-25-2, which currently references a paragraph that is not used in Codification.	74-77	**This update is not applicable – no action required.**
Derivatives and Hedging—Fair Value Hedges	815-25	Adds guidance on loans that are hedged items in a fair value hedge to the “recorded investment” definition.	78-80	Not a term in statutory accounting. **This update is not applicable – no action required.**
Fair Value Measurement—Overall	820-10	Exemption to requirement to measure fair value in Topic 958 originated from an incorrect codification of the basis for conclusions in FASB Statement No. 116,	81-86	**This update is not applicable – no action required.**

Ref #2020-26

Topic	ASC Reference	Abbreviated Summary of Change	Related Paragraphs	SAP Status/Recommendation
		Accounting for Contributions Received and Contributions Made.		
Transfers and Servicing—Overall	860-10	Adds a link to the Master Glossary definition of the term “attached call option” and the term “attached call” is updated to “attached call option.”	87-92	The minor (single word) definitional update is not substantially material, to justify adoption. Exhibit A in SSAP No. 103R already appropriately references and defines an “Attached Call” as a “call option…” **This update is not applicable – no action required.**
Transfers and Servicing—Sales of Financial Assets	860-20	Eliminates sentence that refers to initial measurement, which is covered in sections 815-10-30 and 860-20-30.	93-94	Removal of sentence is not necessary. **This update is not applicable – no action required.**
Financial Services—Insurance—Acquisition Costs	944-30	Conforms terminology in Subtopic 944-30 with the revised criteria for deferred acquisition cost capitalization established by ASU 2010-26, Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts.	95-96	Capitalization of deferred acquisition costs is not a concept recognized by statutory accounting. **This update is not applicable – no action required.**
Not-for-Profit Entities—Overall	958-10	Simplifies and provides a more relevant example for this guidance.	97-98	Specific guidance for NFP’s is not applicable for SSAP. **This update is not applicable – no action required.**
Not-for-Profit Entities—Presentation of Financial Statements	958-205	Clarifies and illustrates the accounting for situations resulting in the expiration of donor-imposed restrictions.	99-100	Donor-imposed restrictions is not a concept recognized by statutory accounting.

Ref #2020-26

Topic	ASC Reference	Abbreviated Summary of Change	Related Paragraphs	SAP Status/Recommendation
				This update is not applicable – no action required.
Not-for-Profit Entities—Master Glossary	958	Eliminates the term "agency transactions" and updates all links to the term "agency transaction" as they have the same definition.	101-107	**This update is not applicable – no action required.**
Not-for-Profit Entities—Revenue Recognition	958-605	Eliminates the link to one of two separate definitions of the term "control." There cannot be two identical terms in the same Subtopic.	108-110	Statutory accounting uses an alternative definition for the term "control." **This update is not applicable – no action required.**
Not-for-Profit Entities—Consolidation	958-810	Clarifies that the economic interest must be in the controlled not-for-profit entity, instead of using the vague phrase "other such organizations."	111-112	Statutory accounting uses an alternative definition for the term "control." **This update is not applicable – no action required.**
Amendments to SEC Materials			113-118	**This update is not applicable – no action required.**
Amendments to Status Sections			119-164	**This update is not applicable – no action required.**

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Ref #2020-27

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

Issue: *ASU 2019-09, Financial Services – Insurance: Effective Date*

Check (applicable entity):

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

Description of Issue: FASB issued *ASU 2019-09, Financial Services – Insurance* to defer the effective date of the amendments in *ASU 2018-12, Targeted Improvements to the Accounting for Long-Duration Contracts*.

ASU 2018-12 was issued to improve U.S. GAAP recognition, measurement, presentation and disclosure requirements for long-duration contracts issued by an insurance entity. ASU 2018-12 had four primary areas of focus:

1. Assumptions - requires assumptions to be updated, and eliminates the U.S. GAAP provisions for risk of adverse deviation and premium deficiency testing.

2. Market Risk Benefits – requires all market risk benefits associated with deposit (or account balance contracts) to be measured at fair value.

3. Deferred Acquisition Costs - requires that deferred acquisition costs be amortized on a constant basis over the expected life of the contract.

4. Disclosures - requires new disclosures, predominantly in the form of rollforwards, to enable users to evaluate the amount, timing and uncertainty of cash flows arising from long-duration contracts.

Early adoption is permitted, however for most public entities ASU 2018-12 is now effective for fiscal years beginning after December 15, 2021. For all other entities, the effective date is for fiscal years beginning after December 15, 2023.

While minor edits were adopted to the Preamble, ***ASU 2018-12*** **was <u>rejected for statutory accounting</u>. The sole function of ASU 2019-09 is to extend the effective date for ASU 2018-12.**

Existing Authoritative Literature: As previously noted, ASU 2018-12 was rejected for statutory accounting.

References from Appendix D – Cross-Reference to SAP:

GAAP Pronouncement	Name	Status	Disposition	Statutory Reference
2018-12	Financial Services—Insurance (Topic 944): Targeted Improvements to the Accounting for Long-Duration Contracts	Complete	Reject	Preamble 50, 51R, 52, 54R, 55, 56, 71, 86

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

Ref #2020-27

Information or issues (included in *Description of Issue*) not previously contemplated by the Working Group: As ASU 2019-09 solely addresses the effective date of ASU 2018-12, which was previously rejected for statutory accounting, in the Preamble 50, 51R, 52, 54R, 55, 56, 71, 86. NAIC staff recommends rejecting ASU 2019-09 in *Appendix D—Nonapplicable GAAP Pronouncements*, as the pronouncement relates to transition of a previously issued GAAP pronouncement.

Convergence with International Financial Reporting Standards (IFRS): N/A in relation to this agenda item.

Staff Recommendation:
NAIC Staff recommends the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to *Appendix D—Nonapplicable GAAP Pronouncements* to reject *ASU 2019-09—Financial Services – Insurance* as not applicable for statutory accounting. This ASU solely addresses the effective date of ASU 2018-12, which was rejected by the Statutory Accounting Principles (E) Working Group on Aug. 3, 2019.

Staff Note: On June 10, 2020, the FASB exposed a proposed ASU, for a 45-day comment period, that would grant insurance companies that issue long-duration contracts, such as life insurance and annuities, an additional year to implement *Accounting Standards Update No. 2018-12, Financial Services—Insurance (Topic 944): Targeted Improvements to the Accounting for Long-Duration Contracts*. Under the proposal, the implementation of the insurance standard would be delayed by another year. Public insurers, excluding small public companies, could delay implementing the standard to fiscal years after Dec. 15, 2022, while all others could wait until fiscal years after Dec. 15, 2024. As ASU 2018-12 was rejected for SAP, it is anticipated that this extension will also be rejected as not applicable for statutory accounting once the ASU is final. This notice is just intended to advise of the further extension of the effective date.

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

Status:
On July 30, 2020, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to *Appendix D—Nonapplicable GAAP Pronouncements* to reject *ASU 2019-09—Financial Services – Insurance* as not applicable to statutory accounting.

On October 13, 2020, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed revisions to *Appendix D—Nonapplicable GAAP Pronouncements* to reject *ASU 2019-09—Financial Services – Insurance* as not applicable to statutory accounting.

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Ref #2020-28

Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
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Issue: *ASU 2020-01, Investments—Equity Securities (Topic 321), Investments—Equity Method and Joint Ventures (Topic 323), and Derivatives and Hedging (Topic 815), Clarifying the Interactions between Topic 321, Topic 323, and Topic 815*

Check (applicable entity):

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

Description of Issue: In Jan. 2016, FASB issued *ASU 2016-01, Financial Instruments, Recognition and Measurement of Financial Assets and Financial Liabilities,* which allows an entity to measure certain equity securities (without a readily determinable fair value) at cost, less any impairments. This alternative measurement method and ASU 2016-01 were rejected for statutory accounting.

ASU 2020-01 addresses stakeholder questions regarding accounting for the transition between the alternative measurement method allowed in ASU 2016-01 (at cost, less impairments) to the equity method of accounting. Investments that are accounted for under the equity method of accounting are excluded from the fair value instrument disclosures in *SSAP No. 100R—Fair Value*.

Two main issues are discussed in this ASU:

- Issue 1: Accounting for Certain Equity Securities upon the Application or Discontinuation of the Equity Method of Accounting: The amendments in ASU 2020-01 clarify that an entity should consider observable transactions that require it to either apply or discontinue the equity method of accounting for the purposes of applying the measurement alternative in accordance with Topic 321-Investments-Equity Securities immediately before applying or upon discontinuing the equity method.

  Paragraphs were amended in Topics 321 and 323 to state that an entity should remeasure the security upon adopting the equity method of accounting or upon discontinuance of the equity method, respectively. The value would then be applied to retained earnings. (Although the alternative measurement method under ASU 2016-01 was rejected, reporting entities can use the market value method instead of the equity method, if they qualify under SSAP No. 97. Under statutory accounting, a change to or from the equity method of accounting from the market value method must be approved by the commissioner. When this occurs, the investment is adjusted the reporting the equity interest in the SCA entity under the new method, with the difference recognized as an unrealized gain or loss.)

- Issue 2: Scope Considerations for Forward Contracts and Purchased Options on Certain Securities: The amendments in this ASU clarify that an entity should not consider whether, upon the settlement of the forward contract or exercise of the purchased option, individually or with existing investments, the underlying securities would be accounted for under the equity method in Topic 323: Investments-Equity Method and Joint Ventures or the fair value option in accordance with the financial instruments guidance in Topic 815: Derivatives and Hedging. An entity would also evaluate the remaining characteristics to determine the accounting for those forward contracts and purchased options.

Amendments to Topic 815 were added to explain that the guidance in the Certain Contracts on Debt and Equity Securities subsections apply to those forward contracts and purchased options that are not derivative instruments, but that involve the acquisition of securities that will be accounted for under Topic 321-Equity Securities.
For statutory accounting, *EITF 96-11, Accounting for Forward Contracts and Purchased Options to Acquire Securities Covered by FASB Statement No. 115* was previously rejected. As such, this topic is not part of statutory accounting.

Existing Authoritative Literature:

SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies (bolding for emphasis)

6. **Investments in these ventures, except for joint ventures, partnerships and limited liability companies with a minor ownership interest[1], shall be reported using an equity method as defined in *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*, paragraphs 8.b.i. through 8.b.iv.** A reporting entity whose shares of losses in a SSAP No. 48 entity exceeds its investment in the SSAP No. 48 entity shall disclose the information required by SSAP No. 97, paragraph 35.a.

10. **The amount to be recorded shall be defined as the initial investment in an investee at cost (as defined in paragraph 3 of *SSAP No. 68—Business Combinations and Goodwill*) plus subsequent capital contributions to the investee.** The carrying amount of the investment shall be adjusted for the amortization of the basis difference (difference between the cost and the underlying GAAP equity), as well as to recognize the reporting entity's share of: (i) the audited U.S. GAAP basis earnings or losses of the investee after the date of acquisition, adjusted for any distributions received, or (ii) if audited U.S. GAAP basis financial statements of the investee are not available, the earnings or losses of the investee after the date of acquisition, adjusted for any distributions received, based on either one of the valuation methodologies allowed under paragraphs 9.a. or 9.b. A reporting entity's share of adjustments, excluding changes in capital contributions to the investee, that are recorded directly to the investee's stockholders' equity shall also be recorded as adjustments to the carrying value of the investment with an offsetting amount recorded to unrealized capital gains and losses on investments.

SSAP No. 86—Derivatives (bolding for emphasis)

18. Derivative instruments represent rights or obligations that meet the definitions of assets (*SSAP No. 4—Assets and Nonadmitted Assets*) or liabilities (SSAP No. 5R) and shall be reported in financial statements. In addition, derivative instruments also meet the definition of financial instruments as defined in *SSAP No. 27—Off-Balance-Sheet and Credit Risk Disclosures*. **Should the cost basis of the derivative instrument be undefined (i.e., no premium is paid), the instrument shall be disclosed in accordance with paragraphs 44-48 of *SSAP No. 100R—Fair Value*. Derivative instruments used in hedging, income generation or replication (synthetic asset) transactions shall be recognized and measured in accordance with the specific provisions within this statement and are admitted assets to the extent they conform to the requirements of this statement.**

SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities (bolding for emphasis)

[1] With the identification of whether the reporting entity has a minor ownership interest, reporting entities must also identify whether the investment is a related-party transaction. Pursuant to the concepts reflected in *SSAP No. 25—Affiliates and Other Related Parties*, consideration shall be given to the substance of the transaction and the parties whose action or performance materially impacts the insurance reporting entity holding the security. For example, if the underlying assets within a SSAP No. 48 entity represent assets issued by an affiliate, then the SSAP No. 48 entity shall be considered a related party (affiliate) investment, with the transaction subject to the accounting and reporting provisions of SSAP No. 25. As identified in SSAP No. 25, it is erroneous to conclude that the inclusion of a non-related intermediary, or the presence of non-related assets in a structure predominantly comprised of related party investments, eliminates the requirement to identify and assess the investment transaction as a related party arrangement.

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

5. Control is defined as the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of the investee, whether through the (a) ownership of voting securities, (b) by contract other than a commercial contract for goods or nonmanagement services, (c) by common management, or (d) otherwise. Control shall be presumed to exist if a reporting entity and its affiliates directly or indirectly, own, control, hold with the power to vote, or hold proxies representing 10% or more of the voting interests of the entity[2].

6. Control as defined in paragraph 5 shall be measured at the holding company level. For example, if one member of an affiliated group has a 5% interest in an entity and a second member of the group has an 8% interest in the same entity, the total interest is 13% and therefore each member of the affiliated group shall be presumed to have control. This presumption will stand until rebutted by an evaluation of all the facts and circumstances relating to the investment based on the criteria in *FASB Interpretation No. 35, Criteria for Applying the Equity Method of Accounting for Investments in Common Stock, an Interpretation of APB Opinion No. 18.* The corollary is required to demonstrate control when a reporting entity owns less than 10% of the voting securities of an investee. The insurer shall maintain documents substantiating its determination for review by the domiciliary commissioner**. An investment in an SCA entity may fall below the level of ownership described in paragraph 5, in which case, the reporting entity would discontinue the use of the equity method, as prescribed in paragraph 13.g. Additionally, through an increase in the level of ownership, a reporting entity may become qualified to use the equity method of accounting (paragraph 8.b.), in which case, the reporting entity shall add the cost of acquiring additional interest to the current basis of the previously held interest and shall apply the equity method prospectively, as of the date the investment becomes qualified for equity method accounting.** Examples of situations where the presumption of control may be in doubt include the following:

a. Any limited partner investment in a limited partnership, unless the limited partner is affiliated with the general partner.

b. An entity where the insurer owns less than 50% of an entity and there is an unaffiliated individual or group of investors who own a controlling interest.

c. An entity where the insurer has given up participating rights[3] as a shareholder to the investee.

13.g. **An investment in a SCA entity may fall below the level of ownership described in paragraph 5 from the sale of a portion of an investment by the reporting entity, the sale of additional interests by an investee,**

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[2] Investments in an exchange traded fund (ETF) or a mutual fund (as defined by the SEC) does not reflect ownership in an underlying entity, regardless of the ownership percentage the reporting entity (or the holding company group) has of the ETF or mutual fund unless ownership of the ETF actually results in "control" with the power to direct or cause the direction of management of an underlying company. ETFs and mutual funds are comprised of portfolios of securities subject to the regulatory requirements of the federal securities laws. ETFs and mutual funds held by a reporting entity shall be reported as common stock, unless the ETF qualifies for bond or preferred stock treatment per the *Purposes and Procedures Manual of the NAIC Investment Analysis Office*. Reporting entities are not required to verify that SCAs (subject to SSAP No. 97) are represented in the portfolio of securities held in ETFs or mutual funds or to adjust the value of SCAs as a result of investments in ETFs or mutual funds.

[3] The term "participating rights" refers to the type of rights that allows an investor to effectively participate in significant decisions related to an investee's ordinary course of business and is distinguished from the more limited type of rights referred to as "protective rights". Refer to the sections entitled: "Protective Rights" and "Substantive Participating Rights" in *EITF 96-16, Investor's Accounting for an Investee When the Investor Has a Majority of the Voting Interest but the Minority Shareholder or Shareholders Have Certain Approval or Veto Rights*. The term "participating rights" shall be used consistent with the discussion of substantive participating rights in this EITF.

or other transactions. The reporting entity shall discontinue accruing its share of the earnings or losses of the investee for an investment that no longer qualifies for an equity method. The earnings or losses that relate to the investment interests retained by the reporting entity and that were previously accrued shall remain as a part of the carrying amount of the investment. The investment account shall not be adjusted retroactively under the conditions described in this subparagraph. However, dividends received by the investor in subsequent periods which exceed the reporting entity's share of earnings for such periods shall be applied as a reduction of the carrying amount of the investment.

14. Once the reporting entity elects to use a valuation approach for a particular subsidiary, the reporting entity may not change the valuation method to another method without the approval of the domiciliary commissioner. For instance, if an entity selects the market valuation method, it may not change to an equity method or vice versa without approval from the domiciliary commissioner. Further, in order for an entity to transfer from a paragraph 8.a., or 8.b.ii. valuation to a paragraph 8.b.iii. valuation, the SCA shall not exceed the 20% threshold (as defined in paragraphs 8.b.ii.) for three consecutive years prior to making the change. When an investment qualifies for use of another method of accounting, the reporting entity shall adopt the new method of accounting and the investment shall be adjusted to reflect the reporting entity's equity interest in the SCA entity under the new method. A corresponding amount shall be recorded as an unrealized gain or loss.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): This ASU was issued to clarify ASU 2016-01, Financial Instruments-Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities, which was rejected by the Working Group at the Summer 2016 National Meeting. ASU 2016-01 was rejected as SAP reporting classifications and valuation measurements differ from GAAP.

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

Convergence with International Financial Reporting Standards (IFRS): None

Staff Recommendation:

Staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to reject *ASU 2020-01, Investments—Equity Securities (Topic 321), Investments—Equity Method and Joint Ventures (Topic 323), and Derivatives and Hedging (Topic 815), Clarifying the Interactions between Topic 321, Topic 323, and Topic 815* for statutory accounting. These revisions noting rejection are proposed to *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*, *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities* and *SSAP No. 86—Derivatives*, as illustrated below.

SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies

<u>28. This statement rejects *ASU 2020-01, Investments—Equity Securities (Topic 321), Investments—Equity Method and Joint Ventures (Topic 323), and Derivatives and Hedging (Topic 815), Clarifying the Interactions between Topic 321, Topic 323, and Topic 815*.</u>

SSAP No. 86—Derivatives

69. This statement rejects <u>*ASU 2020-01, Investments—Equity Securities (Topic 321), Investments—Equity Method and Joint Ventures (Topic 323), and Derivatives and Hedging (Topic 815), Clarifying the Interactions between Topic 321, Topic 323, and Topic 815* and</u> *ASU 2018-03, Recognition and Measurement of Financial Assets and Financial Liabilities*, and *ASU 2016-03, Intangibles—Goodwill and Other, Business Combinations, Consolidation, Derivatives and Hedging*.

Ref #2020-28

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

48. This statement rejects *ASU 2020-01, Investments—Equity Securities (Topic 321), Investments—Equity Method and Joint Ventures (Topic 323), and Derivatives and Hedging (Topic 815), Clarifying the Interactions between Topic 321, Topic 323, and Topic 815, ASU 2019-06, Intangibles—Goodwill and Other Business Combinations, and Non-for-Profit Entities, ASU 2011-10, Derecognition of in Substance Real Estate, APB Opinion No. 18, The Equity Method of Accounting for Investments in Common Stock, AICPA Accounting Interpretations APB 18, The Equity Method of Accounting for Investments in Common Stock:* Accounting Interpretations of *APB Opinion No. 18, FASB Technical Bulletin No. 79-19, Investor's Accounting for Unrealized Losses on Marketable Securities Owned by an Equity Method Investee, FASB Emerging Issues Task Force No. 87-21, Change of Accounting Basis in Master Limited Partnership Transactions, FASB Emerging Issues Task Force No. 96-16, Investor's Accounting for an Investee When the Investor Has a Majority of the Voting Interest but the Minority Shareholder or Shareholders Have Certain Approval or Veto Rights*, *FASB Emerging Issues Task Force No. 98-2: Accounting by a Subsidiary or Joint Venture for an Investment in the stock of Its Parent Company or Joint Venture Partner* and *FASB Staff Position No. APB 18-1*, *Accounting by an Investor for Its Proportionate Share of Accumulated Other Comprehensive Income of an Investee Accounted for under the Equity Method in Accordance with APB Opinion No. 18 upon a Loss of Significant Influence.*

Staff Review Completed by:
NAIC Staff – Fatima Sediqzad
April 2020

Status:
On July 30, 2020, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to reject *ASU 2020-01, Investments—Equity Securities (Topic 321), Investments—Equity Method and Joint Ventures (Topic 323), and Derivatives and Hedging (Topic 815), Clarifying the Interactions between Topic 321, Topic 323, and Topic 815* for statutory accounting. As illustrated above, revisions noting rejection are proposed to *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*, *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities* and *SSAP No. 86—Derivatives*.

On October 13, 2020, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed revisions to reject *ASU 2020-01, Investments—Equity Securities (Topic 321), Investments—Equity Method and Joint Ventures (Topic 323), and Derivatives and Hedging (Topic 815), Clarifying the Interactions between Topic 321, Topic 323, and Topic 815* for statutory accounting. The revisions noting rejection were adopted to *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*, *SSAP No. 86—Derivatives* and *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*.

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Ref #2020-29

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

Issue: ***ASU 2020-05—Effective Dates for Certain Entities***

Check (applicable entity):

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

Description of Issue:
FASB issued *ASU 2020-05, Revenue from Contracts with Customers (Topic 606) and Leases (Topic 842), Effective Dates for Certain Entities*, which updates the effective dates for *ASU 2014-19, Revenue from Contracts with Customers (Topic 606)* and *ASU 2016-02, Leases (Topic 842)*. Both ASU 2014-19 and ASU 2016-02 have been rejected for statutory accounting. The guidance in ASU 2020-05 defers the effective date for the prior ASUs by one year for companies that have not yet implemented the new guidance.

Existing Authoritative Literature:
The ASUs related to ASC Topic 606 have been rejected in *SSAP No. 47—Uninsured Plans* and the ASUs related to Topic 842 have been rejected in *SSAP No. 22R—Leases*.

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

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

Convergence with International Financial Reporting Standards (IFRS): ASC Topic 606 and 842 both result from joint projects FASB and IASB.

Staff Recommendation: NAIC staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive, and expose revisions to *Appendix D—Nonapplicable GAAP Pronouncements* to reject *ASU 2020-05, Revenue from Contracts with Customers (Topic 606) and Leases (Topic 842), Effective Dates for Certain Entities* as not applicable to statutory accounting.

This item is proposed to be rejected as not applicable as ASU 2020-05 only impacts the effective date for U.S. GAAP guidance that has been rejected for statutory accounting.

Staff Review Completed by: Jake Stultz, June 2020

Status:
On July 30, 2020, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to *Appendix D—Nonapplicable GAAP Pronouncements* to reject *ASU 2020-05, Revenue from Contracts with Customers (Topic 606) and Leases (Topic 842), Effective Dates for Certain Entities* as not applicable to statutory accounting.

Ref #2020-29

On October 13, 2020, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed revisions to *Appendix D—Nonapplicable GAAP Pronouncements* to reject *ASU 2020-05, Revenue from Contracts with Customers (Topic 606) and Leases (Topic 842), Effective Dates for Certain Entities* as not applicable to statutory accounting.

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Fields of Opportunities

STATE OF IOWA

KIM REYNOLDS
GOVERNOR

ADAM GREGG
LT. GOVERNOR

DOUG OMMEN
COMMISSIONER OF INSURANCE

October 6, 2020

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

RE: Ref #2019-21 – SSAP No. 43R, Loan-backed and Structured Securities

Dear Mr. Bruggeman:

The Iowa Insurance Division (the "Division") would like to make comment regarding the ongoing discussions of Reference #2019-21 – SSAP No. 43R, Loan-backed and Structured Securities. The Working Group has exposed Issue Paper No. 1XX in regards to this topic which has received extensive commentary from interested parties.

The impetus for this project was to review the scope of SSAP 43R to determine whether certain types of investments with unique characteristics should be reported as loan-backed and structured securities within the scope of SSAP 43R. This was in response to the identification of such investments by regulators and the SVO and concerns raised that some may not be of the character that regulators would expect to be reported as bonds on Schedule D-1. When defining the project as a SSAP 43R scoping project, it was expected that all of the investments identified were being reported in scope of SSAP 43R.

It has since been identified that there is diversity in practice in how these investments are classified, and that some companies believe that many of the investments identified for evaluation in this project are within the scope of SSAP 26R. The appropriate classification between SSAP 26R and SSAP 43R is an important topic, and the Working Group should consider whether there are clarifications needed to address the differences in interpretation. However, this issue is secondary to the primary purpose of this project, which is to determine whether investments with certain unique characteristics should qualify as bonds for Schedule D-1 reporting.

It has been identified that the definition of a bond under current statutory accounting principles is broad and includes, "any securities representing a creditor relationship, whereby there is a fixed schedule for one or more future payments." Given the broad definition, it is possible for an insurer to acquire any asset through a debt-issuing trust or special purpose vehicle and report it as a Schedule D-1 bond, even if that asset would be otherwise inadmissible if held directly, and even if there is no economic substance to the trust. In other words, the insurer could be in an identical economic position to holding the inadmissible asset directly and still qualify for Schedule D-1 reporting.

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In most cases, securitizations serve a bona fide economic purpose and can create high-quality bonds out of a pool of otherwise non-investable assets through overcollateralization and the prioritization of payments to debtholder classes. However, the current guidance is too broad to distinguish between those with economic substance and those without, leaving the reporting of these assets susceptible to abuse.

Therefore, the Division recommends that the Working Group focus its efforts on developing a principles-based definition for those assets that qualify for Schedule D-1 bond treatment as the initial step for this project. To facilitate this discussion, the Division has included as Appendix A of this letter, a draft definition that we believe serves as a good starting point for identifying those principles. This draft is intended to facilitate the discussions of the Working Group and industry and we look forward to hearing feedback on both the draft and the proposed direction of the project.

Once the Working Group has reached consensus regarding those assets that qualify for Schedule D-1 bond reporting, there may be certain characteristics that, while they do not impair qualification as a bond, may warrant separate identification on Schedule D-1. This, along with clarification of the classification between SSAP 26R and SSAP 43R and review of the accounting and measurement methodologies will be important secondary objectives of the project. But it is first necessary to answer the question of what qualifies as a bond, before these secondary objectives can be fully addressed.

Sincerely,

Kevin Clark, Chief Accounting Specialist, Iowa Insurance Division

Carrie Mears, Chief Investment Specialist, Iowa Insurance Division

Appendix A

Introduction

The following draft definition provides a basis for distinguishing between the two types of bonds which have been identified through discussions to date. Those are issuer obligations and asset backed securities. It clarifies that issuer obligations are those backed by the credit of an operating entity. A debt security that is issued by an entity whose purpose is the pass-through of collateral cash flows is not an issuer obligation.

The definition of asset backed securities specifies that they involve the securitization of **financial assets**. When an insurer invests in a securitization of assets, it is important that the nature of those assets lend themselves to the production of cash flows. Therefore, the securitization of non-financial assets should receive bond treatment only in instances where the nature of the assets lends itself to the production of cash flows. Those specific instances should be separately identified for Schedule D-1 qualification, as is currently the case with lease-backed securities and equipment trust certificates.

The definition of asset backed securities also stipulates that an asset backed security redistributes the risk of the underlying collateral such that the investor is in a different position than if the underlying collateral were held directly. Under this definition, an entity that simply passes through the proceeds of the underlying collateral has done nothing to alter the nature of the investment, has no economic substance, and should therefore be looked through to determine the appropriate accounting.

Finally, it introduces the concept that a key characteristic of a bond and what makes it a debt investment, rather than an equity-like investment, is that it represents a senior or priority interest in the assets of the issuer. This is true for issuer obligations as well as asset backed securities. Therefore, in order for something to meet the definition of a bond, there must be a more-than-insignificant subordinated interest present, or said another way, overcollateralization. The residual position is akin to an equity investment, and should not qualify for Schedule D-1 reporting.

Principles-based Definition of a Bond to be Reported on Schedule D, Part 1: (New Elements in Red)

1. Bonds shall be defined as any securities representing a creditor relationship, whereby there is a fixed schedule for one or more future payments, and which qualify as Issuer Obligations or Asset Backed Securities.

2. Issuer Obligations represent the debt of operating entities, which have a purpose other than the pass through of investment proceeds. Examples of issuer obligations include (SSAP 26R examples):

    a. U.S. Treasury securities;(INT 01-25)

    b. U.S. government agency securities;

    c. Municipal securities;

    d. Corporate bonds, including Yankee bonds and zero-coupon bonds;

    e. Convertible bonds, including mandatory convertible bonds as defined in paragraph 11.b;

    f. Fixed-income instruments specifically identified:

        i. Certifications of deposit that have a fixed schedule of payments and a maturity date in excess of one year from the date of acquisition;

Appendix A

ii. Bank loans issued directly by a reporting entity or acquired through a participation, syndication or assignment;

iii. Hybrid securities, excluding: surplus notes, subordinated debt issues which have no coupon deferral features, and traditional preferred stocks.

iv. Debt instruments in a certified capital company (CAPCO) (INT 06-02)

3. Asset backed securities represent debt issued through the securitization of financial assets. There are two defining characteristics that must be present in order for a security to meet the definition of an asset backed security:

   a. The financial assets collateralizing the debt issuance are expected to be the primary source of cash flows for repayment of the debt;

   b. The securitization of the financial assets collateralizing the debt issuance redistributes the credit risk of the underlying financial assets, such that the creditor is in a different position than if the underlying collateral were held directly.

   Asset backed securities are typically issued from a trust or special purpose vehicle, though the presence or lack of a trust or special purpose vehicle is not a definitive criterion for determining that a security meets the definition of an asset backed security.

4. Inherent in the definition of a bond, whether represented by an issuer obligation or asset backed security, is the notion that the creditor has a senior interest in the assets of the issuer. The most subordinated interest, sometimes referred to as the first-loss position, represents the interest of an equity holder, rather than a creditor. Therefore, in order to meet the definition of a bond, a more-than-insignificant subordinated interest must be present.

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Draft: 8/21/20

Statutory Accounting Principles (E) Working Group
E-Vote
August 17, 2020

The Statutory Accounting Principles (E) Working Group of the Accounting Practices and Procedures (E) Task Force conducted an e-vote that concluded Aug. 17, 2020. The following Working Group members participated: Carrie Mears, Vice Chair (IA); Richard Ford (AL); Kim Hudson (CA); William Arfanis (CT); Rylynn Brown (DE); Eric Moser (IL); Stewart Guerin (LA); Judy Weaver (MI); Doug Bartlett (NH); Tom Dudek (NY); Joe DiMemmo (PA); David Smith (VA); and Amy Malm (WI).

1. Adopted Non-Contested Statutory Accounting Revisions During its Public Hearing

The Working Group received public comments (Attachment One-C1) on previously exposed items.

Ms. Mears made a motion, seconded by Mr. Guerin, to extend the effective dates of the accounting interpretations (INTs) detailed below. With extension, the INTs will be applicable for the Sept. 30, 2020, financial statements and will expire as of Dec. 30, 2020. The motion passed unanimously.

- INT 20-02: Extension of 90-Day Rule for the Impact of COVID-19. This interpretation provides an optional extension of the 90-day rule before nonadmitting premium receivables and receivables from non-government uninsured plans. (Attachment One-C2)

- INT 20-04: Mortgage Loan Impairment Assessment Due to COVID-19. This interpretation provides limited time exceptions to defer assessments of impairment for bank loans, mortgage loans and investments that predominantly hold underlying mortgage loans, which are affected by forbearance or modifications in response to COVID-19. (Attachment One-C3)

- INT 20-05: Investment Income Due and Accrued. This interpretation provides an exception for the nonadmittance of recorded investment income due and accrued that becomes more than 90 days past due. Reported investment income interest due and accrued that becomes more than 90 days past due may continue to be admitted in the Sept. 30, 2020, financial statements. (Attachment One-C4)

2. Exposed Nonsubstantive Statutory Accounting Revisions During its Public Hearing

Ms. Mears made a motion, seconded by Mr. Guerin, to expose agenda item 2020-31: Early Application of SSAP No. 32R for a 32-day public comment period ending Sept. 18. This agenda item proposes nonsubstantive revisions, which would allow for early adoption of *SSAP No. 32R—Preferred Stock.* The motion passed unanimously.

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

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American Property Casualty Insurance Association
INSURING AMERICA apci.org

Stephen W. Broadie
Vice President, Financial & Counsel

August 14, 2020

Dale Bruggeman
Chair, NAIC Statutory Accounting Principles (E) Working Group
Ohio Department of Insurance
50 W. Town St., Suite 300
Columbus, OH 43215

Re: Interpretations in Response to COVID-19 Expiring 2nd Quarter 2020

Dear Mr. Bruggeman:

The American Property Casualty Insurance Association (APCIA) asks the Statutory Accounting Principles (E) Working Group to extend INTs 20-02 (*Extension of the Ninety-Day Rule for the Impact of COVID-19*), 20-04 (*Mortgage Loan Impairment Assessment Due to COVID-19*), and 20-05 (*Investment Income Due and Accrued*) through the third quarter of 2020. APCIA is the primary national trade association for home, auto, and business insurers. The association promotes and protects the viability of private competition for the benefit of consumers and insurers, with a legacy dating back 150 years. APCIA members represent all sizes, structures, and regions—protecting families, communities, and businesses in the U.S. and across the globe.

We appreciate the willingness of the Working Group and NAIC staff to consider extension of these three important interpretations through the third quarter of 2020. It is especially important in our view to extend the application of INT 20-02. The majority of states are still encouraging insurers to provide or extend grace periods for premium payment due to the effects of COVID-19 and the related governmental restrictions on economic activity, and those insurers should not suffer a surplus penalty for providing that relief. Similar considerations apply to the mortgage loan impairment guidance in INT 20-04 and the collectability assessment and admittance exceptions for investment income due and accrued in INT 20-05. These are limited-time extensions due to extraordinary circumstances and provide necessary temporary flexibility for insurers to continue to support their policyholders and the American economy during this troubled time.

APCIA supports Working Group adoption of these extensions by an email vote.

Sincerely,

Stephen W. Broadie

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August 15, 2020

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

RE: Items Exposed for Comment by the Statutory Accounting Principles Working Group on July 30 with Comments due August 15

Dear Mr. Bruggeman:

Interested parties thank the NAIC Statutory Accounting Principles (E) Working Group (the "Working Group") for your continuing effort to address the various statutory accounting issues arising from the ongoing pandemic caused by the novel coronavirus, COVID-19. We appreciate the opportunity to comment on the exposure drafts released for comment the Working Group.

We offer the following comments:

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

Interested parties appreciate the Working Group's timely proposal to provide continued accounting relief through September 30, 2020 financial statements as related to INT, 20-02: Extension of the Ninety-Day Rule for the Impact of COVID-19, INT 20-04, *Mortgage Loan Impairment Assessment Due to COVID-19,* and INT 20-05, *Investment Income Due and Accrued.* Insurers continue to receive requests from borrowers to provide temporary financial relief related to commercial mortgage loans, and other investments, due to COVID-19. As shared previously with the Working Group, the insurance industry is a significant investor in the capital markets and would like to be positioned well to contribute to the ultimate economic recovery once COVID-19 subsides, which ultimately will be to the benefit of our policyholders. Accounting relief provided by INT 20-04 and INT 20-05 through September 30th financial reporting will facilitate this. We believe that, depending on facts and circumstances in the 4th Quarter, 2020, a further extension should be considered for year-end reporting.

* * *

Thank you for considering interested parties' comments. If you have any questions in the interim, please do not hesitate to contact us.

Sincerely,

D. Keith Bell Rose Albrizio

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Interpretation of the Statutory Accounting Principles Working Group

INT 20-02: Extension of Ninety-Day Rule for the Impact of COVID-19

INT 20-02 Dates Discussed

Email Vote to Expose March 26, 2020; April 15, 2020; July 30, 2020; August 17, 2020

INT 20-02 References

SSAP No. 6—Uncollected Premium Balances, Bills Receivable for Premiums, and Amounts Due From Agents and Brokers (SSAP No. 6)
SSAP No. 47—Uninsured Plans (SSAP No. 47)
SSAP No. 51—Life Contracts (SSAP No. 51)
SSAP No. 65—Property and Casualty Contracts (SSAP No. 65)

INT 20-02 Issue

1. A previously unknown virus began transmitting between October 2019 and March 2020, with the first deaths in the U.S. reported in early March 2020. The disease caused by the virus is known as Coronavirus Disease 2019 (COVID-19). Several states and cities have issued "stay home" orders and forced all non-essential businesses to temporarily close. This has led to a significant increase in unemployment and, in certain states, mandatory closure of many businesses. Total economic damage is still being assessed; however, the total impact is likely to exceed $1 trillion in the U.S. alone. This interpretation is intended to cover policies impacted by COVID-19.

2. Should a temporary extension of the 90-day rule, extending the nonadmission guidance for premium receivables due from policyholders or agents and for amounts due from policyholders for high deductible policies, and for uncollected uninsured plan receivables (excluding Medicare and similar government plans) be granted for the March 31 and June 30, 2020, (1st and 2nd quarter) financial statements, for policies in U.S. jurisdictions that have been impacted by COVID-19?

INT 20-02 Discussion

3. The Working Group reached a consensus for a one-time optional extension of the ninety-day rule for uncollected premium balances, bills receivable for premiums and amounts due from agents and policyholders and for amounts due from policyholders for high deductible policies and amounts due from non-government uninsured plans, as follows:

   a. For policies in effect and current prior to the date as of the declaration of a state of emergency by the U.S. federal government on March 13, 2020, and policies written or renewed on or after March 13, insurers may follow the timeline described in paragraph 5 before nonadmitting premiums receivable from policyholders or agents as required per SSAP No. 6, paragraph 9.

   b. For uncollected uninsured plan receivables (excluding Medicare and similar government plans) which were current prior to the date of the declaration of a state of emergency by the U.S. federal government on March 13, 2020, and policies written or renewed on or after March 13, insurers may follow the timeline described in paragraph 5 before nonadmitting these balances as required per SSAP No. 47, paragraph 10.a.

c. For life premium due and uncollected which were current prior to the date of the declaration of a state of emergency by the U.S. federal government on March 13, 2020, and policies written or renewed on or after March 13, insurers may follow the timeline described in paragraph 5 before nonadmitting these balances as required per SSAP No. 51R, paragraph 12.

d. For high deductible policies in effect and current prior to the date as of the declaration of a state of emergency by the U.S. federal government on March 13, 2020, and policies written or renewed on or after March 13, insurers may follow the timeline described in paragraph 5before nonadmitting amounts due from policyholders for high deductible policies as required per SSAP No. 65, paragraph 37.

e. Existing impairment analysis remains in effect for these affected policies.

4. The Working Group noted that a 60-day extension had been granted previously for regionally significant catastrophes, including *INT 13-01: Extension of Ninety-Day Rule for the Impact of Hurricane/Superstorm Sandy;* and *INT 05-04: Extension of Ninety-day Rule for the Impact of Hurricane Katrina, Hurricane Rita and Hurricane Wilma*, *INT 17-01: Extension of Ninety-Day Rule for the Impact of Hurricane Harvey, Hurricane Irma and Hurricane Maria*, and *INT 18-04: Extension of Ninety-Day Rule for the Impact of Hurricane Florence and Hurricane Michael*. This recommendation is for a longer period than the extensions that have been granted in the past as COVID-19 is a nationally significant event due to the expected overall impact to the U.S. economy.

5. Due to the short-term nature of this extension, which is only applicable for the March 31 and June 30, 2020, (1st and 2nd quarter) financial statements and only for the categories of assets listed in paragraph 3, this interpretation will be publicly posted on the Statutory Accounting Principles (E) Working Group's website. This INT will allow assets that meet the definition of paragraph 3 to be admitted assets even if they are greater than 90 days past due. As the exceptions provided in this interpretation are not applicable in the September 30, 2020, (3rd quarter) financial statements, this interpretation will automatically expire as of September 29, 2020. This interpretation will be automatically nullified on September 29, 2020, and will be included as a nullified INT in Appendix H – Superseded SSAPs and Nullified Interpretations in the "As of March 2021" *Accounting Practices and Procedures Manual*.

a. On August 17, 2020, the provisions in this INT were extended to be applicable for the September 30, 2020, (3rd quarter) financial statements. With this extension, this Interpretation will automatically expire as of December 30, 2020, (prior to the year-end 2020 financial statements). Subsequent consideration will occur to determine if an extension is needed beyond September 30, 2020.

INT 20-02 Status

6. On July 30, 2020, the Statutory Accounting Principles (E) Working Group exposed this interpretation for possible extension to September 30, 2020, (3rd quarter financial statements). If the extension were adopted, the proposed paragraph 5.a. would be incorporated into the INT. On August 17, 2020, the Statutory Accounting Principles (E) Working Group extended the provisions of this INT to be applicable for the September 30, 2020, (3rd quarter) financial statements, incorporating paragraph 5.a. into the INT.

7. The Statutory Accounting Principles (E) Working Group will subsequently review this interpretation to determine if an extension is needed to the effective date

Interpretation of the Statutory Accounting Principles Working Group

INT 20-04: Mortgage Loan Impairment Assessment Due to COVID-19

INT 20-04 Dates Discussed

Email Vote to Expose March 26, 2020; April 15, 2020; July 30, 2020; August 17, 2020

INT 20-04 References

SSAP No. 26R—Bonds
SSAP No. 30—Common Stock
SSAP No. 37—Mortgage Loans
SSAP No. 43R—Loan-backed and Structured Securities
SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies

INT 20-04 Issue

1. A previously unknown virus began transmitting between October 2019 and March 2020, with the first deaths in the U.S. reported in early March 2020. The disease caused by the virus is known as Coronavirus Disease 2019 (COVID-19). Several states and cities have issued "stay home" orders and forced all non-essential businesses to temporarily close. This led to a significant increase in unemployment and the potential permanent closure of many businesses. Total economic damage is still being assessed however the total impact is likely to exceed $1 trillion in the U.S. alone.

2. In response to COVID-19, Congress and Federal and state prudential banking regulators have considered provisions pertaining to loans as a result of the effects of the COVID-19. While primarily related to mortgage loans, these provisions are intended to be applicable for the term of a loan modification, but solely with respect to a modification, including a forbearance arrangement, an interest rate modification, a repayment plan, and any other similar arrangement that defers or delays the payment of principal or interest, that occurs during the applicable period for a loan that was not more than 30 days past due as of December 31, 2019.

3. Furthermore, guidance has been issued by the Financial Condition (E) Committee to all U.S. insurers filing with the NAIC in an effort to encourage insurers to work with borrowers who are unable to, or may become unable to meet their contractual payment obligations because of the effects of COVID-19. As detailed in that guidance, the Committee, which is the NAIC parent committee of all the solvency policy making task forces and working groups of the NAIC, supports the use of prudent loan modifications that can mitigate the impact of COVID-19.

4. This interpretation intends to address the impact of loan forbearance or prudent modifications on the statutory accounting and reporting requirements for bank loans, mortgage loans, as well as investments with underlying mortgage loans. Particularly, this interpretation considers whether a temporary, limited-time statutory exception for the assessment of impairment shall be granted for bank loans, mortgage loans and investment products with underlying mortgage loans. This exception would only defer the assessment of impairment due to situations caused by the forbearance or modification of mortgage loan payments and would not delay the recognition of other than temporary impairments if the entity made a decision to sell the investment and/or if provisions other than the limited-time forbearance or modifications of mortgage loans payments caused the entity to identify that they would not recover the reported carrying value of the investment.

INT 20-04 Discussion

5. Although a variety of structures have the potential to be impacted by the economic stimulus provisions, this interpretation is limited to investments specifically identified. Except for the specific inclusion of bank loans, this interpretation does not include investments captured in scope of *SSAP No. 26R—Bonds* or investments captured in the identified standards that are not predominantly impacted by underlying mortgage loans with forbearance or modification provisions in response to COVID-19. Investments in scope of this interpretation include:

a. *SSAP No. 26R—Bonds:* Bank loans in scope of SSAP No. 26R

b. *SSAP No. 37—Mortgage Loans:* All mortgage loans in scope of SSAP No. 37.

c. *SSAP No. 30—Common Stock:* SEC registered investments with underlying mortgage loans (e.g., mortgage-backed mutual funds).

d. *SSAP No. 43R—Loan-backed and Structured Securities:* Securities in scope of SSAP No. 43R with underlying mortgage loans. This includes residential and commercial mortgage backed securities (RMBS & CMBS), and credit risk transfers (CRTs) issued through government sponsored enterprises (GSEs). Other investments in scope of SSAP No. 43R are also captured within this interpretation if the underlying investments predominantly reflect mortgage loan products.

e. *SSAP No. 48—Joint Ventures, Partnerships and Limited Liabilities Companies:* Investments in scope of SSAP No. 48 that have underlying characteristics of mortgage loans. These investments could include private equity mortgage loan funds.

Bank Loans

6. Bank loans, if meeting certain parameters, are in scope of *SSAP No. 26R—Bonds.* Bank loans per SSAP No. 26R, are defined as fixed-income instruments, representing indebtedness of a borrower, made by a financial institution. Bank loans can be issued directly by a reporting entity or acquired through an assignment, participation or syndication. The guidance in SSAP No. 26R states an other-than-temporary impairment shall be considered to have occurred it if is probable the reporting entity will be unable to collect amounts due according the contract terms of a debt security in effect at the date of issue/acquisition. The measurement of the impairment loss shall not include partial recoveries of fair value subsequent to the balance sheet date. The impairment guidance applicable to bank loans states that if it is probable or if repayment does not occur according to the terms of the original contract (i.e., payment timing and amounts), an impairment shall be considered to have occurred.

Mortgage Loans

7. Mortgage loans are in scope of *SSAP No. 37—Mortgage Loans* and reported on Schedule B: Mortgage Loans. The guidance in SSAP No. 37, paragraph 16, identifies that a mortgage loan shall be considered impaired when mortgage loan payments are not received in accordance with the contractual terms of the mortgage agreement. As such, a deference or modification of mortgage loan payments (whether interest or principal) would ordinarily trigger an impaired classification and require impairment assessment under SSAP No. 37. The guidance in SSAP No. 37 utilizes a valuation allowance to recognize unrealized losses from impairment assessments and permits subsequent reversals of unrealized losses reflected in the valuation allowance based on subsequent assessments. If an impairment is deemed other than temporary, the unrealized loss is realized without the potential for subsequent recoveries.

SEC Registered Funds with Underlying Mortgage Loans

8. The scope of *SSAP No. 30—Common Stock* includes SEC registered open-end investment companies (mutual funds), closed-end funds and unit investment trusts, regardless of the types or mix of securities owned by the fund. Investments in scope of this statement include mortgage-backed mutual funds and other such investments. Items in scope of SSAP No. 30 are reported on Schedule D-2-2: Common Stock. These investments are reported at fair value, with changes in fair value recognized as unrealized gains or losses. The guidance in SSAP No. 30 requires recognition of an other than temporary impairment (OTTI) (realized loss) if a reporting entity decision has decided to sell the security at an amount below its carrying value or if the decline in fair value is determined to be other than temporary pursuant to *INT 06-07: Definition of Phrase "Other Than Temporary."* As investments in scope of SSAP No. 30 are reported at fair value, subsequent recoveries (or losses) in fair value, after recognition of an OTTI, are recognized as unrealized gains or losses until sold or additional OTTI recognition.

Loan-Backed and Structured Securities with Underlying Mortgage Loans

9. The scope of *SSAP No. 43R—Loan-Backed and Structured Securities* includes residential mortgage backed securities (RMBS), commercial mortgage backed securities (CMBS) and credit risk transfers (CRTs) issued through government sponsored enterprises (GSEs). (These are commonly referred as Structured Agency Credit Risk Securities (STACRs), which are issued by Freddie Mac, and Connecticut Avenue Securities (CAS), which are issued by Fannie Mae.) Other mortgage loan products that meet the structural requirements as a LBSS can also be captured in scope of SSAP No. 43R. Investments in scope of this statement securities are reported on Schedule D-1: Long-Term Bonds. Pursuant to the guidance in SSAP No. 43R, paragraphs 30-36, if a fair value of a LBSS is less than its amortized cost basis at the balance sheet date, an entity shall assess whether the impairment is other than temporary. Recognition of an OTTI is then contingent on the reporting entity intentions:

a. If the entity intends to sell the security, an OTTI shall be considered to have occurred. In these situations, the entity shall recognize a realized loss for the difference between the amortized cost basis and fair value. These realizes losses are not permitted to be reversed.

b. If the entity does not intend to sell the security, the entity shall assess whether it has the intent and ability to retain the investment in the security for a period of time sufficient to recover the amortized cost basis. If the entity does not have the intent and ability to retain the investment for the time sufficient to recover the amortized cost basis, an OTTI shall be considered to have occurred. In these situations, the entity shall recognize a realized loss for the difference between the amortized cost basis and fair value. These realizes losses are not permitted to be reversed.

c. Regardless if the entity does not have the intent to sell or has the intent and ability to hold, if the entity does not expect to recover the entire amortized cost basis of the security, an OTTI shall be considered to have occurred. In these situations, the entity shall recognize a realized loss for the difference between the amortized cost basis and the present value of cash flows expected to be collected.

Other Invested Assets with Underlying Mortgage Loans

10. The scope of *SSAP No. 48—Joint Ventures, Partnerships and Limited Liabilities Companies* includes investments that may have underlying characteristics of mortgage loans. These items are reported on Schedule BA: Other Long-Term Invested Assets. These investments could include private equity mortgage loan funds as well mortgage or hybrid real estate investment trusts (REITs). The guidance in SSAP No. 48, paragraph 19, requires recognition of an OTTI if it is probable that the reporting entity will be unable to recover the carrying amount of the investment or sustain earnings to justify the carrying amount of the investment. The existing

guidance already indicates that a depressed fair value below the carrying amount or the existence of operating losses are not necessarily indicators of a loss that is other than temporary.

INT 20-04 Consensus

11. The Working Group reached a consensus for limited time exceptions to defer assessments of impairment for bank loans, mortgage loans and investments which predominantly hold underlying mortgage loans, which are impacted by forbearance or modifications in response to COVID-19. These exceptions are applicable for the March 31 and June 30, 2020, (1^{st} and 2^{nd} quarter) financial statements and only in response to mortgage loan forbearance or modifications granted in response to COVID-19. As such, the exceptions provided in this interpretation are not applicable in the September 30, 2020, (3^{rd} quarter) financial statements.

12. For modification programs designed to provide temporary relief for borrowers current as of December 31, 2019, the reporting entities may presume that borrowers are current on payments are not experiencing financial difficulties at the time of the modification for purposes of determining impairment status and thus no further impairment analysis is required for each loan modification in the program. The exceptions granted in this interpretation are detailed as follows:

a. *SSAP No. 26R—Bonds*: Provide a limited-time exception for assessing impairment under SSAP No. 26, paragraph 13, for bank loans with payments (either principal or interest) that have short-term deferrals or modifications in response to COVID-19. This interpretation shall not delay impairment assessments for reasons other than the short-term deferral or modification of interest or principal payments in response to COVID-19 and shall not delay recognition of realized losses if a reporting entity believes a bank loan is OTTI.

b. *SSAP No. 37—Mortgage Loans*: Provide a limited-time exception for assessing impairment under SSAP No. 37, paragraph 16, for mortgage loans with payments (either principal or interest) that have short-term deferrals or modifications in response to COVID-19. This interpretation shall not delay impairment assessments for reasons other than the short-term deferral or modification of interest or principal payments in response to COVID-19 and shall not delay recognition of realized losses if a reporting entity believes a mortgage loan is OTTI.

c. *SSAP No. 30R—Common Stock:* Provide a limited-time exception for assessing OTTI under SSAP No. 30, paragraph 10, and INT 06-07 due to fair value declines for SEC registered funds that have underlying mortgage loans that have been deferred or modified in response to COVID-19 unless the reporting entity intends to sell the security. If the entity has made a decision to sell the security, recognition of the OTTI shall continue to be required. As these investments are reported at fair value, declines in fair value would continue to be reported as unrealized losses.

d. *SSAP No. 43R—Loan-Backed and Structured Securities:* Provide a limited-time exception for assessing OTTI under SSAP No. 43R, paragraphs 30-36, due to fair value declines in investments that have underlying mortgage loans deferred or modified in response to COVID-19 unless the reporting entity intends to sell the security. If the entity has made a decision to sell the security, then recognition of an OTTI shall continue to be required.

e. *SSAP No. 48—Joint Ventures, Partnerships and Limited Liabilities Companies:* Provide a limited-time exception for assessing OTTI under SSAP No. 48 due to fair value declines in investments that have underlying mortgage loans deferred or modified in response to COVID-19 unless the entity intends to sell the security. Additionally, an OTTI shall be assessed if factors other than the mortgage loan forbearance or modification have resulted with a decline that is considered other than temporary, or the reporting entity does not believe it is probable they will collect the carrying amount of the investment.

13. Subsequent to modifications or restructurings that impact original contractual terms of items in scope of this interpretation, future assessments of impairment shall be based on the modified terms.

14. As detailed in paragraph 11, the exceptions granted in this interpretation are applicable for the March 31 and June 30, 2020, (1^{st} and 2^{nd} quarter) financial statements and only in response to bank and mortgage loan forbearance or modifications granted in response to COVID-19. As the exceptions provided in this interpretation are not applicable in the September 30, 2020 (3^{rd} quarter) financial statements, this interpretation will automatically expire as of September 29, 2020. This interpretation will be publicly posted on the Statutory Accounting Principles (E) Working Group's website. This interpretation will be automatically nullified on September 29, 2020 and will be included as a nullified INT in Appendix H – Superseded SSAPs and Nullified Interpretations in the "As of March 2021" *Accounting Practices and Procedures Manual*.

a. On August 17, 2020, the provisions in this INT were extended to be applicable for the September 30, 2020, (3^{rd} quarter) financial statements. With this extension, this Interpretation will automatically expire as of December 30, 2020, (prior to the year-end 2020 financial statements). Subsequent consideration will occur to determine if an extension is needed beyond September 30, 2020.

INT 20-04 Status

15. On July 30, 2020, the Statutory Accounting Principles (E) Working Group exposed this interpretation for possible extension to September 30, 2020, (3^{rd} quarter financial statements). If the extension were adopted, the proposed paragraph 14.a. would be incorporated into the INT. On August 17, 2020, the Statutory Accounting Principles (E) Working Group extended the provisions of this INT to be applicable for the September 30, 2020, (3^{rd} quarter) financial statements, incorporating paragraph 14.a. into the INT.

16. The Statutory Accounting Principles (E) Working Group will subsequently review this interpretation to determine if an extension is needed to the effective date.

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Interpretation of the Statutory Accounting Principles Working Group

INT 20-05: Investment Income Due and Accrued

INT 20-05 Dates Discussed

Email Vote to Expose May 5, 2020; May 20, 2020; July 30, 2020; August 17, 2020

INT 20-05 References

- *SSAP No. 34—Investment Income Due and Accrue*

INT 20-05 Issue

1. A previously unknown virus began transmitting between October 2019 and March 2020, with the first deaths in the U.S. reported in early March 2020. The disease caused by the virus is known as Coronavirus Disease 2019 (COVID-19). Several states and cities have issued "stay home" orders and forced all non-essential businesses to temporarily close. This led to a significant increase in unemployment and the potential permanent closure of many businesses. Total economic damage is still being assessed however the total impact is likely to exceed $1 trillion in the U.S. alone.

2. In response to COVID-19, temporary interpretations have been considered to provide exceptions to existing statutory accounting guidance with regards to the 90-day rule for various receivables, as well as guidance on the assessment of impairment and trouble debt restructurings. In response to these interpretations, a request to provide a temporary exception to *SSAP No. 34—Investment Income Due and Accrued* has been requested.

3. This interpretation intends to assess the requirements to review investment income due and accrued and consider whether temporary exceptions could be granted in response to COVID-19. Issues addressed within this interpretation include:

   a. Recognition and admittance of investment income under SSAP No. 34.

   b. Review of FASB staff technical inquiries and responses on investment income.

INT 20-05 Discussion

SSAP No. 34 Provisions

4. Investment income due is defined in SSAP No. 34 as the investment income earned and legally due to be paid to the reporting entity as of the reporting date. Investment income accrued is defined as investment income earned as of the reported date but not legally due to be paid to the reporting entity until subsequent to the reporting date.

5. Pursuant to SSAP No. 34, investment income due and accrued shall be recorded as an asset and assessed for impairment in accordance with *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets*. Amounts determined to be uncollectible shall be written off, and then an assessment shall be made of the remaining balance to determine nonadmitted amounts. SSAP No. 34 identifies this as a two-step process as follows:

   a. Investment income due and accrued is assessed for collectibility. If in accordance with SSAP No. 5R, it is probable the investment income due and accrued balance is uncollectible, the amount shall be written off and shall be charged against investment income in the period the determination was made.

b. Any remaining investment income due and accrued (amounts considered probable for collection) representing either 1) amounts that are over 90-days past due (generated by any assets except mortgage loans in default) or 2) amounts designated elsewhere in the *NAIC Accounting Practices and Procedures Manual* as nonadmitted shall be considered nonadmitted. These items shall be subject to continuing assessments of collectibility and, if determined to be uncollectible, a write-off shall be recorded in the period such determination is made.

6. Pursuant to SSAP No. 34, accrued interest on mortgage loans in default shall only be recorded if deemed collectible. If uncollectible, accrued interest shall not be recorded and any previously accrued amounts shall be written off. If a mortgage loan in default has interest 180-days past due, which is assessed as collectible, all interest shall be recorded as a nonadmitted asset.

FASB Staff Technical Inquiry

7. The FASB staff received a technical inquiry regarding the recognition of interest income in response to COVID-19 when a “loan payment holiday” is provided that allows the borrowers to temporarily stop payments. The FASB Staff technical inquiry on interest income recognition was discussed April 17, 2020. In the scenario considered by the FASB staff:

a. Interest is not accrued when the loan payment holiday is in effect.

b. The loan modification did not represent a troubled debt restructuring.

c. The loan modification would be accounted for as a continuation of the original lending arrangement (not as an extinguishment with a new loan recognized).

8. With this inquiry two views were presented in how interest should be recognized when a payment holiday is given and interest is not accrued:

a. View 1 – Upon modification, a new effective interest rate is determined that equates to the revised remaining cash flows to the carrying amount of the original debt and is applied prospectively for the remaining term. That is, interest income is recognized during the payment period holiday.

b. View 2 – Upon modification, the institution should recognize interest income on the loan in accordance with the contractual terms. Under this view, the institution would not recognize interest income during the payment holiday and would resume recognizing interest income when the payment holiday.

9. The FASB staff reviewed the submission and concluded both views to be appropriate.

INT 20-05 Consensus

10. The Working Group considered limited time collectibility assessments and admittance exceptions for investment income due and accrued and reached the following consensus:

a. Continue with existing guidance in SSAP No. 34 that investment income shall be recorded when due (earned and legally due) or accrued (earned but not legally due until after the reporting date).

If investments have been impacted by forbearance or other modification provisions, a reporting entity shall assess whether the investment income has been earned in accordance with the modified terms. Investment income shall only be recognized when earned.

b. Continue with existing guidance in SSAP No. 34 to require an assessment of whether recorded investment income due and accrued is uncollectible.

i. For mortgage loans, bank loans and investment products with underlying mortgage loans impacted by forbearance or modification provisions, reporting entities may presume that borrowers and investments that were current as of December 31, 2019, were not experiencing financial difficulties at the time of the forbearance or modification for purposes of determining collectibility. For these investments, further evaluation of collectibility is not required for the 1st and 2nd quarter 2020 financial statements unless other indicators that interest would not be collected are known (e.g., the entity has filed for bankruptcy).

ii. For investments not impacted by forbearance or modification provisions, this interpretation does not provide an assumption of collectibility and the provisions of SSAP No. 34 shall be followed in evaluating collectibility and assessing whether an impairment exists.

c. Provide an exception for the nonadmittance of recorded investment income due and accrued that is deemed collectible and over 90-days past due. With this exception, reported investment income interest due and accrued that becomes over 90-days past due in the 1st or 2nd quarter may continue to be admitted in the June 30, 2020, (1st and 2nd quarter) financial statements. This exception does not encompass accrued interest on mortgage loans that are in default. Mortgage loans in default shall continue to follow the SSAP No. 34 guidance. *SSAP No. 37—Mortgage Loans* identifies that determining that a loan is in default is per the contractual terms of the loan. For mortgage loans modified, determination of default shall be based on the modified contractual terms.

11. The Working Group considered the FASB technical guidance and reached a consensus consistent with the FASB staff on how interest should be recognized when a payment holiday is given and interest is not accrued. With this guidance, either of the following methods could be applied:

a. A new effective interest rate is determined that equates the revised remaining cash flows to the carrying amount of the original debt and is applied prospectively for the remaining term. With this approach, interest income is recognized during the payment period holiday.

b. The reporting entity should recognize interest income on the loan in accordance with the contractual terms. Under this view, the reporting entity would recognize no interest income during the payment holiday and would resume recognizing interest income when the payment holiday ends.

12. The exceptions and provisions detailed in this interpretation are applicable for the June 30, 2020, (2nd quarter) financial statements. As the exceptions provided in this interpretation are not applicable in the September 30, 2020, (3rd quarter) financial statements, as this interpretation will automatically expire as of September 29, 2020. This interpretation will be publicly posted on the Statutory Accounting Principles (E) Working Group's website. This interpretation will be automatically nullified on September 29, 2020, and will be included as a nullified INT in Appendix H – Superseded SSAPs and Nullified Interpretations in the "As of March 2021" *Accounting Practices and Procedures Manual*.

a. On August 17, 2020, the provisions in this INT were extended to be applicable for the September 30, 2020 (3^{rd} quarter) financial statements. With this extension, this Interpretation will automatically expire as of December 30, 2020 (prior to the year-end 2020 financial statements). Subsequent consideration will occur to determine if an extension is needed beyond September 30, 2020.

INT 20-05 Status

13. On July 30, 2020, the Statutory Accounting Principles (E) Working Group exposed this interpretation for possible extension to September 30, 2020, (3^{rd} quarter financial statements). If the extension were adopted, the proposed paragraph 12.a. would be incorporated into the INT. On August 17, 2020, the Statutory Accounting Principles (E) Working Group extended the provisions of this INT to be applicable for the September 30, 2020, (3^{rd} quarter) financial statements, incorporating paragraph 12.a. into the INT.

14. The Statutory Accounting Principles (E) Working Group will subsequently review this interpretation to determine if an extension is needed to the effective date.

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Statutory Accounting Principles (E) Working Group
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September 18, 2020

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

RE: Items Exposed for Comment by the Statutory Accounting Principles Working Group on July 30 with Comments due September 18

Dear Mr. Bruggeman:

Interested parties appreciate the opportunity to comment on the exposure drafts released for comment by the NAIC Statutory Accounting Principles (E) Working Group (the Working Group). We offer the following comments:

Ref #2019-24: Levelized and Persistency Commission

The Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to *SSAP No. 71—Policy Acquisition Costs and Commissions* (SSAP No. 71) to clarify levelized commissions guidance and provide additional direction regarding commissions that are based on policy persistency. The revisions also clarify that the recognition of commission expense is based on experience to date. The revisions are intended to clarify the original intent of SSAP No. 71 regarding levelized commissions. Reporting entities that have not complied with the original intent of the statement are to reflect the change as a correction of an error (as a mistake in the application of an accounting principle) pursuant to SSAP No. 3 in the December 31, 2020 financial statements. In accordance with SSAP No. 3, correction of all accounting errors in previously issued financial statements, for which an amended financial statement was not filed, are to be reported as an adjustment to unassigned funds (surplus) in the period in which the error was detected. Disclosure shall also occur in accordance with SSAP No. 3.

Interested parties would like to propose the following edits to SSAP No. 71, similar to those sent in January 2020.

SUMMARY CONCLUSION

2. Acquisition costs are those costs that are incurred in the acquisition of new and renewal insurance contracts and include those costs that vary with and are primarily related to the acquisition of insurance contracts (e.g., agent and broker commissions, certain underwriting and policy issue

costs, and medical and inspection fees). Acquisition costs and commissions shall be expensed as incurred. Determination of when acquisition costs and commissions have been incurred shall be made in accordance with SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets. For example, when commissions are paid directly to an agent based upon renewal such as in traditional trail commission arrangements, commission expense would be recognized when the obligating event (i.e., the renewal) occurs and the related premium revenue is recognized.

3. Contingent commission liabilities shall be determined in accordance with the terms of each individual commission agreement. Commission liabilities determined on the basis of a formula that relates to loss experience shall be established for the earned portion. Assumptions used to calculate the contingent commission liability shall be consistent with the terms of the policy contract and with the assumptions made in recording other assets and liabilities necessary to reflect underwriting results of the reporting entity such as retrospective premium adjustments and loss reserves, including incurred but not reported. Other than the commission arrangements discussed in Paragraph 2, commission contracts that include persistency (or other such components) shall not use these clauses to defer recognition of commission expense. If a commission is based on annual policy persistency (or other similar components), the commission shall be accrued ratably over each annual period based on experience to date for which the persistency commission will be paid.~~the policy period that the commission relates~~. In regard to persistency commission, it is inappropriate to wait until the amount is fully earned and/or unavoidable to accrue experience to date commission expenses. Actual policy cancellation would reverse the accrual of the related persistency commission.

4. Levelized commissions occur in situations where agents receive normal (non-level) commissions with payments made by a third party. It is intended, but not necessarily guaranteed, that the amounts paid to the agents by the third party would ultimately be repaid (with interest explicit or implied) to the third party by levelized payments (which are less than the normal first year commissions but exceed the normal renewal commissions) from the reporting entity. (Note: levelized repayments made by the reporting entity extend the repayment period but might not be a straight-line repayment.) These transactions are, in fact, funding agreements between a reporting entity and a third party,. A funding agreement is an agreement whereby a third party provides a lump sum of money in return for a stream of payments over a predetermined time period. The payment stream is fixed without regard to the traditional elements of continued premium payments or policy persistency. The continuance of the stream of payments specified in the levelized commission contract is a mechanism to bypass recognition of those expenses which are ordinarily charged to expense in the first year of the contract. Consequently, the normal link between the persistency of the policy, the continuance of the premium payment or the maintenance of the agent's license with the reporting entity is not maintained with respect to the payment stream.

5. The use of an arrangement such as a levelized commission arrangement where commission payments are not linked to traditional elements such as premium payments and policy persistency, but rather are linked to the repayment of an advance amount paid by a third party to the agents requires the establishment of a liability by the reporting entity for the full amount of the unpaid principal and accrued interest which is payable to a third party related to levelized commissions [FN].

~~New Footnote – The guidance in this paragraph notes that levelized commissions which use a third party to pay agents that are linked to traditional elements require establishment of a liability for the amounts that have been paid to the agents and any interest accumulated to date.~~

Effective Date and Transition

7. This statement is effective for years beginning January 1, 2001. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*. ~~The nonsubstantive revisions adopted ________ regarding levelized commission intend to clarify the original intent of this statement. Reporting entities that have not complied with the original intent of the statement shall reflect the change as a correction of an error (as a mistake in the application of an accounting principle) pursuant to SSAP No. 3 in the December 31, 2020 financial statements. In accordance with SSAP No. 3, correction of all accounting errors in previously issued financial statements, for which an amended financial statement was not filed, shall be reported as an adjustment to unassigned funds (surplus) in the period in which the error was detected. Disclosure shall also occur in accordance with SSAP No. 3.~~

We request that the above edits be incorporated into the proposed Ref #2019-24.

In addition, we believe that what have been deemed non-substantive clarifications to the original intent of SSAP No. 71 proposed by the SAPWG in Ref #2019-24 are in fact **substantive modifications** that materially change accounting practices that were established long before the 2001 codification, and that continue today in many different forms

Per the SAPWG process, substantive statutory accounting revisions introduce original or modified accounting principles. Substantive revisions can be reflected in an existing Statement of Statutory Accounting Principles (SSAP) or a new SSAP. Nonsubstantive statutory accounting revisions are characterized as language clarifications that do not modify the original intent of a SSAP. SSAPs are considered the highest authority (Level 1) in the statutory accounting hierarchy.

The proposed accounting treatment in Ref #2019-24 is significantly different than the current interpretation of the original SSAP and general statutory principles, specifically, full recognition of an expense at the time the policy is issued versus incremental recognition of commission costs over time as the policy persists and they become legal obligations. The current proposed language does not address the many varying product/distribution compensation arrangements in the industry and IP believe this will cause unintended consequences. The link between the traditional elements such as policy persistency and the accrual of commissions is a long-standing principle. Eliminating the link to the policy persistency is not a clarification, it is a substantive change that modifies the original intent of SSAP No. 71, thus requiring further evaluation.

Interested parties believe that the exposure as written will also unintentionally impact the accounting for certain types of traditional trail commission arrangements that are commonplace in the market for life and annuity products. Although funding agreements can also have elements that are based upon policy persistency, there exists in the industry a longstanding practice of compensating agents directly based upon policy persistency. In these scenarios, the reporting entity has an agreement in place with agents that requires commission payment if and only if a policy persists (for example, at each annual renewal). If a policyholder opts not to renew, the reporting entity has no obligation to pay further commissions to the agent.

As written, interested parties believe this exposure would require the reporting entity to accrue these trail commissions at policy inception, which would be counter to the principles contained in SSAP No. 5R -

Liabilities, Contingencies and Impairment of Assets. These commissions are not liabilities until the policy persists, and, until that time, the transaction obligating the entity has not occurred. Language added to paragraph 2 is intended to distinguish the scope of the guidance in paragraphs 3-5 from these traditional trail commission arrangements.

Further, interested parties strongly disagree with the modifications to paragraph 7. Reporting entities have filed annual statements based on the current interpretation of SSAP No. 71 with unqualified opinions from their external auditors. Regulatory examinations have also been completed by various states of domicile insurance departments without adjustment. IP believe that if the proposed revisions are adopted and result in an accounting change, these should be reflected as a change in accounting principle. Per SSAP No. 3, "A change in accounting principle results from the adoption of an accepted accounting principle, or method of applying the principle, which differs from the principles or methods previously used for reporting purposes." Reporting entities that in good faith applied a particular method by following SSAP No. 71 and were not required to adjust statements as a result of audits or regulatory examinations, should not be considered to have made an **accounting error**. As such, interested parties disagree with the modifications in paragraph 7. As noted above, the proposed revisions to SSAP No. 71 substantially change the interpretation that has been followed for years, and therefore, the original text would apply for a reporting entity that must change its method of applying the revised SSAP No. 71.

In summary, we recommend that the NAIC consider the changes contained in the current Ref #2019-24 exposure be reclassified as **substantive, that an issue paper be drafted, and that this be re-exposed and processed accordingly.**

Ref #2019-34: Related Parties, Disclaimers of Affiliation and Variable Interest Entities

The Working Group exposed proposed changes to SSAP No. 25 as described below:

- Based on the comments from the Group Solvency Issues (E) Working Group, NAIC staff added a new disclosure that provides information on minority ownership interests, as well as significant relationships between minority owners and other U.S. domestic insurers/groups. This new disclosure is not intended to include passive fund owners, such as ETFs and mutual funds. This is in paragraph 22 in the exhibit to this agenda item.

- NAIC staff removed the direct references to U.S. GAAP and SEC guidance that was included in the initial draft revisions. It was not intended to incorporate by reference the guidance from these sources but was instead intended to show that the revisions were going to be more consistent with the U.S. GAAP and SEC guidance. The language that was added to the description of related parties in paragraph 4 in the original exposure draft are all language from either U.S. GAAP or from laws and regulations related to the SEC.

- With the proposed rejection of the U.S. GAAP VIE guidance for statutory accounting, our intention is to rely on SSAP No. 25, including the proposed revisions, to capture related parties for reporting. These updates are not intended to change reporting in Schedule BA or Schedule D for any investments.

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

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

Ref #2020-17: Updating the SCA Review Process

The Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities* to provide updated descriptive language regarding SCA reviews. Additionally, this agenda item proposes a more streamlined method for communicating SCA review results.

Interested parties offer the following comments:

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

Ref #2020-18: SSAP No. 97 Update

The Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*, removing the statement that guarantees or commitments from the insurance reporting entity to the SCA can result in a negative equity valuation of the SCA. This update reflects recently adopted guidance from agenda item 2018-27 which states that reported equity losses of an SCA shall not go negative (thus the reported basis will stop at zero), however to the extent there is a financial guarantee or commitment, that liability would be recognized in accordance with *SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets.*

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

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

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

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

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

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

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

- We agree that with respect to 8.b.ii entities, the statutory accounting guidance would require an insurer to report negative equity since 8.b.ii entities are considered an extension of the insurance company. 8.b.ii entities may own assets that would not be admitted if owned by the insurer, so it is reasonable to require the insurer to report negative equity in those subsidiaries to prevent such assets from becoming admissible simply because they are owned by an 8.b.ii subsidiary and not owned directly by the insurer.

- We, however, do not agree that the application of the paragraph 9 adjustments should ever result in the insurer's investment in a foreign insurance subsidiary being reported at an amount less than zero. Prior to applying the SSAP No. 97 paragraph 9 adjustments, the GAAP equity of a foreign insurance subsidiary is subject to the following recoverability and impairment tests on the net assets inherent in its GAAP equity:
  - ✓ GAAP loss recognition testing of DAC and reserves, for which additional liabilities would be established for expected future losses beyond recovery of any GAAP assets (including recoverability of deferred acquisition costs, or DTAs),
  - ✓ GAAP impairment testing of asset balances (e.g. – goodwill, DTA's, investment other-than-temporary losses)

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

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

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

Ref #2020-19: Clarification Edits - Mortgage Loan Participations

The Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to *SSAP No. 37—Mortgage Loans* to clarify that a participant's financial rights may include the right to take legal action against the borrower (or participate in the determination of legal action), but do not require that the participant have the right to solely initiate legal action, foreclosure, or under normal circumstances, require the ability to communicate directly with the borrower.

Interested parties support this proposal.

Ref #2020-20: Disclosure of Rolled Cash Equivalent Investments

The Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to *SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments* to require the identification/disclosure of cash equivalents and short-term investments, or substantially similar investments, which remain on the same reporting schedule for more than one consecutive reporting period. (This revision expands current disclosure requirements to include cash equivalent investments.) Additionally, the revisions clarify that the disclosure is satisfied through the use of the code on the investment schedules.

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

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

Ref #2020-21: SSAP No. 43R - Designation Categories for RMBS/CMBS Investments

The Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to *SSAP No. 43R—Loan-backed and Structured Securities*, to reflect the updated final designation guidance for RMBS/CMBS securities. This update will reflect the guidance recently adopted for the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P manual).

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

> "Step 3: Determine Final Designation – The final NAIC designation**~~, as determined by the modeled price range,~~** is determined by comparing the carrying value (divided by remaining par amount) of a security (based on paragraph 27.a.ii.) to the NAIC CUSIP specific modeled breakpoint values assigned to the six (6) NAIC designations for each CUSIP. ***The final*** NAIC designations ***is*** mapped to ***an*** NAIC designation **category according to the instructions** in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office*~~**, along with instructions for tranches that have no expected loss under any of the selected modeling scenarios and instructions for non-modeled securities**~~. The final NAIC designation ~~**and NAIC designation category**~~ shall be applicable for statutory accounting and reporting purposes**, and the NAIC designation category will be used for** investment schedule reporting and establishing ~~**RBC and**~~ AVR charges. The final NAIC designation is not used for establishing the appropriate carrying value method in Step 2 (paragraph 27.a.ii.)."

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

Ref #2020-22: Accounting for Perpetual Bonds

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

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

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

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

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

- **Amortization of premiums and accretion of discounts:** The proposal notes that due to a lack of a maturity date, insurers do not accrete discounts or amortize premiums on perpetual bonds. However, many insurers in the interested parties group do have methodologies to amortize premiums and accrete discounts. Most often, companies amortize premiums to the call date for the bonds (i.e., apply yield to worst) and accrete discounts to a date that is far into the future (i.e., consistent with how Bloomberg treats such bonds when quoting market yields for the bonds). Investors believe this approach to estimating a yield is a reasonable depiction of the true yield expected to be earned on the investments.

- **Call date is a pseudo-maturity date:** The capital markets and investors (including insurers) consider the call date in the bonds to be a pseudo-maturity date. That is, it is expected that the perpetual bonds will be called on the call date. Oftentimes insurers price the bonds to the call date. Many times, the bonds have step-up coupon provisions at the call date, which provides an incentive for the issuer to call the bonds, or there are other reasons why there is a market compulsion for the issuer to call such bonds on the call date. The expectation that the bonds will be called is one of the key characteristics that results in many companies reporting such bonds as fixed income for US GAAP reporting purposes. In the rare cases where perpetual bonds do not have callability, all other characteristics are the same as those bonds with callability (e.g., capital markets consider them bonds, the trade like bonds, the investment objective is the same as bonds, etc.) and thus interested parties believe they should be reported the same as all other bonds.

- **How perpetual bonds trade in the market:** The market's view of the call provisions on perpetual bonds, as outlined above, is a key reason (among others) that perpetual bonds trade in the capital markets like bonds. As a result, these instruments are more sensitive to interest rate movements, are generally priced like bonds (inclusive of accrued interest) and are quantified and measured in terms of par value and not in terms of shares of stock.

- **US GAAP reporting:** Those insurers who invest in perpetual bonds generally report them as fixed income for US GAAP reporting purposes. Some companies evaluate the investment characteristics (per the guidance in Topic 815) to determine if the characteristics such as redemption rights, voting rights, conversion rights, dividend rights, and protective covenants are more debt like or equity like when determining the appropriate reporting. Additionally, companies consider how the investments are viewed in the capital markets. The analysis performed generally concludes that perpetual bonds are more bond like than equity like. When classified as bonds, they are evaluated for impairment like any other bond (e.g., insurers assess the ability for the issuer to pay interest and principal).

- **Investment strategy for perpetual bonds:** Insurers invest in perpetual bonds for their fixed cash flows (interest and expected return of principal when called by the issuer) and not for market appreciation. Like other bonds, the expected fixed cash flows are used for cash flow matching to insurance liabilities. Many perpetual bonds have a fixed coupon and if not called the coupon adjusts to a current floating rate plus a spread (e.g., that is stepped-up significantly from original issuance spreads). Also, when insurers manage their investment portfolios (e.g., investment allocations, assessing risks, etc.), perpetual bonds are classified as bonds and not equities.

- **Monetization of perpetual bonds:** A key reason equity securities are reported at fair value for Statutory reporting purposes is because there is no certainty in the cash flows they generate and return to the investor (return of principal and return on investment), which includes dividend payments. Additionally, the return of an investor's original investment can only be monetized by selling the equity security at fair value. As a result, fair value is an important measurement when

> considering the expected return to the investor. Regarding perpetual bonds, the opposite situation exists. The cash flows have a much higher level of certainty (interest to be paid for the life of the investment is contractual and does not require the issuer's board declaring a dividend like a preferred stock and the return of par at the call date) like any other bond. As a result, similar to other bonds, we do not believe fair value is a relevant measurement principle for such investments for Statutory reporting purposes.

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

Ref #2020-23: Update to Leasehold Improvements

The Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to *SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements* and *SSAP No. 73—Health Care Delivery Assets and Leasehold Improvements in Health Care Facilities*, to allow the amortization of leasehold improvements to match the associated lease term, which is guidance that agrees with U.S. GAAP, ASC Topic 842.

Interested parties support this proposal.

Ref #2020-24: Accounting and Reporting of Credit Tenant Loans

The Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed this agenda item with a request for comments on the two general options for the accounting treatment of credit tenant loans (CTL). Notification will also be sent to the Valuation of Securities (E) Task Force of this agenda item in response to their referral. With this notification, NAIC staff will request further confirmation that a SVO-Listing could be developed to capture the CTLs that meet the SVO's structural and legal analysis and possess bond characteristics.

Interested parties' response – please see separate letter

Ref #2020-25EP: Editorial and Maintenance Update

The Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed editorial revisions to *SSAP No. 5R—Liabilities, Contingencies and Impairments of Asset* and *SSAP No. 62R—Property and Casualty Reinsurance*.

Interested parties have no comments on this item.

Ref #2020-26: ***ASU 2015-10, Technical Corrections & Improvements***

The Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to *Appendix D—Nonapplicable GAAP Pronouncements* to reject *ASU 2015-10, Technical Corrections & Improvements* as not applicable to statutory accounting.

Interested parties have no comments on this item.

Ref #2020-27: ***ASU 2019-09, Financial Services – Insurance; Effective Date***

The Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to *Appendix D—Nonapplicable GAAP Pronouncements* to reject *ASU 2019-09—Financial Services – Insurance* as not applicable to statutory accounting.

Interested parties have no comments on this item.

Ref #2020-28: ***ASU 2020-01, Investments—Equity Securities (Topic 321), Investments—Equity Method and Joint Ventures (Topic 323), and Derivatives and Hedging (Topic 815), Clarifying the Interactions between Topic 321, Topic 323, and Topic 815***

The Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to reject *ASU 2020-01, Investments—Equity Securities (Topic 321), Investments—Equity Method and Joint Ventures (Topic 323), and Derivatives and Hedging (Topic 815), Clarifying the Interactions between Topic 321, Topic 323, and Topic 815* for statutory accounting. The revisions note rejection are proposed to *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*, *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities* and *SSAP No. 86—Derivatives*.

Interested parties have no comments on this item.

Ref #2020-29: ***ASU 2020-05—Effective Dates for Certain Entities***

The Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to *Appendix D—Nonapplicable GAAP Pronouncements* to reject *ASU 2020-05, Revenue from Contracts with Customers (Topic 606) and Leases (Topic 842), Effective Dates for Certain Entities* as not applicable to statutory accounting.

Interested parties have no comments on this item.

Ref #2020-30: Premium Refunds and Other Adjustments

The Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed the agenda item with a request for comments/input on the issues described in the proposal. NAIC staff was also directed to draft guidance to address premium refunds and other policy adjustments for both property and casualty and accident and health lines of business.

Comments were requested on the following:

1. NAIC Staff's preliminary recommendation is that the proposed guidance should follow the existing principles of adjustable premium and shall be recognized as adjustments to premium based on experience to date.

2. Examples of existing products that have premium adjustments for reasons other than the existing guidance or how the existing guidance can be expanded.

3. If accounting treatment that is being applied is different from premium adjustments, please provide overview of key attributes.

Interested parties offer the following comments:

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

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

   Suggested revisions to Paragraph 4 of SSAP No. 54-R:

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

      a. For refunds or reductions in premiums under the terms of the policyholder or group contract refer to:
         1. Contracts Subject to Redetermination – Paragraphs 27-32 below
         2. Retrospectively Rated Contracts - SSAP No. 66

b. For voluntary refunds or reductions in premiums that are not specified by the terms of the policyholder or group contract, the timing of the recognition of the payment (or credit to gross billed premiums) is based on when the corresponding gross premium is or has been earned. To illustrate (not intended to be an exhaustive list):
   1. For premium reductions pertaining to previous or expired periods of coverage, the full amount of the reduction is recognized immediately.
   2. For premium reductions that relate to the current month's coverage, the reduction is recognized in the current month.
   3. For reductions that relate to subsequent months' coverage, the reduction will be recognized in the month to which it pertains so as to match the recognition of the reduction with that of the gross premium and coverage period to which it pertains.

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

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

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

Interested parties offer our assistance in developing additional guidance or in providing feedback on draft guidance.

Ref #2020-31: Early application of *SSAP No. 32R—Preferred Stock*

The Working Group voted by e-vote to move this item to the active listing, categorized as nonsubstantive, and exposed edits to *SSAP No. 32R—Preferred Stock* as detailed above. This item has a comment period deadline ending September 18, 2020.

Interested parties have no comments on this item.

Thank you for considering interested parties' comments. If you have any questions in the interim, please do not hesitate to contact us.

Sincerely,

D. Keith Bell Rose Albrizio

cc: NAIC staff and Interested parties

Statement of Statutory Accounting Principles No. 25

Affiliates and Other Related Parties

STATUS

Type of Issue..	Common Area
Issued	Initial Draft
Effective Date	January 1, 2001
Affects...	Supersedes SSAP No. 96 with guidance incorporated August 2011; Nullifies and incorporates INT 03-16
Affected by	No other pronouncements
Interpreted by..	No other pronouncements
Relevant Appendix A Guidance	A-440

SCOPE OF STATEMENT

1. Related party transactions are subject to abuse because reporting entities may be induced to enter transactions that may not reflect economic realities or may not be fair and reasonable to the reporting entity or its policyholders. As such, related party transactions require specialized accounting rules and increased regulatory scrutiny. This statement establishes statutory accounting principles and disclosure requirements for related party transactions.

2. This statement shall be followed for all related party transactions, including transactions with parties that own 10% or more of the reporting entity, even if the transaction is also governed by other statutory accounting principles. Furthermore, this statement shall be followed in all transactions which involve unrelated parties as intermediaries between related parties. In determining whether a transaction is a related party transaction, consideration shall be given to the substance of the agreement and the parties whose actions or performance materially impact the insurance reporting entity under the transaction. For example, an investment acquired from a non-related intermediary in which the investment return is

predominantly contingent on the performance of a related party shall be considered a related party investment. As a general principle, it is erroneous to conclude that the mere inclusion of a non-related intermediary eliminates the requirement to assess and properly identify the related party transaction in accordance with the provisions of this statement. It is also erroneous to conclude that the presence of non-related assets in a structure predominantly comprised of related party investments eliminates the requirement to assess and identify the investment transaction as a related party arrangement.

3. If a company receives the stock of an affiliated company as a capital contribution rather than through a purchase, the transaction shall be accounted for according to *SSAP No. 25—Affiliates and Other Related Parties, SSAP No. 95—Nonmonetary Transactions*, or *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*, based on the details of each transaction. The statutory purchase method within *SSAP No. 68—Business Combinations* is not applicable for stock received as a capital contribution.

SUMMARY CONCLUSION

4. Related parties are defined as entities that have common interests as a result of ownership, control, affiliation or by contract. Related parties shall include but are not limited to the following:

a. Affiliates of the reporting entity, as defined in paragraph 5;

b. Trusts for the benefit of employees, such as pension and profit-sharing trusts and Employee Stock Ownership Plans that are managed by or under the trusteeship of management of the reporting entity, its parent or affiliates;

c. The principal owners, directors, and officers of the reporting entity;

d. Any immediate family member of a principal owner, director or executive officer of the reporting entity, which means any child, stepchild, parent, stepparent, spouse, sibling, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law, or individual related by blood or marriage whose close association is equivalent to a family relationship of such director, executive officer or nominee for director, or any person (other than a tenant or employee) sharing the household of such director, executive officer or nominee for director;

e. Companies and entities which share common control, such as principal owners, directors, or officers, including situations where a principal owners, directors, or officers have a controlling stake in another reporting entity;

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

~~d.~~g. The management of the reporting entity, its parent or affiliates (including directors);

~~e.~~h. Members of the immediate families of principal owners and management of the reporting entity, its parent or affiliates and their management;

~~f.~~i. Parties with which the reporting entity may deal if either party directly or indirectly controls or can significantly influence the management or operating policies of the other to an extent that one of the transacting parties might be prevented from fully pursuing its own separate interest;

~~g.~~j. A party which can, directly or indirectly, significantly influence the management or operating policies of the reporting entity, which may include a provider who is contracting with the reporting entity. This is not intended to suggest that all provider contracts create related party relationships;

~~h.~~k. A party which has an ownership interest in one of the transacting parties and can significantly influence the other to an extent that one or more of the transacting parties might be prevented from fully pursuing its own separate interests;

~~i.~~l. Attorney-in-fact of a reciprocal reporting entity or any affiliate of the attorney-in-fact; and

~~j.~~m. A U.S. manager of a U.S. Branch or any affiliate of the U.S. manager of a U.S. Branch.

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

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

7. Control as defined in paragraph 6 shall be measured at the holding company level. For example, if one member of an affiliated group has a 5% interest in an entity and a second member of the group has an 8% interest in the same entity, the total interest is 13%, and therefore, each member of the affiliated group shall be presumed to have control. This presumption will stand until rebutted by an evaluation of all the facts and circumstances relating to the investment based on the criteria in *FASB Interpretation No. 35, Criteria for Applying the Equity Method of Accounting for Investments in Common Stock, an Interpretation of APB Opinion No. 18*. The corollary is required to demonstrate control when a reporting entity owns less than 10% of the voting securities of an investee. The insurer shall maintain documents substantiating its determination for review by the domiciliary commissioner. Examples of situations where the presumption of control may be in doubt include the following:

a. Any limited partner investment in a limited partnership, unless the limited partner is affiliated with the general partner.

b. An entity where the insurer owns less than 50% of an entity and there is an unaffiliated individual or group of investors who own a controlling interest.

c. An entity where the insurer has given up participation rights[1] as a shareholder to the investee.

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

~~8.~~9. Transactions between related parties must be in the form of a written agreement. The written agreement must provide for timely settlement of amounts owed, with a specified due date. Amounts owed to the reporting entity over ninety days from the written agreement due date shall be nonadmitted, except to the extent this is specifically addressed by other statements of statutory accounting principles (SSAPs). If the due date is not addressed by the written agreement, any uncollected receivable is nonadmitted.

Related Party Loans

~~9.~~10. Loans or advances (including debt, public or private) made by a reporting entity to its parent or principal owner shall be admitted if approval for the transaction has been obtained from the domiciliary commissioner and the loan or advance is determined to be collectible based on the parent or principal owner's independent payment ability. An affiliate's ability to pay shall be determined after consideration of the liquid assets or revenues available from external sources (i.e., determination shall not include dividend paying ability of the subsidiary making the loan or advance) which are available to repay the balance and/or maintain its account on a current basis. Evaluation of the collectibility of loans or advances shall be made periodically. If, in accordance with *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets*, it is probable the balance is uncollectible, any uncollectible receivable shall be written off and charged to income in the period the determination is made. Pursuant to *SSAP No. 72—Surplus and Quasi-Reorganization*, forgiveness by a reporting entity of any debt, surplus note or other obligation of its parent or other stockholder shall be accounted for as a dividend.

~~10.~~11. Loans or advances by a reporting entity to all other related parties shall be evaluated by management and nonadmitted if they do not constitute arm's-length transactions as defined in paragraph 13. Loans or advances made by a reporting entity to related parties (other than its parent or principal owner) that are economic transactions as defined in paragraph 13 shall be admitted. This includes financing arrangements with providers of health care services with whom the reporting entity contracts with from time to time. Such arrangements can include both loans and advances to these providers. Evaluation of the collectibility of loans or advances shall be made periodically. If, in accordance with SSAP No. 5R, it is

[1] The term "participating rights" refers to the type of rights that allows an investor to effectively participate in significant decisions related to an investee's ordinary course of business and is distinguished from the more limited type of rights referred to as "protective rights". Refer to the sections entitled: "Protective Rights" and "Substantive Participating Rights" in EITF 96-16, *Investor's Accounting for an Investee When the Investor Owns a Majority of the Voting Stock but the Minority Shareholder or Shareholders Have Certain Approval or Veto Rights*. The term "participating rights" shall be used consistent with the discussion of substantive participating rights in this EITF.

probable the balance is uncollectible, any uncollectible receivable shall be written off and charged to income in the period the determination is made.

~~11.~~12. Any advances under capitation arrangements made directly to providers, or to intermediaries that represent providers, that exceed one month's payment shall be nonadmitted assets.

~~12.~~13. Indirect loans are loans or extensions of credit to any person who is not an affiliate, where the reporting entity makes loans or extensions of credit with the agreement or understanding that the proceeds of the transactions, in whole or in substantial part, are to be used to make loans or extensions of credit to, to purchase assets of, or to make investments in, any affiliate of the reporting entity making the loans or extensions of credit. The admissibility of indirect loans made by a reporting entity for the benefit of its parent or principal owner shall be determined in accordance with the guidelines in paragraph 9. Indirect loans or advances made for the benefit of all other related parties shall be evaluated and accounted for consistent with loans or advances to related parties as described in paragraph 10 and paragraph 11.

Transactions Involving the Exchange of Assets or Liabilities

~~13.~~14. An arm's-length transaction is defined as a transaction in which willing parties, each being reasonably aware of all relevant facts and neither under compulsion to buy, sell, or loan, would be willing to participate. A transaction between related parties involving the exchange of assets or liabilities shall be designated as either an economic transaction or non-economic transaction. An economic transaction is defined as an arm's-length transaction which results in the transfer of the risks and rewards of ownership and represents a consummated act thereof, i.e., "permanence." The appearance of permanence is also an important criterion in assessing the economic substance of a transaction. In order for a transaction to have economic substance and thus warrant revenue (loss) recognition, it must appear unlikely to be reversed. If subsequent events or transactions reverse the effect of an earlier transaction prior to the issuance of the financial statements, the reversal shall be considered in determining whether economic substance existed in the case of the original transaction. Subsequent events are addressed in *SSAP No. 9—Subsequent Events*. An economic transaction must represent a bonafide business purpose demonstrable in measurable terms. A transaction which results in the mere inflation of surplus without any other demonstrable and measurable betterment is not an economic transaction. The statutory accounting shall follow the substance, not the form of the transaction.

~~14.~~15. In determining whether there has been a transfer of the risks and rewards of ownership in the transfer of assets or liabilities between related parties, the following—and any other relevant facts and circumstances related to the transaction—shall be considered:

a. Whether the seller has a continuing involvement in the transaction or in the financial interest transferred, such as through the exercise of managerial authority to a degree usually associated with ownership;

b. Whether there is an absence of significant financial investment by the buyer in the financial interest transferred, as evidenced, for example, by a token down payment or by a concurrent loan to the buyer;

c. Whether repayment of debt that constitutes the principal consideration in the transaction is dependent on the generation of sufficient funds from the asset transferred;

d. Whether limitations or restrictions exist on the buyer's use of the financial interest transferred or on the profits arising from it;

e. Whether there is retention of effective control of the financial interest by the seller.

~~15.~~16. A transaction between related parties may meet the criteria for treatment as an economic transaction at one level of financial reporting, but may not meet such criteria at another level of financial reporting. An example of such a transaction is a reporting entity purchasing securities at fair value from an affiliated reporting entity that carried the securities at amortized cost. This transaction meets the criteria of an economic transaction at this level of financial reporting, and therefore, the selling reporting entity would record a gain and the acquiring reporting entity would record the securities at their cost (fair value on the transaction date). At the common parent level of reporting, this transaction has resulted in the mere inflation of surplus, and therefore, is a non-economic transaction. The parent reporting entity shall defer the net effects of any gain or increase in surplus resulting from such transactions by recording a deferred gain and an unrealized loss. The deferred gain shall not be recognized by the parent reporting entity unless and until arms-length transaction(s) with independent third parties give rise to appropriate recognition of the gain.

~~16.~~17. A non-economic transaction is defined as any transaction that does not meet the criteria of an economic transaction. Similar to the situation described in paragraph 15, transfers of assets from a parent reporting entity to a subsidiary, controlled or affiliated entity shall be treated as non-economic transactions at the parent reporting level because the parent has continuing indirect involvement in the assets.

~~17.~~18. When accounting for a specific transaction, reporting entities shall use the following valuation methods:

a. Economic transactions between related parties shall be recorded at fair value at the date of the transaction. To the extent that the related parties are affiliates under common control, the controlling reporting entity shall defer the effects of such transactions that result in gains or increases in surplus (see paragraph 15);

b. Non-economic transactions between reporting entities, which meet the definition of related parties above, shall be recorded at the lower of existing book values or fair values at the date of the transaction;

c. Non-economic transactions between a reporting entity and an entity that has no significant ongoing operations other than to hold assets that are primarily for the direct or indirect benefit or use of the reporting entity or it's affiliates, shall be recorded at the fair value at the date of the transaction; however, to the extent that the transaction results in a gain, that gain shall be deferred until such time as permanence can be verified;

d. Transactions which are designed to avoid statutory accounting practices shall be reported as if the reporting entity continued to own the assets or to be obligated for a liability directly instead of through a subsidiary.

Examples of transactions deemed to be non-economic include security swaps of similar issues between or among affiliated companies, and swaps of dissimilar issues accompanied by exchanges of liabilities between or among affiliates.

Transactions Involving Services

~~18.~~19. Transactions involving services between related parties can take a variety of different forms. One of the significant factors as to whether these transactions will be deemed to be arm's length is the amount charged for such services. In general, amounts charged for services are based either on current market rates or on allocations of costs. Determining market rates for services is difficult because the circumstances surrounding each transaction are unique. Unlike transactions involving the exchange of assets and liabilities between related parties, transactions for services create income on one party's books and expense on the second party's books, and therefore, do not lend themselves to the mere inflation of surplus. These arrangements are generally subject to regulatory approval.

~~19.~~20. Transactions involving services provided between related parties shall be recorded at the amount charged[2]. Regulatory scrutiny of related party transactions where amounts charged for services do not meet the fair and reasonable standard established by Appendix A-440, may result in (a) amounts charged being recharacterized as dividends or capital contributions, (b) transactions being reversed, (c) receivable balances being nonadmitted, or (d) other regulatory action. Expenses that result from cost allocations shall be allocated subject to the same fair and reasonable standards, and the books and records of each party shall disclose clearly and accurately the precise nature and details of the transaction. See *SSAP No 70—Allocation of Expenses* for additional discussion regarding the allocation of expenses.

Disclosures

~~20.~~21. The financial statements shall include disclosures of all material related party transactions, including transactions with the ownership interests identified in paragraph 22. In some cases, aggregation of similar transactions, that on a stand-alone basis are not material, may be appropriate. Sometimes, the effect of the relationship between the parties may be so pervasive that disclosure of the relationship alone will be sufficient. If necessary to the understanding of the relationship, the name of the related party should be disclosed. Transactions shall not be purported to be arm's-length transactions unless there is demonstrable evidence to support such statement. The disclosures shall include:

a. The nature of the relationships involved;

b. A description of the transactions for each of the periods for which financial statements are presented, and such other information considered necessary to obtain an understanding of the effects of the transactions on the financial statements. Exclude reinsurance transactions, any non-insurance transactions which involve less than ½ of 1% of the total admitted assets of the reporting entity, and cost allocation transactions. The following information shall be provided if applicable:

i. Date of transaction;

ii. Explanation of transaction;

iii. Name of reporting entity;

iv. Name of affiliate;

v. Description of assets received by reporting entity;

vi. Statement value of assets received by reporting entity;

[2] The amount charged shall be reviewed when there are any modifications or waivers subsequent to the establishment of the contract terms. If waivers or modifications to amounts charged occur, the related party transaction shall be reassessed to determine whether the contract continues to reflect fair and reasonable standards. If the transaction was with a parent or other stockholder and the charge for services has been fully waived, then the guidance in SSAP No. 72 for recognition as contributed capital (forgiveness of reporting entity obligation) or as a dividend (forgiveness of amount owed to the reporting entity) shall apply.

vii. Description of assets transferred by reporting entity; and

viii. Statement value of assets transferred by reporting entity.

c. The dollar amounts of transactions for each of the periods for which financial statements are presented and the effects of any change in the method of establishing the terms from that used in the preceding period;

d. Amounts due from or to related parties as of the date of each balance sheet presented and, if not otherwise apparent, the terms and manner of settlement;

e. Any guarantees or undertakings, written or otherwise, shall be disclosed in accordance with the requirements of SSAP No. 5R. In addition, the nature of the relationship to the beneficiary of the guarantee or undertaking (affiliated or unaffiliated) shall also be disclosed;

f. A description of material management or service contracts and cost-sharing arrangements involving the reporting entity and any related party. This shall include, but is not limited to, sale lease-back arrangements, computer or fixed asset leasing arrangements, and agency contracts, which remove assets otherwise recordable (and potentially nonadmitted) on the reporting entity's financial statements;

g. The nature of the control relationship whereby the reporting entity and one or more other enterprises are under common ownership or control and the existence of that control could result in operating results or financial position of the reporting entity significantly different from those that would have been obtained if the enterprises were autonomous. The relationship shall be disclosed even though there are no transactions between the enterprises; and

h. The amount deducted from the value of an upstream intermediate entity or ultimate parent owned, either directly or indirectly, via a downstream subsidiary, controlled, or affiliated entity, in accordance with the *Purposes and Procedure Manual of the NAIC Investment Analysis Office*, "Procedures for Valuing Common Stocks and Stock Warrants."

22. The disclosures of ownership interests in the reporting entity shall be provided outside of the financial statements (Schedule Y). The intent of this disclosure is to capture information related to active ownership and is not intended for passive fund owners to be reported.

a. Disclosure is required for all owners with greater than 10% ownership of the reporting entity.

b. Reporting entity must disclose each owner's ultimate controlling party and must provide a listing of other U.S. insurance groups or entities under that ultimate controlling party's control.

~~21.~~23. Refer to the Preamble for further discussion regarding disclosure requirements.

Relevant Literature

~~22.~~24. This statement adopts *FASB Statement No. 57, Related Party Disclosures* with a modification to paragraph 4 to require disclosure of compensation arrangements, expense allowances, and other similar items in the ordinary course of business.

~~23.~~25. This statement rejects *ASU 2013-06, Not-For-Profit Entities, Services Received from Personnel of an Affiliate* and AICPA *Accounting Interpretations, Business Combinations: Accounting Interpretations of APB Opinion No. 16, No. 39*, "Transfers and Exchanges between Companies under Common Control."

~~24.~~26. Guidance in paragraph 8 was incorporated from SSAP No. 96 as discussed in *Issue Paper No. 128—Settlement Requirements for Intercompany Transactions, An Amendment to SSAP No. 25—Accounting for and Disclosures about Transactions with Affiliates and Other Related Parties*. SSAP No. 96 was nullified in 2011 with the guidance from that SSAP retained within this SSAP.

Effective Date and Transition

~~25.~~27. This statement is effective for years beginning January 1, 2001. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*.

~~26.~~28. Guidance reflected in paragraph 8, incorporated from SSAP No. 96, is effective for reporting periods ending December 31, 2007. Early adoption is permitted. A change resulting from the application of this paragraph shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*. Guidance reflected in paragraph 3, incorporated from *INT 03-16: Contribution of Stock*, was originally effective December 7, 2003.

REFERENCES

Other

- *Purposes and Procedures Manual of the NAIC Investment Analysis Office*

Relevant Issue Papers

- *Issue Paper No. 25—Accounting for and Disclosures about Transactions with Affiliates and Other Related Parties*

- *Issue Paper No. 128—Settlement Requirements for Intercompany Transactions, An Amendment to SSAP No. 25—Accounting for and Disclosures about Transactions with Affiliates and Other Related Parties*

Ref #2020-17

Subsidiary, Controlled and Affiliated Entities (SCA) Filing Procedures – Filing a Sub-1 Form

Note to filer: Per the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual), Subsidiary, Controlled and Affiliated Entities (SCAs) are required to be filed. A Sub-1 form is required to be filed within ~~30~~ 90 days of the acquisition or formation of the investment. A Sub-2 form is required to be filed annually for any existing investment~~, by June 30th of the next calendar year~~ by August 31st or one month after the audit report date. Prior to September 5, 2016, these filings were completed in ISIS. After September 5, 2016, they will be completed in VISION. These filing instructions help navigate filings through VISION. For additional questions, please contact the individuals below.

Also see "SCA Filing Procedures-Sub 2" for instructions on how to file a Sub-2 form and an appeal to a Sub-2 form.

Fatima Sediqzad, SCA Valuation & Accounting Policy Advisor fsediqzad@naic.org 816.783.8894

Jill Youtsey, FRS Insurance Reporting Analyst II jyoutsey@naic.org 816.783.8419

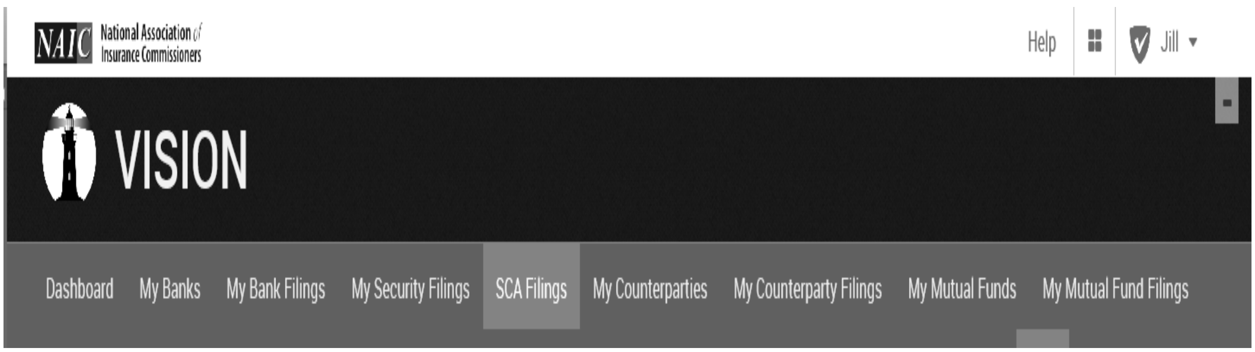
Note: Do NOT hit "Cancel" at any time during the filing process; this will discard your filing and you will have to start over!

1. Accessing VISION to File a SCA

A. Log on to the filing website https://vision.naic.org

1. If you need a User ID and Password contact the NAIC Help Desk at 816-783-8500 or via email at securitiessupport@naic.org. All first-time VISION users will need a User ID.

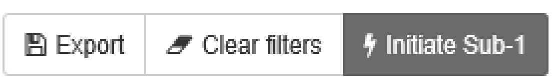
2. Click on the "SCA Filings" tab.



a. The "SCA Filings" tab details all prior SCA filings and/or initiate a Sub-1 filing

2. Filing a Sub-1 form (Initial Filing)

A. From the "SCA Filings" screen, click on the "Initiate Sub-1" button.



B. Follow the filing wizard:

1. Filer and SCA Tab – *Select insurance reporting entity and identify which SCA you are filing.*

a. **Select Filer** – if you have multiple companies you file for, pick the correct Insurance Reporting Entity

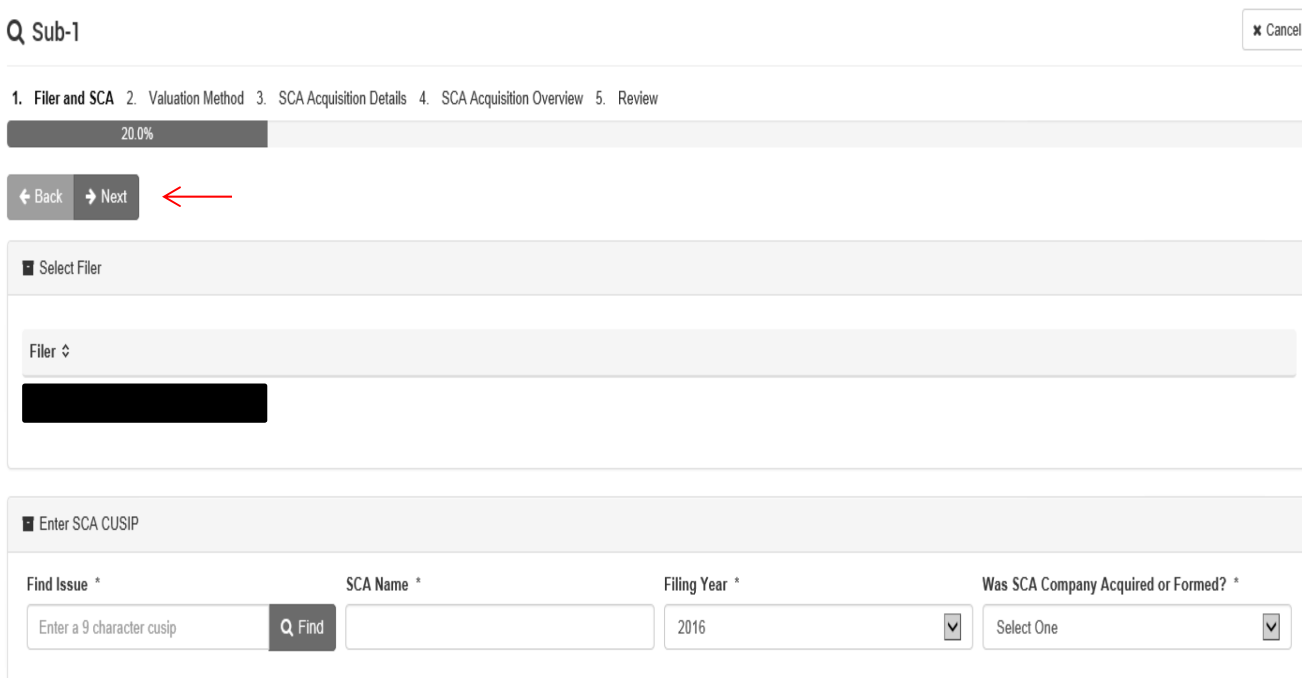
b. **Find Issue** – Enter the SCA's CUSIP and select "Find"

i. If you do not have a valid CUSIP or PPN, contact CUSIP Global Services at 212-438-6500 or via email at cusip_ppn@cusip.com. This is a requirement to file an SCA.

c. **SCA Name** – Enter the legal name of the SCA

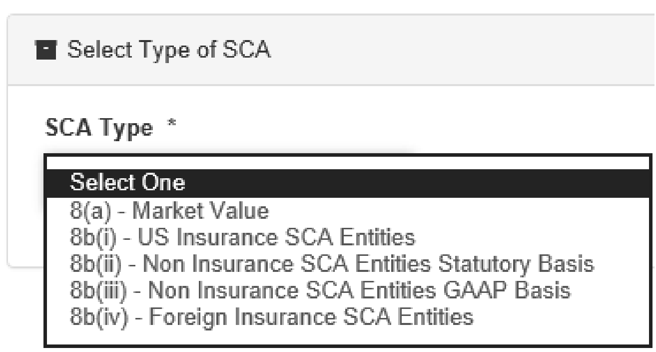
d. **Filing Year** – Enter the year of the audited financials. (Often prior year – 12/31/2015)
e. **Was SCA Company Acquired or Formed? –** Select answer

f. When all of the fields above have been filled in, click **"Next"**



2. <u>**Valuation Method Tab**</u> – I*dentify which valuation method the SCA is using*

a. **Select SCA Type** – Refer to *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities* to ensure selection of the correct valuation method:



b. *Subsequent questions are tailored based on SCA Type:*

i. <u>8(a) – Market Value</u>

(a) **Discount percentage**: Sliding scale discount based on ownership percentage. (See Appendix C of SSAP No. 97.)

ii. 8b(i) – US Insurance SCA Entities – (Must be licensed insurance entity)

(a) **Stock Type** – common or preferred stock ownership

(b) **CoCode** – NAIC company code of the SCA insurance company

iii. 8b(ii) – Non Insurance SCA Entities Statutory Basis

(a) **Accounting Standard** – US GAAP or Foreign basis as used in audit support

(b) **Stock Type** – common or preferred stock ownership

iv. 8b(iii) – Non Insurance SCA Entities GAAP Basis

(a) **Accounting Standard** – US GAAP or Foreign basis as used in audit support

(b) **Stock Type** – common or preferred stock ownership

v. 8b(iv) – Foreign Insurance SCA Entities

(a) **Stock Type** – Common or preferred stock ownership

c. *When all of the questions have been addressed, click "Next"*

3. SCA Acquisition Details Tab – I*dentify what type of business the SCA is, when it was acquired, and report goodwill (if applicable).*

a. **Principal Business** – Identify the principal business of the SCA company

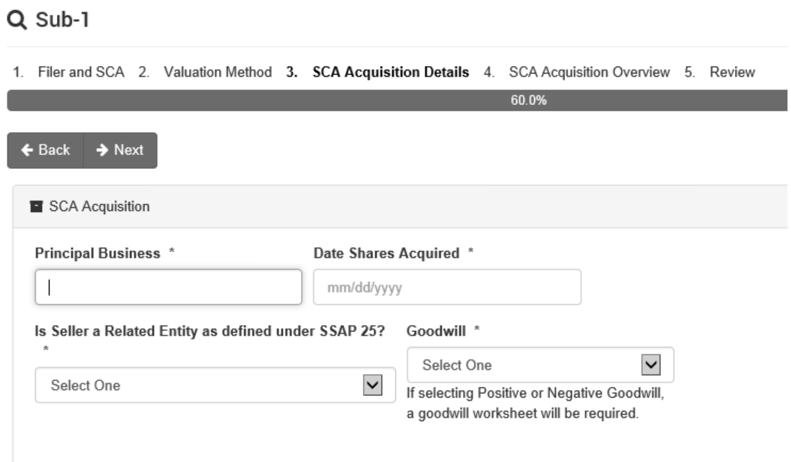
b. **Date Shares Acquired –** Include Month / Date / Year

c. **Is Seller a Related Entity as defined under SSAP 25? –** Select Yes / No
Depending on the answer, there may be a few more questions.

d. **Goodwill** – Based on the acquisition of the SCA, select:

- No Goodwill
- Positive Goodwill
- Negative Goodwill

(If positive or negative goodwill, goodwill worksheet will be a required attachment.)



4. <u>SCA Acquisition Overview Tab</u> – Report *claimed value of SCA and include filing comments*

   a. **Total Value Claimed** – Value of SCA (Include Goodwill)

   b. **Shares owned** – Number of shares insurance reporting entity owns

   c. **Value Per Share** – Total value claimed divided by the number of shares owned

   d. **Percent Outstanding Shares Owned** – Percentage of shares issued and outstanding that the insurance reporting entity owns

   e. **Consideration Paid** – Amount paid for SCA

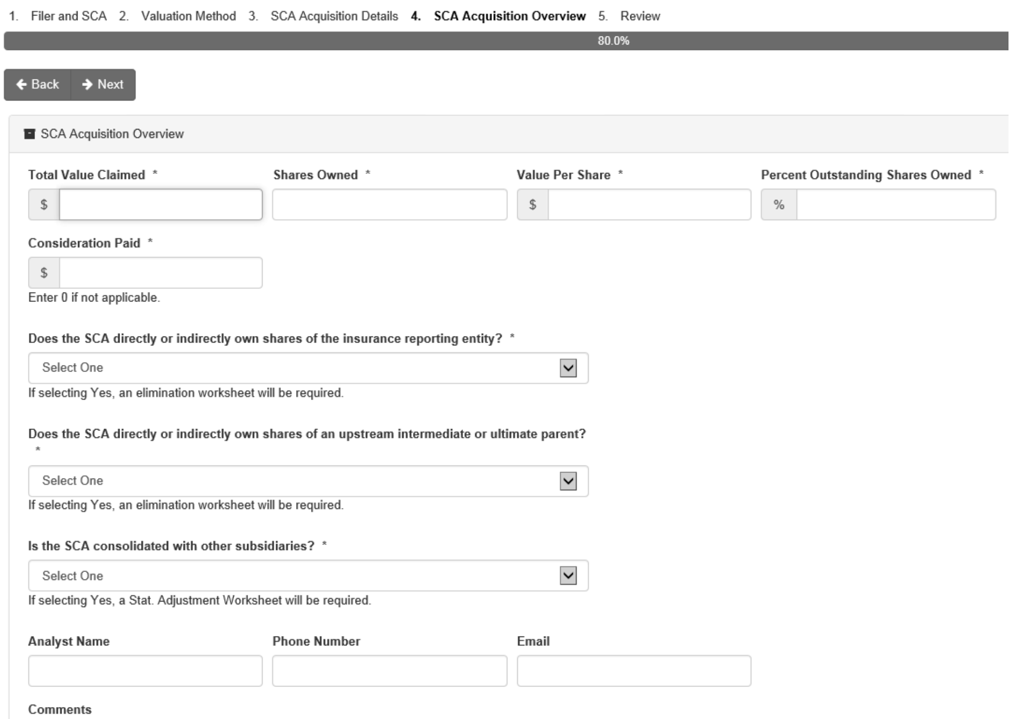
   f. **Does the SCA directly or indirectly own shares of the insurance reporting entity?** Relates to reciprocal ownership. *SCA Elimination Worksheet will be required:* http://www.naic.org/sca_subsidiary_controlled_affiliated.htm

   g. **Does the SCA directly or indirectly own shares of an upstream intermediate or ultimate parent?** Relates to reciprocal ownership. *SCA Elimination Worksheet will be required:* http://www.naic.org/sca_subsidiary_controlled_affiliated.htm

   h. **Is the SCA consolidated with other subsidiaries?** The Stat. Adjustment Worksheet will be required: http://www.naic.org/sca_subsidiary_controlled_affiliated.htm)

   i. **Analyst Name / Phone Number / Email** – Name and contact information for Individual who prepared the filing in case SCA reviewer has questions.

   j. **Comments** – Available for additional information for reviewing the SCA.


1. Filer and SCA 2. Valuation Method 3. SCA Acquisition Details **4. SCA Acquisition Overview** 5. Review

80.0%

Back Next

SCA Acquisition Overview

Total Value Claimed * $

Shares Owned *

Value Per Share * $

Percent Outstanding Shares Owned * %

Consideration Paid * $

Enter 0 if not applicable.

Does the SCA directly or indirectly own shares of the insurance reporting entity? *

Select One

If selecting Yes, an elimination worksheet will be required.

Does the SCA directly or indirectly own shares of an upstream intermediate or ultimate parent? *

Select One

If selecting Yes, an elimination worksheet will be required.

Is the SCA consolidated with other subsidiaries? *

Select One

If selecting Yes, a Stat. Adjustment Worksheet will be required.

Analyst Name

Phone Number

Email

Comments

5. <u>**Review tab**</u>

   a. Review all fields of the SCA to ensure they are filed correctly.

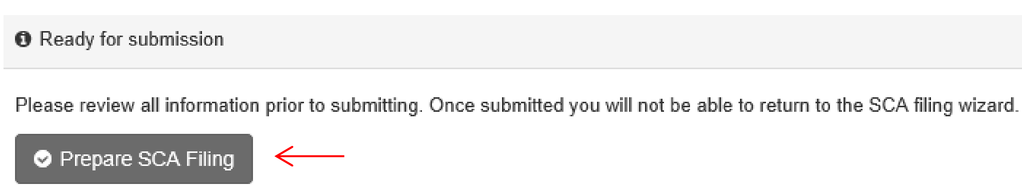
<u>**IMPORTANT NOTES:**</u>

If something is not filled out correctly, click "Back" and update!!

After clicking "Prepare SCA Filing" you <u>WILL NOT</u> be able to make any changes!!

*<u>**DO NOT**</u> hit cancel at any point during the filing process - This will discard your filing!!*

When finished reviewing, click the "Prepare SCA Filing" button


Ready for submission

Please review all information prior to submitting. Once submitted you will not be able to return to the SCA filing wizard.

Prepare SCA Filing

6. <u>SCA Filing Detail Tab</u> – Shows all the filing detail and attach supporting documents

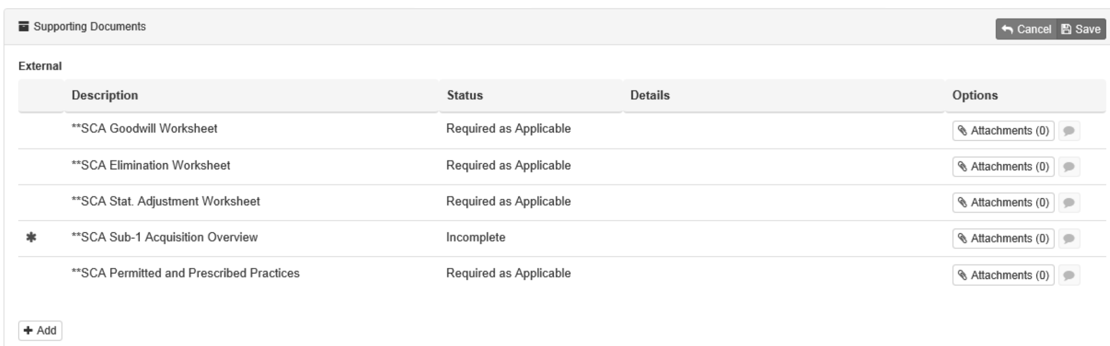
a. To attach a document

- Click "Edit" under Supporting Documents

- Click "Attachments" to the file you want to add
  If you have a document to add that is not listed click "+ Add"

- Find your document and upload

- When finished uploading documents click "Save" under Supporting Documents


Supporting Documents
Cancel Save

External

	Description	Status	Details	Options
	**SCA Goodwill Worksheet	Required as Applicable		Attachments (0)
	**SCA Elimination Worksheet	Required as Applicable		Attachments (0)
	**SCA Stat. Adjustment Worksheet	Required as Applicable		Attachments (0)
✱	**SCA Sub-1 Acquisition Overview	Incomplete		Attachments (0)
	**SCA Permitted and Prescribed Practices	Required as Applicable		Attachments (0)

+ Add

b. Required Sub-1 Documents

- SCA Sub-1 Acquisition Overview - <u>Always</u> required for Sub-1 - "*"

c. Other Required Documents

- Required depending on answers to questions:
  (a) SCA Goodwill Worksheet – If positive or negative goodwill
  (b) SCA Elimination Worksheet – If "Yes" to the Reciprocal Ownership
  (c) SCA Stat. Adjustment Worksheet – If "Yes" to Consolidated

Note: If applicable, these are required, but there will not be a ""*.

d. Worksheets and other SCA documents available:
<u>http://www.naic.org/sca_subsidiary_controlled_affiliated.htm</u>

<u>After attaching all required documents - Click "Submit" to finalize Sub-1 filing:</u>

Ref #2020-17

After Submitting – You Have Completed the Sub-1 Filing!!!

Upon submission of the Sub 1 filing in VISION, an NAIC analyst will review it. When the filing has been reviewed, the filer can download the final review results from the filing screen. The filer will click on the filing number under the “SCA Filings” tab of the VISION home screen. Once in the filing screen, the “Export State Information” button will be visible on the screen. When the filer clicks this button, the final review results will open. Filer should save this for their records.

Subsidiary, Controlled and Affiliated Entities (SCA) Filing Procedures – Filing a Sub-2 Form or an Appeal to a Sub-2 Form

Note to filer: Per the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual), Subsidiary, Controlled and Affiliated Entities (SCAs) are required to be filed. A Sub-1 form is required to be filed within ~~30~~ 90 days of the acquisition or formation of the investment. A Sub-2 form is required to be filed annually for any existing investment~~, by June 30th of the next calendar year~~ by August 31st or one month after the audit report date. Prior to September 5, 2016, these filings were completed in ISIS. After September 5, 2016, they will be completed in VISION. These filing instructions help navigate filings through VISION. For additional questions, please contact the individuals below.

Also see "SCA Filing Procedures-Sub 1" for instructions on how to file a Sub-1 form.

Fatima Sediqzad, SCA Valuation & Accounting Policy Advisor fsediqzad@naic.org 816.783.8894

Jill Youtsey, FRS Insurance Reporting Analyst II jyoutsey@naic.org 816.783.8419

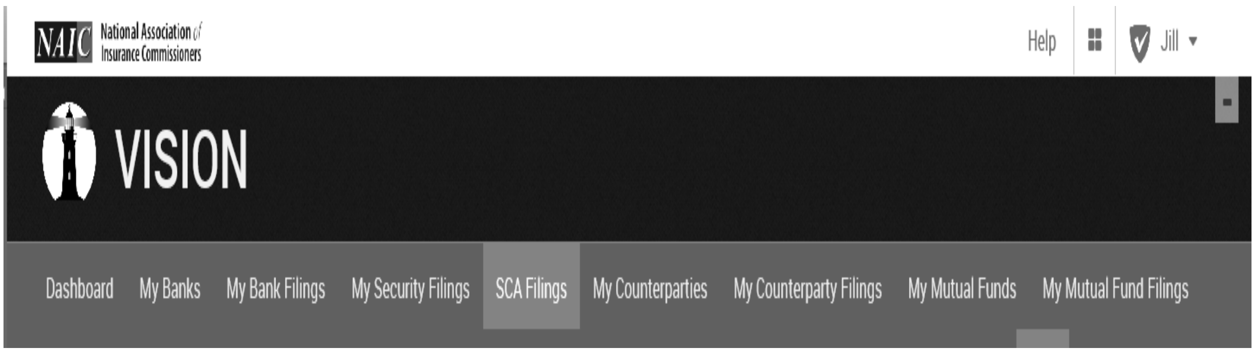
Note: Do NOT hit "Cancel" at any time during the filing process; this will discard your filing and you will have to start over!

1. Accessing VISION to File a SCA

A. Log on to the filing website https://vision.naic.org

1. If you need a User ID and Password contact the NAIC Help Desk at 816-783-8500 or via email at securitiessupport@naic.org. All first-time VISION users will need a User ID.

2. Click on the "SCA Filings" tab.



a. The "SCA Filings" tab details all prior SCA filings and/or initiate a Sub-1 filing

2. Filing a Sub-2 form (Annual Update)

A. From the "SCA Filings" screen, click on the Filing Number of the most recent filing for the SCA you wish to file

1. You can sort the SCA Filings screen by any of the headers, or even search for a particular SCA

Filing Number	CUSIP	Issuer Name
1007405	G3154#107	CNA EUROPE HLDGS LTD
1006721	142042100	CARIBOU COFFEE INC
1006847	056345408	BACARDI CORP
1005644	530007103	LIBBY CAP PARTNERS INC
1006766	433523107	HIPPO INC

B. Clicking on the Filing Number will bring up SCA Filing Detail

1. Click on the "Initiate Sub-2" button

C. Follow the filing wizard – *the filing wizard automatically populates with what was previously approved by the SCA analyst*

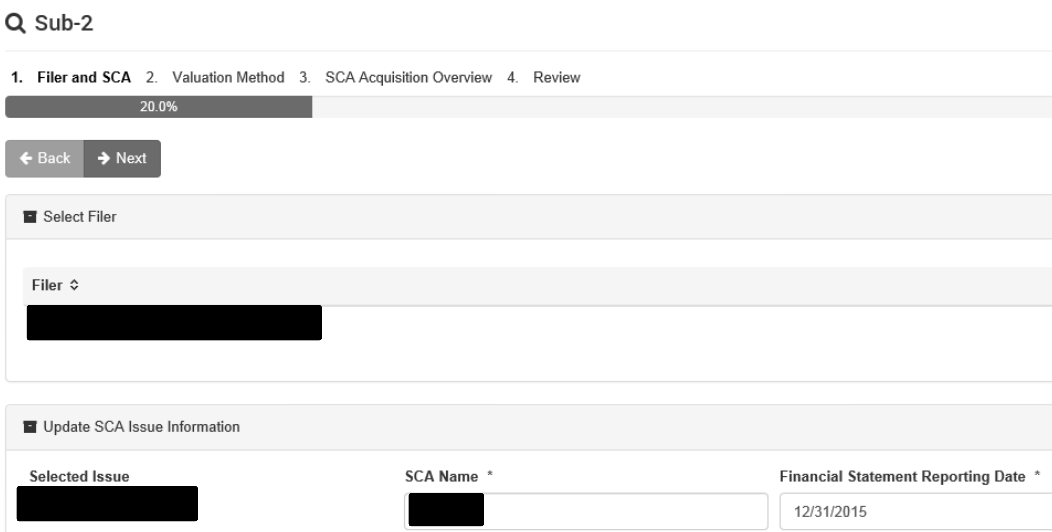
1. **<u>Filer and SCA tab</u>** – *this tab is used to pick the insurance reporting entity and to identify what SCA you are filing*

a. **Select Filer** – if you have multiple companies you file for pick the correct Insurance Reporting Entity

b. **SCA Name** – Only change this if there was a name change for the SCA company

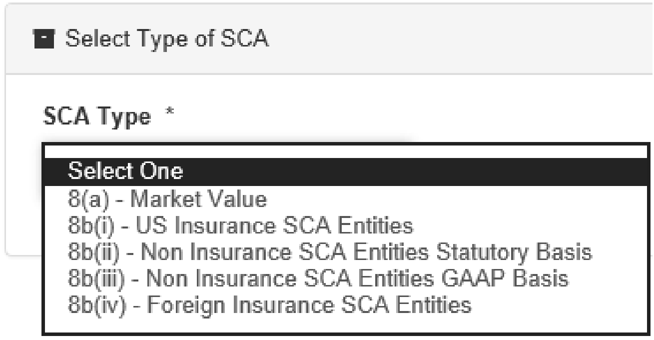
c. **Financial Statement Reporting Date** – enter the date of the audited financials

d. When all of the fields above have been filled in, click "**Next**"



2. **<u>Valuation Method tab</u>** – *this tab is used to identify what valuation method the SCA is using*

a. **Select SCA Type** – Refer to *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities* to ensure you are selecting the correct valuation method (*Depending on valuation method other questions might be asked)*



b. *Subsequent questions are tailored based on SCA Type:*

i. <u>8(a) – Market Value</u>

(a) **Discount percentage**: Sliding scale discount based on ownership percentage. (See Appendix C of SSAP No. 97.)

ii. <u>8b(i) – US Insurance SCA Entities – (Must be licensed insurance entity)</u>

(a) **Stock Type** – common or preferred stock ownership

(b) **CoCode** – NAIC company code of the SCA insurance company

iii. <u>8b(ii) – Non Insurance SCA Entities Statutory Basis</u>

(a) **Accounting Standard** – US GAAP or Foreign basis as used in audit support

(b) **Stock Type** – common or preferred stock ownership

<u>iv. 8b(iii) – Non Insurance SCA Entities GAAP Basis</u>

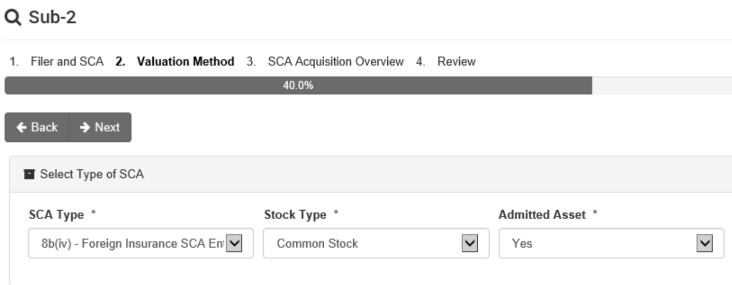
(a) **Accounting Standard** – US GAAP or Foreign basis as used in audit support

(b) **Stock Type** – common or preferred stock ownership

v. <u>8b(iv) – Foreign Insurance SCA Entities</u>

(a) **Stock Type** – Common or preferred stock ownership

c. **Admitted Asset** – If asset is admitted choose yes (both admitted and nonadmitted SCAs need to be filed)



3. <u>**SCA Acquisition Overview tab**</u> – *this tab is used to show the claimed value of the SCA*

a. **Total Value Claimed** – Value of SCA (Include Goodwill from purchase of SCA)

b. **Shares Owned** - number of shares the insurance reporting entity owns

c. **Value Per Share** - total value claimed divided by the number of shares owned

d. **Percent Outstanding Shares Owned** - percentage of shares issued and outstanding that the insurance reporting entity owns

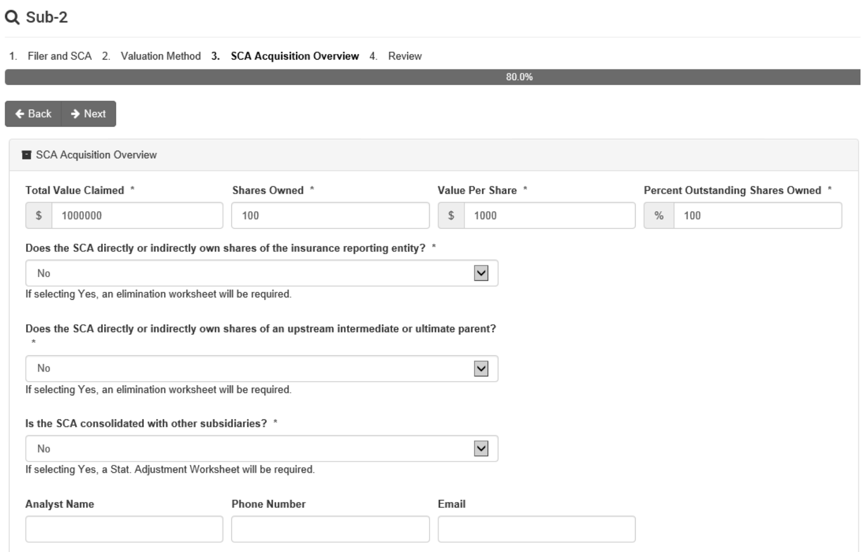
e. **Does the SCA directly or indirectly own shares of the insurance reporting entity?** This relates to reciprocal ownership – refer to SSAP No. 97 for m ore detail (SCA Elimination Worksheet will need completed – found at <u>http://www.naic.org/sca_subsidiary_controlled_affiliated.htm</u>)

f. **Does the SCA directly or indirectly own shares of an upstream intermediate or ultimate parent?** This relates to reciprocal ownership – refer to SSAP No. 97 for more detail (SCA Elimination Worksheet will need completed – found at <u>http://www.naic.org/sca_subsidiary_controlled_affiliated.htm</u>)

g. **Is the SCA consolidated with other subsidiaries?** The Stat. Adjustment Worksheet will be required and will help tie out an SCA that has been consolidated (Worksheet found at <u>http://www.naic.org/sca_subsidiary_controlled_affiliated.htm</u>)

h. **Analyst Name / Phone Number / Email** – Name and contact information for Individual who prepared the filing in case SCA reviewer has questions.

i. **Comments** – Available for additional information for reviewing the SCA.



4. Review tab

a. Review all fields of the SCA to ensure they are filed correctly

i. *If something is not filled out correctly, go back and update at this point because you won't be able to after you click "Prepare SCA Filing"*

ii. When finished reviewing, click the "Prepare SCA Filing" button

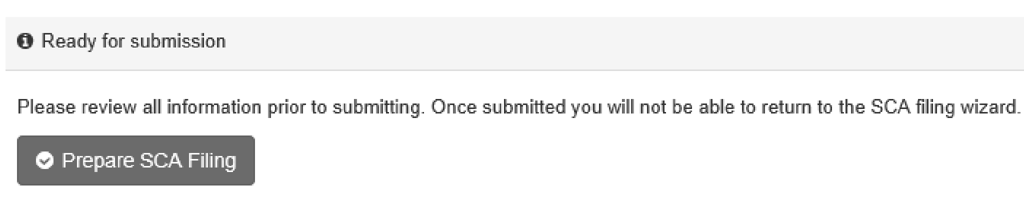
IMPORTANT NOTES:

If something is not filled out correctly, click "Back" and update!!

After clicking "Prepare SCA Filing" you WILL NOT be able to make any changes!!

***DO NOT** hit cancel at any point during the filing process - This will discard your filing!!*

When finished reviewing, click the "Prepare SCA Filing" button



5. **<u>SCA Filing Detail tab</u>** – *This tab will show all the filing details and this is where you will attach all your supporting documents*

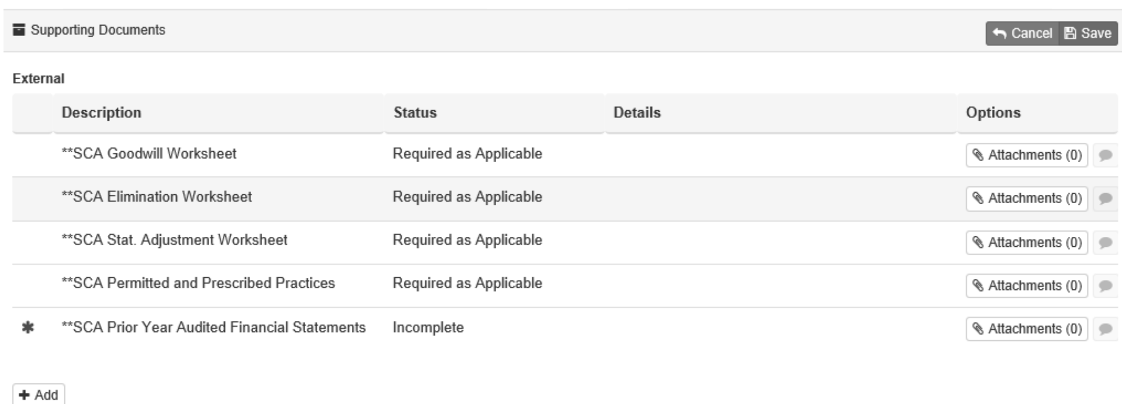
a. To attach a document:

1. Click “Edit” under Supporting Documents

2. Click “Attachments” to the file you want to add

   - *If you have a document to add that is not listed click the “+ Add” button and attach from there*

3. Find your document and upload – when finished uploading documents click “Save” under Supporting Documents



b. Required Sub-2 Documents

1. SCA Prior Year Audited Financial Statements – attach the audit for the SCA filing – <u>Always</u> required for Sub-2 – “*”

c. Other Required Documents

1. Required depending on answers to questions:
   (a) SCA Goodwill Worksheet – If you chose Positive or Negative Goodwill, this will need to be included
   (b) SCA Elimination Worksheet – If you answered Yes to the Reciprocal Ownership questions, this will need to be included

(c) SCA Stat Adj. Worksheet – If you answered Yes to the Consolidated SCA question, this will need to be included

Note: If applicable, these are required, but there will not be a ""*.

d. Worksheets and other SCA documents can be found at http://www.naic.org/sca_subsidiary_controlled_affiliated.htm

After attaching all required documents - Click "Submit" to finalize ~~Sub-1~~Sub-2 filing:

After Submitting – You Have Completed the Sub-2 Filing!!!

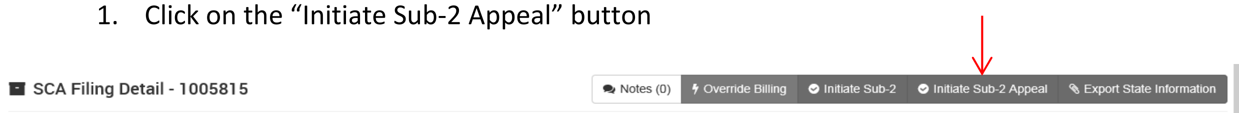
Upon submission of the Sub 1 filing in VISION, an NAIC analyst will review it. When the filing has been reviewed, the filer can download the final review results from the filing screen. The filer will click on the filing number under the "SCA Filings" tab of the VISION home screen. Once in the filing screen, the "Export State Information" button will be visible on the screen. When the filer clicks this button, the final review results will open. Filer should save this for their records.

3. Filing an Appeal to a Sub-2 Filing

A. From the "SCA Filings" screen, click on the Filing Number of the SCA you wish to file an appeal for
   1. You can sort the "SCA Filings" screen by any of the headers, or even search for a particular SCA

Filing Number	CUSIP	Issuer Name
1007405	G3154#107	CNA EUROPE HLDGS LTD
1006721	142042100	CARIBOU COFFEE INC
1006847	056345408	BACARDI CORP
1005644	530007103	LIBBY CAP PARTNERS INC
1006766	433523107	HIPPO INC

B. Clicking on the “Filing Number” will bring up SCA Filing Detail
   1. Click on the “Initiate Sub-2 Appeal” button



   2. **Analyst Name / Phone Number / Email** – Name and contact information for Individual who prepared the filing in case SCA reviewer has questions.

   3. **Please provide your company’s preferred conclusion and rationale** – enter information to be considered during the appeal process

C. When all of the fields above have been filled in, click “Next”

D. Review the details and click “Prepare SCA Filing”

E. On the “SCA Filing Detail” tab, include any supporting documents that go with the appeal.

F. Click “Submit” to finalize Sub-2 appeal filing.

Upon submission of the Sub 1 filing in VISION, an NAIC analyst will review it. When the filing has been reviewed, the filer can download the final review results from the filing screen. The filer will click on the filing number under the “SCA Filings” tab of the VISION home screen. Once in the filing screen, the “Export State Information” button will be visible on the screen. When the filer clicks this button, the final review results will open. Filer should save this for their records.

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September 18, 2020

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

RE: Ref #2020-24 – SSAP No. 43R, Accounting and Reporting of Credit Tenant Loans

Dear Mr. Bruggeman:

Interested parties would like to thank the Statutory Accounting Principles Working Group (SAPWG) for the opportunity to comment on the exposure Ref #2020-24 – SSAP No. 43R, Accounting and Reporting of Credit Tenant Loans (the Exposure).

<u>NAIC Staff Summary of Issue</u>

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

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

Interested Parties Background Response

Interested parties note that the impetus behind the Exposure is the referral from the Valuation of Securities Task Force (VOSTF) in Attachment O of the July 30, 2020 SAPWG meeting materials, dated May 29, 2020. In its referral, the VOSTF pointed to non-conforming CTLs that had not been submitted to the SVO and/or did not qualify under the SVO's structural and legal analysis. These non-conforming CTLs were being reported on Schedule D with filing exempt designations. This has led to questions about both conforming CTLs and non-conforming CTLs.

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

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

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

Conforming CTLs

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

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

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

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

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

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

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

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

It is no surprise, given this key differentiation, that conforming CTLs were affirmed bond status by the IAWG, SAPWG and VOSTF in mid 1990s after significant analysis and public deliberation. Nor does it make sense to report such conforming CTLs as mortgage loans given that SSAP No. 37 clearly excludes securities from its scope. Further, the corporate credit nature of conforming CTLs, with the additional benefit of the real estate collateral, result in a higher LTV than for most typical mortgage loans, which

[1] This statement adopts the GAAP definition of a security as it is used in FASB Codification Topic 320 and 860.

Security: A share, participation, or other interest in property or in an entity of the issuer or an obligation of the issuer that has all of the following characteristics:

a. It is either represented by an instrument issued in bearer or registered form or, if not represented by an instrument, is registered in books maintained to record transfers made by or on behalf of the issuer.

b. It is of a type commonly dealt in securities exchanges or markets or, when represented by an instrument, is commonly recognized in any area in which it is issued or dealt in as a medium for investment.

c. It either is one of a class or series or by its terms is divisible into a class or series of shares, participations, interests, or obligations.

current mortgage RBC formulas do not contemplate. As such, current mortgage loan RBC requirements would be materially punitive.

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

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

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

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

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

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

We look forward to discussing this further with members of SAPWG.

Non-Conforming CTLs

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

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

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

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

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

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

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

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

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

*****

Thank you for considering Interested parties' comments. Interested parties are committed to working with NAIC staff and SAPWG on this very important and precedent setting topic. If you have any questions in the interim, please do not hesitate to contact us or Mike Reis at michaelreis@northwesternmutual.com or 414-241-8293.

Sincerely,

D. Keith Bell Rose Albrizio

cc: Interested parties

American Property Casualty Insurance Association
INSURING AMERICA apci.org

Matthew B. Vece
Manager, Financial & Tax Counsel

September 18, 2020

Mr. Dale Bruggeman
Chair, NAIC Statutory Accounting Principles (E) Working Group
Ohio Department of Insurance
50 West Town Street, Suite 300
Columbus, OH 43215

Re: Form A on Premium Refunds and Other Adjustments – Ref. #2020-30

Dear Mr. Bruggeman:

The American Property Casualty Insurance Association (APCIA) appreciates the opportunity to comment to the Statutory Accounting Principles (E) Working Group on the exposed Form A on Premium Refunds and Other Adjustments. APCIA is the primary national trade association for home, auto, and business insurers. APCIA promotes and protects the viability of private competition for the benefit of consumers and insurers, with a legacy dating back 150 years. APCIA members represent all sizes, structures, and regions—protecting families, communities, and businesses in the U.S. and across the globe.

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

We look forward to discussing our comments with you and the Working Group.

Sincerely,

Matthew B. Vece
Manager, Financial & Tax Counsel

Lease-Backed Securities Working Group

VIA EMAIL

September 18, 2020

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

Re: **Ref #2020-24 – SSAP No. 43R, Accounting and Reporting of Credit Tenant Loans**

Dear Mr. Bruggeman:

The Lease-Backed Securities Working Group, together with various other institutional investors and other interested market participants which collectively have completed and invested in over $50 billion of lease-backed securities generally, would like to thank the Statutory Accounting Principles Working Group (SAPWG) for the opportunity to comment on the exposure Reference #2020-24 – SSAP No. 43R, Accounting and Reporting of Credit Tenant Loans (the "**Exposure**" or this "**agenda item**").

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

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

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

> **Option 1:** Essentially continue with the historical practice of Schedule D treatment within the scope of SSAP No. 43R for "Credit Tenant Loans" as currently defined in the P&P Manual. At the same time, consider whether other lease-backed transactions -- referred to in the Exposure as "non-conforming CTLs" -- should be reported on Schedule B as mortgages, or on schedule BA under SSAP 21: "Other Admitted Assets".
>
> **Option 2:** Report "all CTLs" (i.e.: CTLs as current defined in the P&P Manual, and the other lease-backed transactions that do not meet the requirements to be reported as "CTLs") on Schedule BA within the Scope of SSAP 21: "Other Admitted Assets".

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

Re: Ref #2024 – SSAP No. 43R, Accounting and Reporting of Credit Tenant Loans
Lease-Backed Securities Working Group Comment Letter

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

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

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

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

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

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

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

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

**Re: Ref #2024 – SSAP No. 43R, Accounting and Reporting of Credit Tenant Loans
Lease-Backed Securities Working Group Comment Letter**

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

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

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

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

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

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

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

Finally and importantly, both CTLs as defined in the P&P Manual and these other rated lease-backed securities are used not just by commercial tenants, but are also a major financial resource used by municipal governments and the United States Federal Government and its agencies to fund major infrastructure improvements and large national security build-to-suit mission-critical facilities. (Examples include major

**Re: Ref #2024 – SSAP No. 43R, Accounting and Reporting of Credit Tenant Loans
Lease-Backed Securities Working Group Comment Letter**

projects for the Veteran's Administration, the IRS, the CIA, the Office of the Director of National Intelligence, the National Nuclear Security Administration, and others too numerous to mention.)

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

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

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

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

We greatly appreciate your time and consideration.

LEASE-BACKED SECURITIES WORKING GROUP

/s

John Garrison, Director

Re: Ref #2024 – SSAP No. 43R, Accounting and Reporting of Credit Tenant Loans Lease-Backed Securities Working Group Comment Letter

Addendum: Credit Experience of Credit Tenant Loans:

Credit Tenant Loans have the strongest credit performance of any private-placement bond type:

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

Among Private Placement Bonds, Credit Tenant Loans have – by a wide margin --both the lowest incidence of "Credit Risk Events" and the lowest economic losses of any asset class, as shown in the following tables reproduces from the April 2019 Study by the Society of Actuaries: 2003-2015 Credit Loss Experience Study: Private Placement Bonds:

Table 7*
LOSS EXPERIENCE BY ASSET TYPE, 2003-2015

Asset Type	Exposure (by Amount)	Number Of CREs	Incidence (by Amount)	Loss Severity	Economic Loss
Notes. Bonds & Debentures	80.5%	301	0.36%	31.5%	0.11%
Equipment Trusts/Lease Obligations	1.1%	19	0.52%	43.4%	0.22%
Credit Tenant Loans	5.3%	17	0.05%	44.9%	0.02%
Project Finance	6.8%	32	0.58%	31.3%	0.18%
Other	6.3%	72	0.31%	30.0%	0.09%

They also have one of the highest internal ratings of any asset class:

Table 8*
PERCENTAGE OF EXPOSURE (BY AMOUNT) BY ASSET TYPE AND INTERNAL RATING, 2003-20015

	Notes Bonds & Debentures	Equipment Trusts/Lease Obligations	Credit Tenant Loans	Project Finance	Other	All Asset Types
AAA	1.7%	5.0%	4.4%	2.9%	3.8%	2.1%
AA	7.4%	22.7%	22.9%	1.4%	8.0%	8.0%
A	24.8%	42.4%	32.8%	15.0%	27.0%	24.9%
BBB	59.5%	22.0%	35.2%	60.7%	53.1%	57.5%
BB	4.1%	2.9%	2.6%	11.4%	5.5%	4.6%
B	1.0%	1.5%	1.4%	4.8%	1.3%	1.3%
<B	0.4%	2.8%	0.4%	1.5%	0.3%	0.5%
NR	1.2%	0.9%	0.4%	2.3%	1.0%	1.2%

** Source: April 2019 Society of Actuaries 2003-2015 Credit Loss Experience Study: Private Placement Bonds*

Daniel Barry
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September 18, 2020

Mr. Dale Bruggeman
Chair, Statutory Accounting Principles (E) Working Group
National Association of Insurance Commissioners
Submitted via Email

Re: Ref# 2024 – SSAP No. 43R, Accounting and Reporting of Credit Tenant Loan

Dear Mr. Bruggeman:

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

About TIAA

Founded in 1918, TIAA is the leading provider of retirement and financial services for those in academic, research, medical, and cultural fields. Over our century-long history, TIAA's mission has always been to aid and strengthen the institutions and participants we serve and to provide financial products that meet their needs. To carry out this mission, we have evolved to include a range of financial services, including asset management and retail services. Today, TIAA manages over $1 trillion in assets, and our investment model and long-term approach aim to benefit the five million retirement plan participants we serve across more than 15,000 institutions.[1] With our strong nonprofit heritage, we remain committed to the mission we embarked on in 1918 of serving the financial needs of those who serve the greater good.

[1] Data are as of June 30, 2020.

Credit Tenant Loans should be treated as bonds.

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

Credit Tenant Loans belong on Schedule D.

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

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

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

Transferring the reporting of CTLs from Schedule D to Schedule BA would result in market participants disfavoring CTLs as an asset class. Schedule BA is perceived within the marketplace as the catch-all schedule for novel, risky, or disfavored asset classes, such as hedge funds or private equity. In fact, many investors have strict policies prohibiting investments in Schedule BA assets; for example, property and casualty insurers are banned from investing in Schedule BA assets. This type of disfavored status is not appropriate for CTLs, which over decades have shined as an asset with both the lowest incidence of default and lowest losses of any asset class[2]. CTLs consistently have the best credit performance among private placement investments. TIAA urges the Working Group against transferring CTLs off Schedule D as an inappropriate treatment of CTLs as an asset class.

Conclusion

TIAA commends the Working Group for its focus on this issue, and we appreciate the opportunity to comment on the exposure draft. We hope our suggestions above prove helpful as the NAIC continues

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[2] *2003-2015 Credit Loss Experience Study: Private Placement Bonds*, Society of Actuaries, April 2019.

its work on the appropriate accounting treatment of CTLs. We would welcome the opportunity to engage further on any aspects of this letter.

Sincerely,

Daniel Barry

Robert Gardner
Senior Vice President & Controller
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October 27, 2020

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: New York Life's Comments on Item 2020-18 *SSAP 97 Update*

Dear Mr. Bruggeman:

New York Life ("NYL") appreciates the opportunity to provide comments on Item 2020-18 (the "Exposure"), which was exposed by the Statutory Accounting Principles (E) Working Group (the "Working Group") during the NAIC 2020 Summer National Meeting.

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

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

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

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

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

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

We believe this language addresses the two competing interests described above. Thank you for considering our comments on this topic. If you have any questions in the interim, please do not hesitate to contact us.

Sincerely,

Robert M. Gardner
Senior Vice President and Controller

Douglas a. Wheeler

Douglas A. Wheeler
Senior Vice President, Office of Governmental Affairs

Statutory Accounting Principles (E) Working Group
November 12 Interim Meeting
Comment Letters Received (SSAP No. 71) - Package 2 of 2

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State Fire Marshal

MARK HAIRE
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RICKY DAVIS
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October 29, 2020

Mr. Dale Bruggeman, Chair
Statutory Accounting Principles Working Group
National Association of Insurance Commissioners

RE: SSAP No. 71 - Policy Acquisition Costs and Commissions

Mr. Bruggeman,

I am writing as an interested regulator regarding the Statutory Accounting Principles Working Group's ("SAPWG") exposed revisions related to the treatment of levelized commission payments pursuant to SSAP No. 71 (Item #2019-24) and the designation by NAIC staff that these changes be considered a non-substantive change as defined in the NAIC's *Policy Statement on Maintenance of Statutory Accounting Principles* ("Policy Statement").

I have heard from several interested patties over the past several weeks regarding the exposed revisions to SSAP No. 71 and have some concerns regarding whether these changes have gone through the proper process and received the necessary scrutiny. In addition, I am also concerned about the potential impact these changes could have on insurers that historically accounted for commissions **in** a manner that conflicts with these new proposed revisions. It is my understanding that levelized commission programs have been around for decades and have gone through multiple examinations by regulators during that time period with little or no material issues noted. Although the current exposed revisions to SSAP No. 71 have been designated a non-substantive change, it appears these new revisions could have unintended consequences and potentially have a material impact on how the company accounts for these particular transactions.

Given the material nature of these transactions and the fact that these programs have been around for decades, it is my opinion that these proposed revisions appear to be a modification to the overall application of an existing SSAP and therefore should be considered a substantive change and follow the NAIC process as defined in the Policy Statement.

I appreciate the oppo1tunity to comment on this issue and encourage the SAPWG to take the necessary steps to study this issue further and provide a reasonable path forward for all of those who are affected by these proposed revisions.

Sincerely,

MIKE CHANEY
COMMISSIONER OF INSURANCE

October 30, 2020

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

RE: Ref #2019-24 Levelized and Persistency Commission (SSAP No. 71, Policy Acquisition Costs and Commissions)

Dear Mr. Bruggeman,

Interested parties (IPs) would like to thank the Statutory Accounting Principles Working Group (SAPWG) for the opportunity to continue to comment on the revisions to exposure Reference #2019-24 – Levelized and Persistency Commission (SSAP No. 71, Policy Acquisition Costs and Commissions) (the "Exposure").

IPs would like to propose the following edits to the most recent exposure discussed on October 15, 2020:

Most recent exposure, paragraph #4:

NAIC staff recommends adding "which attempts" in paragraph 4 as shown as shaded text below:

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

Most recent exposure, paragraph #4, with recommended edits (highlighted):

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

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

Most recent exposure, paragraph #5:

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

~~New Footnote – The guidance in this paragraph notes that levelized commissions which use a third party to pay agents that are linked to traditional elements require establishment of a liability for the amounts that have been paid to the agents and any interest accumulated to date.~~

Most recent exposure, paragraph #5, with recommended edits (highlighted):

5. The use of an arrangement such as ~~a levelized commission arrangement~~ that described in paragraph 4 where commission payments are not linked to traditional elements such as premium payments and policy persistency, but rather are linked to the repayment of an advance amount paid by a third party to the direct selling agents shall be accounted for consistent with other funding agreements in accordance with SSAP 52 – *Deposit-Type Contracts* which requires the establishment of a liability by the reporting entity for the full amount of the unpaid principal and accrued interest which is payable to the third party. ~~FN~~. ~~Arrangements that use a third party to pay agents who write policies for the reporting entity and the insured can be an attempt to de-link the relationship between the insurer and those agents and defer or levelize the acquisition commissions. The insurance reporting entity is required to recognize the full amount of earned commission costs to the direct policy writing agents even if those costs are paid indirectly to the agents by a third party through the use of levelized commission, or similar arrangement, which is in substance a funding arrangement. Having a third party pay commission costs to the selling agent is strong evidence of a potential funding arrangement which shall be recognized as a liability because the substance of the arrangement indicates that repayment is reasonable and probable, even if a contingency has been incorporated into the funding arrangement, unless the underlying policy has been cancelled. A third-party structure cannot recharacterize (e.g. by referencing policy persistency) and delay recognition of liabilities for initial sales commission owed from the writing of policies regardless~~

~~of how a third-party arrangement is structured with regards to the timing of payment from the insurer. The amount owed for full initial sales commission shall be recognized immediately as the writing of an insurance contract is the event that obligates the insurer, and such action shall occur consistently among insurers. As such, this recognition is required regardless if the insurer owes a selling agent directly or if a third-party has been contracted to provide payment to the selling agent.~~ The reporting entity is required to recognize the full repayment amount of earned commission costs by the direct policy writing agents even if those costs are paid indirectly by a third party through the use of levelized commission, or similar arrangement, which is in substance a funding arrangement. Recognition of those commission costs and recording a liability is required in such arrangements that are not linked to or contingent upon traditional elements. Such treatment shall occur consistently among insurers.

We request that the above edits be incorporated into the proposed 2019-24.

IPs found the expansion of paragraph #5 in the most recent exposure to be quite lengthy and redundant in certain aspects. The IP revisions above remove some of the redundancies and clearly state the guidance to be followed to account for arrangements that are in substance funding agreements. IPs retained the concept of the link between the accrual of commissions and traditional elements such as policy persistency.

In addition, we continue to believe that what have been deemed non-substantive clarifications to the original intent of SSAP 71 proposed by the SAPWG in 2019-24 are in fact substantive modifications that materially change accounting practices that were established long before the 2001 codification, and that continue today in many different forms. The link between the traditional elements such as policy persistency and the accrual of commissions is a long-standing principle. Eliminating the link to the policy persistency is not a clarification, it is a substantive change that modifies the original intent of SSAP 71, thus requiring further evaluation. The interpretation of SSAP No.71 that persistency is the obligating event for accrual of the levelized/persistency commissions has been subject to both independent audits and state insurance department examinations without this interpretation being raised as an issue nor requiring adjustments to the companies' financial statements.

<u>Accrual of Liability – SSAP 5R</u>

There is an inherent difference between levelized commissions utilized as a financing mechanism as compared to those such as contingent commissions tied to policy persistency, whereby the insurance company is not obligated to make a commission payment until the policy anniversary which is when the persistency term of the commission contract is met. Prior to each policy anniversary in such arrangements, commissions are not due, payable or earned. Until the policy reaches each anniversary date, the insurance company is not obligated and has no present duty or responsibility for a commission payment.

We would like to emphasize that the **proposed** wording in paragraph #5 conflicts with the wording contained in paragraph #3. Per paragraph #5, "The amount owed for full initial sales commission shall be recognized immediately **<u>as the writing of an insurance contract is the event that obligates</u>** the insurer, and such action shall occur consistently among insurers". The writing of an insurance contract is not the event that obligates an insurer with respect to all commission arrangements with a third party such as contingent commissions. Contingent commissions tied to traditional elements, such as persistency, should be accounted for in the same manner without imposing a different definition of the obligating event. (As a reminder, similar wording was added to paragraph #2 initially and removed in the subsequent exposures).

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

In addition, comments (related to paragraph #3) contained in the October 15, 2020 meeting materials are also inconsistent with the proposed paragraph #5 wording: "NAIC staff notes that the intent of the exposed guidance is **not to require day 1** accrual of traditional persistency commission. We note that commission terminology varies among insurers and recommend remaining as principle based as possible regarding types of commissions. NAIC staff cautions that some of the entities employing funding agreements were characterizing the repayment as persistency commission, even though the commission payments to the writing agents were owed (and typically paid by the funding agent) with the initial sale of the policy."

The latest version of the proposed accounting treatment in 2019-24 is significantly different than the current interpretation of the original SSAP and general statutory principles, specifically, full recognition of an expense at the time the policy is issued under any legal contract versus incremental recognition of commission costs over time as they become legal obligations and the policy persists . The current proposed language does not address the many varying product/distribution compensation arrangements in the industry and IPs continue to believe this will cause unintended consequences.

Persistency and Risk transfer:

Management of capital and surplus is a significant process for all insurance companies. "Surplus relief" has been a fundamental, approved management approach within the industry for a long time. It allows companies to manage capital levels without having to access the capital markets. It has mainly been done via reinsurance. The critical test for reinsurance to be effective is evidence of risk transfer. Lapse risk (persistency) is one of the risks used to determine if a reinsurance contract passes risk transfer requirements and is eligible for reinsurance accounting which relieves the insurer of its reserve liability. In Appendix A-791 lapse risk is considered a significant risk in all products except for immediate annuities and guaranteed interest contracts. If lapse risk is significant to a product and that risk is not included in a reinsurance contract, the reinsurance contract will fail the risk transfer requirements and utilize deposit accounting. The ceding company will not be relieved of the reserve liability. The existing SSAP No. 71 guidance is consistent in the application of persistency being part of the transfer of the risk(liability) to another party. If the lapse risk(persistency) is transferred to another party, the liability that the insurance company may have is also transferred to that party and the insurance company has no liability. Removing persistency as a factor in the accrual of commissions is a dangerous precedent.

The differentiation between commissions based on real insurance risks versus payments based solely upon the passage of time in SSAP 71 goes directly to the risk transfer issue of one type of level commissions versus another. The proposed additional language eliminates this differentiation.

The fundamental objective of statutory accounting is to measure solvency, as expressed in the Preamble to the Accounting Practices and Procedures Manual. Statutory Accounting Principles require expensing amounts that are no longer available to pay policyholder claims in the future or that will have no value in liquidation. However, probable future levelized commission payments are payments that have not yet been made and will not be made if the policy lapses. Accordingly, the cash or other assets held by the insurance company prior to the persistency date necessitating commission payment should be considered available to pay policyholder claims.

Other Considerations:

Levelized commission programs began over 30 years ago, before the 1998 publication of Issue paper No. 71. An example of a levelized commission arrangement from prior years is one utilized by American Equity Investment Life Insurance Company through 2010. The American Equity Investment Service Company ("Service Company") paid certain commissions on policies issued during 1997 to 1999 and 2002 to 2004. In return, Service Company was paid a quarterly levelized commission based on account values that was contingent upon the policy being inforce. There is no evidence that the accounting for this arrangement was ever questioned as not being in accordance with SSAP No. 71, or prior to 2001, as not in accordance with then existing Statutory Accounting Principles. The arrangement was identified as allowing American Equity to levelize its upfront commission expenses for statutory accounting purposes and was cited as one of several alternatives available to American Equity to strengthen its statutory surplus.

Conclusion:

NAIC staff has asserted that the goal of this agenda item is to be consistent with the principles of what a funding agreement is and that the proposed revisions are nonsubstantive and focused on clarifying existing guidance.

We strongly recommend that NAIC staff consider IP's proposed edits which clarify the funding agreement focus and related accounting, or 2019-24 should be re-exposed and classified as substantive.

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October 15, 2020

Mr. Dale Bruggeman
Statutory Accounting Principles Working Group
National Association of Insurance Commissioners
2301 McGee Street, Suite 800
Kansas City, MO 64108-2662

Ref: 2019-24 - Levelized and Persistency Commission

Dear Mr. Bruggerman:

The following responds to the Exposure Draft of "SSAP 71R--Policy Acquisition Costs and Commissions," exposed for comment at the Statutory Accounting Principles Working Group (SAPWG) meeting held October 15, 2020.

1. This change to accounting principles, as apart from the "error correction" language previously included in the prior exposure, has not been assessed as to whether there are costs that would inure to the *detriment* of consumers as to their purchase of products they would be otherwise disposed to acquire. No cost/benefit study has been conducted to indicate that the quantification of any benefits of the proposal would outweigh any costs, from the perspectives of consumers, stockholders, other statement users or even regulators. Further, there has been no market-impact assessment from the perspectives of both product suppliers and /or product consumers.
2. The basic concept of the exposure draft does not consider the discrete contents of contract provisions which legally determine when obligations are incurred and fulfillment of payment obligations become due. If producer A has a contract with Party B, the obligations of B to A are not contractual obligations of insurer C notwithstanding that under separate contract, insurer C has certain contractual obligations to Party B. In the case where there is this sort arrangement, Party B has assumed the persistency risk of insurer C and the contractually denoted compensation reflected in the compensation ultimately due from C to B reflects that assumption of risk, not unlike a reinsurance agreement.
3. The last sentence of paragraph 5 Reads: "As such, this recognition is required regardless if the insurer owes a selling agent directly agent directly or if a third-party has been contracted to provide payment to the selling agent." The third-party, especially where such party is unaffiliated to the insurer, has undertaken a risk position and may have terms in its contracts with direct sellers that are possibly even unknown to the insurer!
4. The concept underlying the Exposure Draft does not match the principles underlying how similar items are accounted for under SAP. Within SSAP 71 itself, contingent commissions generally related to property/casualty business are not required to post a liability for *possible* contingent commission expense until the contingency threshold has actually been recognized, the threshold generally being the incurral of a stated amount of losses incurred as a percentage of premiums. In the instant case, the contingency is not losses incurred but rather persistency which in the life-annuity industry is a key risk factor that is a part of the premium

rate construction/quantification process. This is amplified by the fact that persistency risk is generally a factor in reinsurance agreements and the negotiated ceded premium therefor.

5. Moreover, there are other types of situations that produce outcomes even more likely to come to pass and inure obligations on an insurer; but which currently do not require liability establishment by the insurer. These include long-term lease obligations and long-term employment contracts, where the obligations of the insurer are fixed and basically immutable (except through further negotiation between the lessor and the lessee or through sub-lease) and extend for periods beyond any particular "as of" statement date. In fact such situations do not involve any "contingency." If an insurer has leased space, the rent obligation exists as of the entering of the lease regardless of whether the insurer uses the space or not. The same paradigm applies to long-term employment contracts (as can be gleaned in the press as football coaches and players with multi-year contracts are terminated). In fact, some of those "future" payments have come to pass as of the date statements are filed (e.g., March 1st).
6. Paragraph 5 of the Exposure Draft refers to payment "by a third party to the direct selling agents," but does not consider the possibility that the direct seller is a producer other than agent of the insurer, i.e., possibly a broker.
7. Even accepting the Exposure as is, a question that would pertain was whether the amount alleged to be owed and for which a liability is to be reported, being fixed and determinable as per the contract terms, is to be discounted for the time value of money. Ancillary to that is what discount rate would pertain to the discounting process.
8. Moreover, an historical analysis of each company engaging in the manner contemplated by the Exposure Draft would have a history of the level of ultimate persistency. Therefore, the issue arises as to whether that should be factored into the amount of any calculation forthcoming, if the current Exposure Draft position holds. After all, reserves for insurance liabilities (e.g., life using mortality tables and property/casualty using past loss and loss expense historical experience) employ past experience in their liability formulations.

I note that at the October 15, 2020 SAPWG meeting, I took the opportunity (in detail) to denote the historical perspective as regards the reasons for and the development of Statutory Accounting Principles. Indeed it is hard to compress a decade of that effort (and the reasons therefor) into what turned out to be a few minutes. I did that out of respect to a former generation of regulators who spent their time engaging in the process of formulating Statutory Accounting Principles, not as an academic matter but in order that the regulatory community would have a sound basis, acceptable and respected not only to the American Institute of Certified Public Accountants (AICPA) but to the public, all other relevant institutions and statement users, as well as, of course, regulators "ourselves." It should be noted that the time and effort was in addition to their day jobs, just as your current generation of regulators is doing now. My colleagues and I took that activity seriously and focused on every component of every SSAP we developed. In short, we said what we meant and meant what we said relative to all SSAPs and in particular for these comments, SSAP 71, with due respect to the principles to our foregoing regulators. This does not mean that "our" final work product was sacrosanct from efforts to modernize or change the original SAP; but rather to indicate that when changes are offered and/or implemented they are not cast in such a manner as to cast doubt on the original efforts. The prior comments about "errors" were dismaying and the current comment as to the deletion of that characterization "*for practical reasons*" does not really assuage my dismay.

Very truly yours,

Martin F. Carus, President

Ref #2020-19

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

Issue: Clarification Edits - Mortgage Loan Participations

Check (applicable entity):

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

Description of Issue:
This agenda item has been drafted to propose clarification edits to the statutory accounting guidance for a participation in mortgage loans. In summary, questions have been raised regarding the scope of "financial rights and obligations" that a reporting entity lender should possess via a participation agreement and if these extend beyond the right to receive contractual cash flows. Specifically, whether these rights should include items beyond the attachment to cash flows, such as the ability to independently take legal action against the borrower, participate with other lenders in determining whether legal action should be taken, or under normal circumstances, communicate directly with borrower.

As historical info:

- In agenda item 2016-39, guidance was adopted to clarify the types of investments in scope of SSAP *No. 37—Mortgage Loans*, and confirmed that a reporting entity mortgage loan lending arrangements via a participation agreement and co-lending arrangements (e.g., single mortgage with more than one lender) are in scope of SSAP No. 37. With these structures, the insurer would acquire the mortgage loan via an assignment, syndication or participation agreement between the selling (originating) lender and any co-lenders. This guidance identified that reporting entity lenders through a participation agreement or co-lending situation shall have financial rights and obligations that are similar to those in the direct loan. This action resulted with the following footnote in SSAP No. 37:

  > Reporting entity has a "participation agreement" to invest in mortgages issued by another entity. Although the reporting entity is not named on the original mortgage loan agreement, the original issuer sells a portion of the mortgage loan to an incoming participant lender (co-lender) and the sale is documented by an assignment or participation agreement between the selling lender and the co-lender. With these agreements, the co-lender acquires an undivided participation interest in the loan and will receive direct interest in the amount of their participation in the right to repayment of the loan and the collateral given to secure the loan. <u>The financial rights and obligations of the lenders in these agreements shall be similar to those in a direct loan.</u>

- In agenda item 2018-22, guidance was adopted to clarify the provisions of reporting entity lenders through participation agreements. (This guidance was captured in this agenda item per a regulator request). These revisions further expanded the "participation agreement" footnote provisions, but the provisions for financial rights and obligations was retained. Revised SSAP No. 37 footnote:

  > Reporting entity has a "participation agreement" to invest in a single mortgage loan. The reporting entity is not the lender or record named as a payee on the mortgage loan, but the lender of record sells a portion of the mortgage loan to the reporting entity through an assignment or participation interest under the participation agreement. Under a participation agreement, the reporting entity

acquires an undivided interest in the single mortgage loan proceeds to be received by the lender of record. Under a participation agreement, single mortgage loan proceeds include the periodic mortgage loan principal and interest payments received by the lender of record, and all rights and proceeds received in the foreclosure of a mortgage, deed of trust, deed in lieu of foreclosure, or other similar proceeding by the lender of record. The amount of the proceeds to be received by the reporting entity is based on the ratio of its participation interest to the then-outstanding single mortgage loan balance. To qualify as a mortgage loan under the scope of this statement, the reporting entity must have a signed participation agreement with the lender of record named in the mortgage loan, the financial rights and obligations of the reporting entity under the participation agreement are the same as the lender of record, the reporting entity's participation interest in the single mortgage loan proceeds must be pari-passu with the lender of record named on the mortgage loan agreement, and the participation agreement must be properly and promptly recorded on the lender or record's books and records.

NAIC staff believes that the reference to "rights and obligations" generally reflects the participant's right to be paid when the borrower pays. As the participant's relationship is generally with the original lender, they typically cannot sue the borrower, institute foreclosure independent of the other lenders, or under normal circumstances, communicate directly with the borrower.

State regulators have noted mortgage participation agreements which do not provide loan participants the same rights to pursue legal action as the lender of record. Rather, the participants possess equal rights to proceeds – regardless if received in the normal course of business or through legal proceedings. NAIC staff has received questions regarding if the inability to independently pursue legal recourse diminishes the rights of the participant to such a level that it is not on the pari-passu footing of the original lender as required by SSAP No. 37.

NAIC staff believe that if SSAP No. 37 were to require a participant to have the ability to independently pursue legal action against the obligor (separately from the direct lender), or require the ability to communicate directly with the borrower (under normal circumstances), most participation agreements would not qualify within scope of SSAP No. 37. (NAIC SVO staff has also indicated that a participant's legal relationship is only with the original lender and the participant's ability to operate independent of the original lender is not a common business practice.) It is anticipated that the provisions of the SSAP footnote guidance were intended to ensure that the reporting entity lender had the rights to foreclosure proceeds via their participation agreement, but it was not anticipated that the reporting entity lender would be able to separately engage in foreclosure actions outside of the direct lender (and other participants) via the provisions of their participation agreement.

This agenda item intends to clarify the provisions to ensure consistency in practice. As NAIC staff believes the intent was to include participation mortgages in scope of SSAP No. 37, the proposed edits have clarified that direct communication and unilateral ability to foreclose are not required elements in the reference for "financial rights and obligations." However, comments are requested as to whether these provisions were anticipated to be required. If these provisions were intended, all mortgage loan participations that do not provide this capability would be scoped out of SSAP No. 37 and would need to be captured on Schedule BA.

Existing Authoritative Literature:

SSAP No. 37 defines participating mortgages that are in scope. Applicable guidance has been bolded for emphasis.

SUMMARY CONCLUSION

2. A mortgage loan is defined as a debt obligation that is not a security, which is secured by a mortgage on real estate. In addition to mortgage loans directly originated, a mortgage loan also includes mortgage loans acquired or obtained through assignment, syndication or participation (footnote 1).

Investments that reflect "participating mortgages," "mortgage loan fund," "bundled mortgage loans" or the "securitization of assets" are not considered mortgage loans within scope of this SSAP.

a. A security is a share, participation, or other interest in property or in an entity of the issuer or an obligation of the issuer that has all of the following characteristics:

i. It is either represented by an instrument issued in bearer or registered form, or if not represented by an instrument, is registered in books maintained to record transfers by or on behalf of the issuer.

ii. It is of a type commonly dealt in on securities exchanges or markets or, when represented by an instrument, is commonly recognized in any area in which it is issued or dealt in as a medium for investment.

iii. It either is one of a class or series or by its terms is divisible into a class or series of shares, participations, interests, or obligations.

Footnote 1 -Examples of agreements intended to be captured within this statement:

a. Reporting entity is a "co-lender" in a single mortgage loan agreement that identifies more than one lender (which includes the reporting entity) with the real estate collateral securing all lenders identified in the agreement. For these single-mortgage loan agreements, each lender is incorporated directly into the loan documents. The key differentiating characteristic of a mortgage loan provided under a group "mortgage loan co-lending agreement" rather than a solely owned mortgage loan is that no one lender of the lending group may unilaterally foreclose on the mortgage. With these agreements, the lenders must foreclose on the mortgage loan as a group.

b. Reporting entity has a "participation agreement" to invest in a single-mortgage loan. The reporting entity is not the lender of record named as a payee on the mortgage loan, but the lender of record sells a portion of the mortgage loan to the reporting entity through an assignment or participation interest under the participation agreement. **Under a participation agreement, the reporting entity acquires an undivided interest in the single mortgage loan proceeds to be received by the lender of record. Under a participation agreement, single mortgage loan proceeds include the periodic mortgage loan principal and interest payments received by the lender of record, and all rights and proceeds received in the foreclosure of a mortgage, deed of trust, deed in lieu of foreclosure, or other similar proceeding by the lender of record.** The amount of the proceeds to be received by the reporting entity is based on the ratio of its participation interest to the then-outstanding single mortgage loan balance. **To qualify as a mortgage loan under the scope of this statement, the reporting entity must have a signed participation agreement with the lender of record named in the mortgage loan, the financial rights and obligations of the reporting entity under the participation agreement are the same as the lender of record, the reporting entity's participation interest in the single mortgage loan proceeds must be pari-passu with the lender of record named on the mortgage loan agreement, and the participation agreement must be properly and promptly recorded on the lender or record's books and records.**

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups):
The historical information is included in the summary of issue.

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

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

Staff Recommendation:
NAIC Staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to clarify the requirements for participation loans in *SSAP No. 37—Mortgage Loans*. Revisions clarify that a participant's financial rights may include the right to take legal action against the borrower (or participate in the determination of legal action), but do not require that the participant have the right to solely initiate legal action, foreclosure, or under normal circumstances, require the ability to communicate directly with the borrower.

SUMMARY CONCLUSION

2. A mortgage loan is defined as a debt obligation that is not a security, which is secured by a mortgage on real estate. In addition to mortgage loans directly originated, a mortgage loan also includes mortgage loans acquired or obtained through assignment, syndication or participation (footnote 1). **Investments that reflect "participating mortgages," "mortgage loan fund," "bundled mortgage loans**" or the "securitization of assets" are not considered mortgage loans within scope of this SSAP.

a. A security is a share, participation, or other interest in property or in an entity of the issuer or an obligation of the issuer that has all of the following characteristics:

i. It is either represented by an instrument issued in bearer or registered form, or if not represented by an instrument, is registered in books maintained to record transfers by or on behalf of the issuer.

ii. It is of a type commonly dealt in on securities exchanges or markets or, when represented by an instrument, is commonly recognized in any area in which it is issued or dealt in as a medium for investment.

iii. It either is one of a class or series or by its terms is divisible into a class or series of shares, participations, interests, or obligations.

Footnote 1 - Examples of agreements intended to be captured within this statement:

a) Reporting entity is a "co-lender" in a single mortgage loan agreement that identifies more than one lender (which includes the reporting entity) with the real estate collateral securing all lenders identified in the agreement. For these single-mortgage loan agreements, each lender is incorporated directly into the loan documents. The key differentiating characteristic of a mortgage loan provided under a group "mortgage loan co-lending agreement" rather than a solely owned mortgage loan is that no one lender of the lending group may unilaterally foreclose on the mortgage. With these agreements, the lenders must foreclose on the mortgage loan as a group.

b) Reporting entity has a "participation agreement" to invest in a single-mortgage loan. The reporting entity is not the lender of record named as a payee on the mortgage loan, but the lender of record sells a portion of the mortgage loan to the reporting entity through an assignment or participation interest under the participation agreement. Under a participation agreement, the reporting entity acquires an undivided interest in the single mortgage loan proceeds to be received by the lender of record. Under a participation agreement, single mortgage loan proceeds include the periodic mortgage loan principal and interest payments received by the lender of record, and all rights and proceeds received in the foreclosure of a mortgage, deed of trust, deed in lieu of foreclosure, or other similar proceeding by the lender of record. The amount of the proceeds to be received by the reporting entity is based on the ratio of its participation interest to the then-outstanding single mortgage loan balance. To qualify as a mortgage loan under the scope of this statement, the reporting entity must have a signed participation agreement with the lender of record named in the mortgage loan, the financial rights and obligations of the reporting entity under the participation agreement are the same as the lender of record, the reporting entity's participation interest in the single mortgage loan proceeds must be pari-passu with the lender of record named on the mortgage loan agreement, and the participation agreement must be properly and promptly recorded on the lender or record's books and records. For the purposes of this footnote, "financial rights" may include the right to take legal action against the borrower, or participate with other lenders in determining whether legal action should be taken, but typically does not include the right to solely initiate legal action, foreclosure, or under normal circumstances, communicate directly with the borrower.

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

Status:
On July 30, 2020, the Statutory Accounting Principles (E) Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to *SSAP No. 37—Mortgage Loans*, as shown above, to clarify that a participant's financial rights may include the right to take legal action against the borrower (or participate in the determination of legal action), but do not require that the participant have the right to solely initiate legal action, foreclosure, or under normal circumstances, require the ability to communicate directly with the borrower.

On November 12, 2020, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed revisions to *SSAP No. 37—Mortgage Loans*, as illustrated above. The revisions clarify that a participant's financial rights may include the right to take legal action against the borrower (or participate in the determination of legal action), but do not require that the participant have the right to solely initiate legal action, foreclosure, or under normal circumstances, require the ability to communicate directly with the borrower.

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Ref #2020-23

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

Issue: Update to Leasehold Improvements

Check (applicable entity):

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

Description of Issue:
During 2019, the Working Group adopted substantive revisions to *SSAP No. 22—Leases*, which created SSAP No. 22R. The updated guidance rejects the financing lease treatment that has been adopted in U.S. GAAP but brings in language from ASC Topic 842, which intended to keep SSAP No. 22R as consistent as possible with updated U.S. GAAP. NAIC staff were notified by a company that the revisions to the definition of lease terms in SSAP No. 22R are not consistent with guidance for the depreciable lives of leasehold improvements in *SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements* and *SSAP No. 73—Health Care Delivery Assets and Leasehold Improvements in Health Care Facilities*.

As it stands now, "lease term" is defined in SSAP No. 22R as the noncancelable period of the lease together with options to extend or terminate the lease, if the lessee is reasonably certain to exercise the option. In SSAP No. 19 and SSAP No. 73, the guidance for establishing the life of a leasehold improvement does not allow renewal or option periods to be included. This recommended update will allow the guidance in SSAP No. 19 and SSAP No. 73 to conform with SSAP No. 22R. Note that leasehold improvements remain nonadmitted assets.

Existing Authoritative Literature:

The guidance on "lease term" is included in SSAP No. 22R (language matches ASC Topic 842-10-30-1):

> 24. An entity shall determine the lease term as the noncancellable period of the lease, together with all of the following:
>
> a. Periods covered by an option to extend the lease if the lessee is reasonably certain to exercise that option.
>
> b. Periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option.
>
> c. Periods covered by an option to extend (or not to terminate) the lease in which exercise of the option is controlled by the lessor.

Leasehold improvements are discussed in SSAP No. 19 and in SSAP No. 73.

SSAP No. 19:

> 5. Leasehold improvements that increase the value and enhance the usefulness of the leased asset meet the definition of assets established in SSAP No. 4. Within that definition, such items also meet the criteria defining nonadmitted assets. Accordingly, such assets shall be reported as nonadmitted assets and charged against surplus. These nonadmitted assets shall be amortized against net income over the shorter

of their estimated useful life or the remaining life of the original lease excluding renewal or option periods. Leasehold improvements that do not meet the definition of assets shall be charged to expense when acquired.

SSAP No. 73:

9. Furniture, medical equipment and fixtures, and leasehold improvements shall be depreciated over their estimated useful lives but for a period not to exceed three years, except for a leasehold improvement which shall be amortized against net income over the shorter of its estimated useful life or the remaining life of the original lease excluding renewal or option periods, using methods detailed in SSAP No. 19.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups):
The Working Group adopted substantive revisions to SSAP No. 22 to incorporate language from *ASU 2016-02, Leases (Topic 842)*, which retained the treatment of leases as operating leases by the lessor but incorporated some of the new language and guidance from ASU 2016-02.

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

Convergence with International Financial Reporting Standards (IFRS):
The intent of Topic 842 is to make U.S. GAAP lease treatment more closely resemble that of IFRS lease treatment in *IFRS 16—Leases*.

Staff Recommendation:
NAIC staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and incorporate revisions to *SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements* and *SSAP No. 73—Health Care Delivery Assets and Leasehold Improvements in Health Care Facilities* as noted below. The updated language will allow leasehold improvements to have lives that match the associated lease term, which is guidance that agrees with U.S. GAAP in ASC Topic 842.

SSAP No. 19:

5. Leasehold improvements that increase the value and enhance the usefulness of the leased asset meet the definition of assets established in SSAP No. 4. Within that definition, such items also meet the criteria defining nonadmitted assets. Accordingly, such assets shall be reported as nonadmitted assets and charged against surplus. These nonadmitted assets shall be amortized against net income over the shorter of their estimated useful life or the remaining ~~life of the original~~ lease term, as defined in SSAP No. 22R ~~excluding renewal or option periods~~. Leasehold improvements that do not meet the definition of assets shall be charged to expense when acquired.

SSAP No. 73:

9. Furniture, medical equipment and fixtures, and leasehold improvements shall be depreciated over their estimated useful lives but for a period not to exceed three years, except for a leasehold improvement which shall be amortized against net income over the shorter of its estimated useful life or the remaining lease term~~life of the original lease excluding renewal or option periods~~, using methods detailed in SSAP No. 19.

Staff Review Completed by Jake Stultz, June 2020

Ref #2020-23

Status:
On July 30, 2020, the Statutory Accounting Principles (E) Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to *SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements* and *SSAP No. 73—Health Care Delivery Assets and Leasehold Improvements in Health Care Facilities*, as illustrated above, to allow the amortization of leasehold improvements to match the associated lease term, which is guidance that agrees with U.S. GAAP, ASC Topic 842.

On November 12, 2020, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed revisions to *SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements* and *SSAP No. 73—Health Care Delivery Assets and Leasehold Improvements in Health Care Facilities* to update the amortization guidance for leasehold improvements. The updated language will allow leasehold improvements to have lives that match the associated lease term, which agrees with U.S. GAAP in ASC Topic 842.

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Ref #2020-25EP

NAIC Accounting Practices and Procedures Manual
Editorial and Maintenance Update
July 30, 2020

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

SSAP/Appendix	Description/Revision
SSAP No. 5R	Remove redundant paragraph references
SSAP No. 62R	Add a table that lists the questions addressed in SSAP No. 62R Exhibit A - Implementation Questions and Answers.

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

SSAP No. 5R— Liabilities, Contingencies and Impairments of Assets

24. Except for the measurement and recognition of continued guarantee obligations after the settlement of a contingent guarantee liability described in paragraph 25, ~~and the provisions for SCAs detailed in paragraph 25,~~ this standard does not describe in detail how the guarantor's liability for its obligations under the guarantee would be measured subsequent to initial recognition. The liability that the guarantor initially recognized in accordance with paragraph 20 would typically be reduced (as a credit to income) as the guarantor is released from risk under the guarantee. Depending on the nature of the guarantee, the guarantor's release from risk has typically been recognized over the term of the guarantee (a) only upon either expiration or settlement of the guarantee, (b) by a systematic and rational amortization method, or (c) as the fair value of the guarantee changes (for example, guarantees accounted for as derivatives). The reduction of liability does not encompass the recognition and subsequent adjustment of the contingent liability recognized under paragraph 8 related to the contingent loss for the guarantee. If the guarantor is required to subsequently recognize a contingent liability for the guarantee, the guarantor shall eliminate any remaining noncontingent liability for that guarantee and recognize a contingent liability in accordance with paragraph 8.

25. After recognition and settlement of a contingent guarantee liability in accordance with paragraph 8, a guarantor shall assess whether remaining potential obligations exist under the guarantee agreement. If the guarantor still has potential obligations under the guarantee contract, the guarantor shall recognize the remaining noncontingent guarantee that represents the current fair value of the potential obligation remaining under the guarantee agreement. This noncontingent guarantee liability shall be released in accordance with paragraph 24.

SSAP No. 62R—Property and Casualty Reinsurance
Add a table that lists the questions addressed in SSAP No. 62R Exhibit A - Implementation Questions and Answers.

EXHIBIT A – IMPLEMENTATION QUESTIONS AND ANSWERS

This exhibit addresses common questions regarding implementation of the property and casualty reinsurance accounting standards.

Index to Questions

No.	Question
Applicability	
1	The accounting practices in SSAP No. 62R specify the accounting and reporting for reinsurance contracts. What contracts are considered reinsurance contracts for purposes of applying these accounting practices?
2	The provisions of this statement will apply to (a) reinsurance contracts entered into, renewed or amended on or after January 1, 1994, and (b) any other reinsurance contracts that are in force on January 1, 1995 and cover insurable events on the underlying insurance policies that occur on or after that date. What contracts would be exempt from the accounting rules included in SSAP No. 62R?
3	This statement is to be applied to contracts which are amended on or after January 1, 1994. What if the change in terms is not significant, or the terms changed have no financial effect on the contract?
4	Must the accounting provisions of SSAP No. 62R be applied to an *otherwise exempt* contract if the ceding entity pays additional premiums under the contract on or after January 1, 1994?
5	Prospective and retroactive portions of a reinsurance contract are allowed to be accounted for separately, if practicable. Can the retroactive portion of an existing contract be segregated and, therefore, exempted with other retroactive contracts covering insured events occurring prior to January 1, 1994?
Risk Transfer	
6	Do the risk transfer provisions apply to existing contracts?
7	How does the effective date affect the assessment of whether a significant loss to the reinsurer was reasonably possible?
8	Should risk transfer be reassessed if contractual terms are subsequently amended?
9	How should the risk transfer assessment be made when a contract has been amended?
10	For purposes of evaluating whether a contract with a reinsurer transfers risk, what constitutes a contract?
11	If the assessment of risk transfer changes after the initial assessment at contract inception, how should the ceding entity account for the change?

Ref #2020-25EP

No.	Question
12	SSAP No. 62R requires that reasonably possible outcomes be evaluated to determine the reinsurer's exposure to significant loss. What factors should be considered in determining whether a scenario being evaluated is reasonably possible?
13	In determining the amount of the reinsurer's loss under reasonably possible outcomes, may cash flows directly related to the contract other than those between the ceding and assuming companies, such as taxes and operating expenses of the reinsurer, be considered in the calculation?
14	In evaluating the significance of a reasonably possible loss, should the reasonably possible loss be compared to gross or net premiums?
15	How does a commutation clause affect the period of time over which cash flows are evaluated for reasonable possibility of significant loss to the reinsurer?
16	SSAP No. 62R refers to payment schedules and accumulating retentions from multiple years as features that delay timely reimbursement of claims. Does the presence of those features generally prevent a contract from meeting the conditions for reinsurance accounting?
17	What if a contract contains a feature such as a payment schedule or accumulating retention but could still result in the reasonable possibility of significant loss to the reinsurer?
18	Can a reinsurance agreement compensate a reinsurer for losses?
19	In determining whether a reinsurance contract qualifies under the exception referred to in paragraph 18, how should the economic position of the reinsurer be assessed in relation to that of the ceding entity?
Accounting Provisions	
20	An existing contract that was accounted for as reinsurance no longer qualifies for reinsurance accounting under the accounting rules included in SSAP No. 62R. How should the ceding and assuming companies account for the contract in future periods?
21	What is the definition of past insurable events that governs whether reinsurance coverage is prospective or retroactive? For example, could a reinsurance contract that covers losses from asbestos and pollution claims on occurrence-based insurance policies effective during previous periods be considered prospective if the reinsurance coverage is triggered by a court interpretation that a loss is covered within the terms of the underlying insurance policies?
22	Would the answer to the above question change if the reinsurance were written on a claims-made basis?
23	What is the effect of adjustments to future premiums or coverage in determining whether reinsurance is prospective or retroactive?

No.	Question
24	A reinsurance contract is entered into after the contract's effective date. Is the coverage between the contract's effective date and the date the contract was entered into prospective or retroactive?
25	How is the date the reinsurance contract was entered into determined?
26	Are contracts to reinsure calendar-year incurred losses considered blended contracts that have both prospective and retroactive elements?
27	When the prospective and retroactive portions of a contract are being accounted for separately, how should premiums be allocated to each portion of the contract?
28	A retroactive reinsurance contract contains a cut-through provision that provides the ceding entity's policyholders and claimants with the right to recover their claims directly from the reinsurer. May the ceding entity immediately recognize earned surplus associated with this type of contract?
29	A ceding entity enters into a retroactive reinsurance agreement that gives rise to segregated surplus. If the reinsurer prepays its obligation under the contract, may the ceding entity recognize earned surplus at the time the prepayment is received?
30	If the ceding entity does not expect to receive any recoveries because the reinsurer has agreed to reimburse claimants under the reinsured contracts directly, would the ceding entity be considered to have recovered or terminated its transferred liabilities?
31	What accounting entries would a ceding entity make to report a retroactive reinsurance contract?
32	How should the parties account for an adverse loss development reinsurance contract where, as of the statement date, the attachment level of the contract exceeds the ceding company's current case and IBNR reserves for the covered accident years (i.e. no surplus gain and no reinsurance recoverable as of the statement date), and the ceding company transferred cash to the reinsurer at the inception of the contract?
33	How should a ceding company account for payment of the premium for a retroactive reinsurance contract by the ceding company's parent company or some other person not a party to the reinsurance contract (for example, adverse loss development reinsurance contracts purchased by the parent company in the context of the purchase or sale of the ceding company)?

Status:
On July 30, 2020, the Statutory Accounting Principles (E) Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed editorial revisions to *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets* and *SSAP No. 62R—Property and Casualty Reinsurance*, as illustrated above.

On November 12, 2020, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed editorial revisions to *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets* and *SSAP No. 62R—Property and Casualty Reinsurance*, as illustrated above.

Ref #2020-17

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

Issue: Updating the SCA Review Process

Check (applicable entity):

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

Description of Issue:
This agenda item has been drafted to update part of the SCA filing review process in *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*. In addition to these revisions, minor clarification revisions have also been proposed. In summary, the SCA filing review process begins when a filer submits an SCA filing in VISION and concludes when NAIC staff emails the filer and domiciliary state a review letter with its final approved value.

Current SCA Review Process
The SCA filing review process begins when a filer submits an SCA filing in VISION. NAIC staff will review the filing and verify the information claimed in the filing is validated with appropriate supporting documentation. After the filing has been reviewed and has been issued a completion code to initiate billing, the review has been finalized. Upon completion of the review, a file with the final validated information is available under the "Export State Information" in VISION. NAIC staff will open this and copy the final review information into a NAIC letter template for the relevant type of filing (i.e. Sub 1 filing, Sub 2 filing, Sub 2 Appeal filing, etc.). This letter is then saved, and the review process concludes when NAIC staff emails both the filer and domiciliary state regulator duplicate copies of the review letter. During calendar year 2019, NAIC staff reviewed over 825 filings, the creation of these review letters and correspondence to both filers and regulators amounts to weeks' worth of administrative work.

Proposed Updates
NAIC staff propose updating the SCA filing process by eliminating some of the manual steps in the process. VISION was designed to allow filers to have more control and access to their filing information, including the final review results. As such, filers should be responsible for pulling their own finalized review information from VISION, which will eliminate the need for NAIC staff to manually insert this information into a template and email it to them. **NAIC staff will continue to export this information for regulators and will send them the review information in an email on a monthly basis. Regulators will benefit by receiving only one, monthly correspondence of all applicable SCA reviews – as opposed to a communication for every review.**

Existing Authoritative Literature:

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

EXHIBIT A – SCA REPORTING PROCESS

50. SCA entities, except for domestic SCA insurance company investments accounted for under paragraph 8.b.i, in which the reporting entity has an equity interest (common or preferred stock), are required to be filed with the NAIC. Nonadmitted assets are not required to be filed in a Sub 2 as long as they were nonadmitted, or had a zero value, for the full reporting period (all interim and annual reporting). Immaterial asset SCAs do not have an automatic exclusion from filing, as immaterially of an SCA will be ascertained by the state of domicile of the

insurance reporting entity, but companies are allowed to request an exemption from the domiciliary state to not file an SCA on the basis that it is immaterial. The filing process does not include investments within the scope of SSAP No. 48.

51. Except for domestic SCA insurance company investments accounted for under paragraph 8.b.i, all SCA investments within the scope of this statement, purchased during any one calendar year, shall be reported to the NAIC on a Sub 1 form within 90 days of the acquisition or formation of the investment; this includes nonadmitted, zero-valued and immaterial SCAs. The NAIC will process that filing in the same year but will not at that time approve or disapprove a value for the SCA investment. By August 31 of the following year, the insurance company shall submit a Sub 2 filing for the previously purchased SCA investment reported on a Sub 1 form and later that year, the NAIC will approve a value for the transaction. For SCAs that routinely receive their audit reports after the August 31 deadline, a filing deadline of one month after the audit date shall be applied. The value approved by the NAIC at the conclusion of the Sub 2 form filing is reported by the insurance company on its financial statement blank. If the insurance company has reported a value for the SCA investment on its financial statement blank that differs from the value approved by the NAIC, the insurer is required to adjust the reported value in its next quarterly financial statement blank unless otherwise directed by the insurer's state of domicile.

52. Insurance companies shall use one of the valuation methods described in paragraph 8 to calculate the value of their investments in insurance and non-insurance SCA companies. An insurance company shall calculate the value of its investments in foreign insurance and all non-insurance company SCA entities and report the value to the NAIC no later than August 31, or one month after the audit report date for SCAs that routinely receive their audits after August 31 for existing SCA investments, and within 90 days of the acquisition or formation of a new SCA investment.

Initial Reporting of SCA Investments

53. Reporting the acquisition or formation of a new investment is accomplished by submitting a completed Sub 1 form for each investment, disclosing (i) the valuation reported or to be reported by the insurance company on its latest or next quarterly financial statement blank, (ii) which method of those described in paragraph 8 was used to arrive at the valuation, (iii) the factual context of the transaction and (iv) economic and business motivations for the transaction. The submission will be processed by the NAIC only if the NAIC determines it has been provided with all material information with respect to all SCA companies of the reporting insurance company that require valuation.

54. The purpose of a Sub 1 filing is to determine whether the value claimed is reasonable. If the NAIC determines that the reported transaction meets the tests specified, it will complete the filing in the VISION database. If the NAIC determines that the transaction does not meet the tests specified, it shall not complete the filing in the VISION database and instead notify the reporting insurance company and the state of domicile in writing of its determination.

Subsequent Reporting of SCA Investments

55. By August 31 or one month after the audit report date of the year following the acquisition or formation, and reporting of an SCA investment on the Sub 1 form, the insurance company shall submit a Sub 2 form filing, with all supporting documentation for foreign SCAs provided in English, for the same SCA investment. Additionally, by August 31 or one month after the audit report date of each year, any insurance company that has made a Sub 2 form filing in a previous year must update the information by filing an updated Sub 2 form filing.

56. Each year the NAIC shall compile a list of all SCA investments (excluding insurance company SCAs (paragraph 8.b.i.) nonadmitted and zero-value SCAs) reported as Sub 1 form filings for which a Sub 2 form filing has not yet been received. For these transactions, the NAIC will notify the responsible reporting insurance company and its state of domicile that it has not received a Sub 2 filing for the SCA investment.

57. The purpose of the Sub 2 filing is to determine whether the value calculated by the reporting insurance company for the SCA investment is appropriate and to approve that or some other value for reporting on the insurer's financial statement blank.

58. An insurance company that concludes an SCA transaction at year-end may be unable to file a Sub 1 form prior to the time it would be required to file a Sub 2 form. Where this is the case, the NAIC is authorized to accept and review a Sub 1 filing from such an insurance company and to accept and review the Sub 2 filing after the Sub 1 filing review has been completed.

59. No filing of an investment in a domestic SCA insurance company valued under paragraph 8.b.i. shall be required to be made with the NAIC.

Consistency in Application of Chosen Valuation Method

60. The valuation method used for a specific SCA company shall be determined by the guidance in paragraph 8. If a reporting insurance company previously selected the Market Valuation Method and wished to change to an Equity Method (or vice versa), they may only do so with the approval of the domiciliary commissioner. Once the approval of the domiciliary commissioner has been obtained, the reporting insurance company shall provide the NAIC with evidence of that approval as part of the Sub 1 or Sub 2 filing.

61. For reporting insurance companies that use the Market Valuation Method, the reporting insurance company shall obtain the discount rate to be applied from the NAIC. The discounts identified in Exhibit E are minimum discounts. The NAIC calculation may result in discounts in market value higher than those shown in Exhibit E.

Assessment and Review of Sub 1 Form

62. Upon receipt of the reporting insurance company's Sub 1 filing, the NAIC shall conduct an assessment in the following manner:

a. If the NAIC is aware of any broad regulatory concerns or issues affecting the reporting insurance company or the reported SCA investment, it shall determine whether such concerns or issues are relevant to valuation of the SCA investment. If so, the NAIC shall take such action as seems appropriate under the circumstances.

b. The NAIC shall ensure that the value reported by the insurance company on a Sub 1 form has been arrived at by application of one of the permitted valuation methods described in paragraph 8. If a reporting insurance company submits a Sub 1 form filing that reports a value calculated under an inappropriate method, the NAIC shall contact the insurer to resolve the discrepancy or it shall recalculate the value of the SCA investment under the most appropriate valuation method and notify the reporting insurance company of such action.

c. The NAIC shall review the factual, business and economic context of the transaction to determine whether (i) the SCA investment appears to be an arms-length business arrangement with a reasonable economic value to the reporting insurance company, (ii) the valuation method chosen is reasonable in view of the factual, business and economic context of the transaction, (iii) the transaction is reasonable in the context of all the known facts surrounding the insurance company and its operations and (iv) the value reported appropriately reflects economic value to the insurance company. The NAIC may consider other factors that appear relevant from the context of the transaction including:

   i. The specific tax, accounting or other regulatory treatment sought.

   ii. Whether the transaction effects a legally effective, binding and permanent transfer of the risks and rewards of ownership.

iii. The effect of the SCA valuation on the solvency of the insurer.

iv. The degree of affiliation between the insurer and the party from whom such company was acquired, the form of the consideration (cash, property or the exchange of stock), evidence of ability to recover cost and whether the acquisition price represented the result of arms-length dealing between economic equals.

v. The right to dividends or other payments from the SCA and any limitations thereto.

vi. The nature, extent and demonstrable financial value of the business operations of the SCA.

vii. The value of the assets owned by the SCA.

If the NAIC determines that the transaction does not seem to present economic value to the insurance company, or that the transaction tends to obscure issues that might be relevant to an NAIC member or that the information provided is insufficient or unreliable as a basis upon which to make a determination, then the NAIC shall notify the reporting insurance company and the NAIC member of the reporting insurance company's state of domicile and request guidance.

d. The NAIC shall review whether the reporting insurance company has correctly applied the correct valuation guidance under paragraph 8 and made adjustments, if applicable, under paragraph 9.

63. If the SCA investment reported on the Sub 1 form filing is deemed to meet the assessment and reviews described in paragraph 62, the NAIC shall complete the filing in the VISION database. A completed filing will be a Sub 1 filing where the reported SCA investment meets the tests described above. The completed filing will be revised to a value if and when the filer submits a Sub 2 form on the same transaction and the NAIC approves a final value based on the information provided. (Assignment of completion to an SCA investment does not mean, and shall not be interpreted to mean, that the NAIC is expressing an opinion as to the value claimed by the reporting insurance company for the reported SCA investment. The completion implies only that, based on the information provided, the NAIC has determined that the SCA investment meets the tests described in paragraph 62.)

Assessment and Review of Sub 2 Form

64. By August 31 or one month after the audit report date of each year, the NAIC shall initiate a review of all SCA investments for which new Sub 2 form filings have been received as well as an annual update review of Sub 2 SCA investments already logged in the VISION database. The NAIC review shall encompass a review of the most recent annual statutory reporting by the parent insurance company's Schedule Y (to ascertain the identity of the members of the holding company system and to ensure that information for all SCA companies has been submitted), a review of the parent's financial statement blank to review the last reported value for the SCA investments and a review of the VISION database to determine whether SCA debt and SCA preferred securities have been assigned NAIC designations. As part of its analysis, the NAIC shall review the portion of the bond investments carried by the parent or a subsidiary insurer with a Z notation. If the NAIC determines that the portion of the Z bonds shown on the documentation is significant, the NAIC shall not process the Sub 2 filing until the insurance company reports the bonds to permit removal of the Z notation. Beginning with year-end 2019, two new suffixes will apply: YE and IF. YE means that the security is a properly filed annual update that the SVO has determined will not be assigned an NAIC designation by the close of the year-end reporting cycle. The symbol YE is assigned by the SVO pursuant to the carryover administrative procedure described in Part One, Section 3 f) (iii) of the *Purposes and Procedures Manual of the NAIC Investment Analysis Office*. When the SVO assigns the symbol YE it also assigns the NAIC designation in effect for the previous reporting year. IF means that the security is an initial filing that has been properly filed with the SVO but which the SVO has determined will not be assigned an NAIC designation by the close of the year-end reporting cycle. The symbol IF is assigned by the SVO and communicates that the insurer should self-designate the security for year-end and identify it with the symbol IF. IF, therefore, also communicates to the regulator that the NAIC designation reported by the insurance company was not derived by or obtained from the SVO but has been determined analytically by a reporting insurance company.

65. Upon completion of the procedures described above, the NAIC will determine whether the value reported by the insurance company on the current SCA filing was calculated in accordance with the instructions for the valuation method chosen and verify that the filed value reflects the adjustments required by paragraph 9.

66. Upon approval of a value (including making necessary adjustments), the NAIC will complete the Sub 2 filing with the approved value in the status field of the VISION database.

67. The NAIC shall report its determination to the insurance company. If a significant discrepancy exists between the value claimed by the reporting insurance company and the value approved by the NAIC, the NAIC shall communicate the discrepancy with the company. If the NAIC cannot come to a conclusion based on the support provided, the filing can be rejected in VISION, and written notification will be provided to the reporting insurance company and the company's state of domicile of this action.

Additional Reporting Instructions

68. A reporting entity that has direct ownership of shares of an upstream intermediate or ultimate parent owns an interest in itself and is required to reduce the value of those shares from the value of the reporting entity. This is referred to as elimination of reciprocal ownership.

69. If the shares of the parent are owned indirectly by a reporting entity, for example, because the reporting entity owns a downstream SCA entity that directly owns shares in the parent, the entity that owns the parent's shares must reduce its value by the value of the shares in the parent. This is referred to as elimination of the reciprocal ownership.

70. Any parent reporting entity that owns an interest in itself via either direct or indirect ownership of a downstream affiliate, which in turn owns shares of the parent reporting entity, shall eliminate its proportionate interest in these shares from the valuation of such affiliate.

71. Pursuant to paragraph 22, in lieu of separate GAAP audits of SCA entities of the downstream holding company, the insurer can choose to have a GAAP audit performed at the holding company level with a consolidating balance sheet showing GAAP equity of all the SCA entities. The consolidating balance sheet shall then be adjusted for GAAP to SAP differences of the insurance entities as described in this statement. This adjusted amount would then be the reported value of the investment in downstream holding company at the higher-level insurance company.

Investments in the surplus notes of an SCA shall be accounted for in accordance with the provisions of SSAP No. 41R. If the reporting entity also holds an investment in preferred stock or surplus notes, refer to paragraphs 28-32 of this statement.

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

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

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

Staff Recommendation:
Staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities* to provide clarification updates to the SCA review process. Revisions to the "Updating SCA Review Process – Sub 1 filing" and "Updating SCA Review Process – Sub 2 filing" procedural documents update parts of the SCA filing process.

Proposed Revisions:

Due to the length of Exhibit A, only paragraphs with proposed revisions have been copied below.

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

EXHIBIT A – SCA REPORTING PROCESS

50. SCA entities, except for domestic SCA insurance company investments accounted for under paragraph 8.b.i, in which the reporting entity has an equity interest (common or preferred stock), are required to be filed with the NAIC. Nonadmitted assets are not required to be filed in a Sub 2 as long as they were nonadmitted, or had a zero value, for the full reporting period (all interim and annual reporting). Immaterial asset SCAs do not have an automatic exclusion from filing, as immaterialit~~l~~y of an SCA will be ascertained by the state of domicile of the insurance reporting entity, but companies are allowed to request an exemption from the domiciliary state to not file an SCA on the basis that it is immaterial. The filing process does not include investments within the scope of SSAP No. 48.

51. Except for domestic SCA insurance company investments accounted for under paragraph 8.b.i, all SCA investments within the scope of this statement, purchased during any one calendar year, shall be reported to the NAIC on a Sub 1 form within 90 days of the acquisition or formation of the investment; this includes nonadmitted, zero-valued and immaterial SCAs. The NAIC will process that filing in the same year but will not at that time approve or disapprove a value for the SCA investment. By August 31 of each year~~the following year~~, the insurance company shall submit a Sub 2 filing for the previously purchased SCA investment reported on a Sub 1 form and later that year, the NAIC will approve a value for the transaction. For SCAs that routinely receive their audit reports after the August 31 deadline, a filing deadline of one month after the audit date shall be applied. Filers must provide previous years' audit reports to verify an audit report dated after August 31 in order to not be charged a late fee for a Sub 2 filing that is filed after the August 31 deadline. The value approved by the NAIC at the conclusion of the Sub 2 form filing is reported by the insurance company on its financial statement blank. If the insurance company has reported a value for the SCA investment on its financial statement blank that differs from the value approved by the NAIC, the insurer is required to adjust the reported value in its next quarterly financial statement blank unless otherwise directed by the insurer's state of domicile.

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

Subsequent Reporting of SCA Investments

55. By August 31 or one month after the audit report date of ~~the~~each year~~ following the acquisition or formation~~, and subsequent to the reporting of an SCA investment on the Sub 1 form, the insurance company shall submit a Sub 2 form filing, with all supporting documentation for foreign SCAs provided in English, for the same SCA investment. Additionally, by August 31 or one month after the audit report date of each year, any insurance company that has made a Sub 2 form filing in a previous year must update the information by filing an updated Sub 2 form filing.

67. The NAIC shall report its determination to the insurance company. If a significant discrepancy exists between the value claimed by the reporting insurance company and the value approved by the NAIC, the NAIC shall communicate the discrepancy with the company. If the NAIC cannot come to a conclusion based on the support provided, the filing can be rejected in VISION, and written notification will be provided to the reporting insurance company and the company's state of domicile of this action. This correspondence will be sent to the domiciliary state. Filers are able to download their review information from the NAIC filing system.

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Staff Review Completed by:
Fatima Sediqzad - NAIC Staff
April 2020

Status:
On July 30, 2020, the Statutory Accounting Principles (E) Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*, as shown above, to provide updated descriptive language regarding SCA reviews. Additionally, this agenda item proposes a more streamlined method for communicating SCA review results.

On November 12, 2020, the Statutory Accounting Principles (E) Working Group adopted, as final, revisions to *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*, as illustrated above, to provide updated descriptive language regarding SCA reviews and an updated delivery process of completed SCA reviews for both domestic regulators and financial statement filers. The change in delivery of SCA review documents will occur on Jan. 1, 2021.

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Subsidiary, Controlled and Affiliated Entities (SCA) Filing Procedures – Filing a Sub-1 Form

Note to filer: Per the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual), Subsidiary, Controlled and Affiliated Entities (SCAs) are required to be filed. A Sub-1 form is required to be filed within 90 days of the acquisition or formation of the investment. A Sub-2 form is required to be filed annually for any existing investment, by August 31 or one month after the audit report date. Prior to September 5, 2016, these filings were completed in ISIS. After September 5, 2016, they will be completed in VISION. These filing instructions help navigate filings through VISION. For additional questions, please contact the individuals below.

Also see "SCA Filing Procedures-Sub 2" for instructions on how to file a Sub-2 form and an appeal to a Sub-2 form.

Fatima Sediqzad, SCA Valuation & Accounting Policy Advisor fsediqzad@naic.org 816.783.8894

Jill Youtsey, FRS Insurance Reporting Analyst II jyoutsey@naic.org 816.783.8419

Note: Do NOT hit "Cancel" at any time during the filing process; this will discard your filing and you will have to start over!

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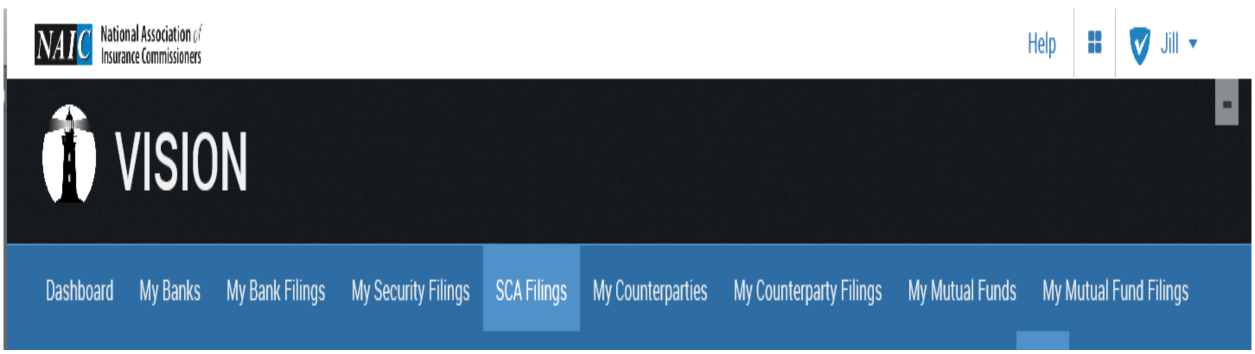
1. Accessing VISION to File a SCA

A. Log on to the filing website https://vision.naic.org

1. If you need a User ID and Password contact the NAIC Help Desk at 816-783-8500 or via email at securitiessupport@naic.org. All first-time VISION users will need a User ID.

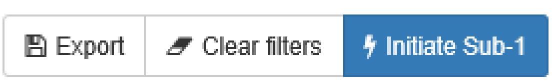
2. Click on the "SCA Filings" tab.



a. The "SCA Filings" tab details all prior SCA filings and/or initiate a Sub-1 filing

2. Filing a Sub-1 form (Initial Filing)

A. From the "SCA Filings" screen, click on the "Initiate Sub-1" button.



B. Follow the filing wizard:

1. **Filer and SCA Tab** – *Select insurance reporting entity and identify which SCA you are filing.*

   a. **Select Filer** – if you have multiple companies you file for, pick the correct Insurance Reporting Entity

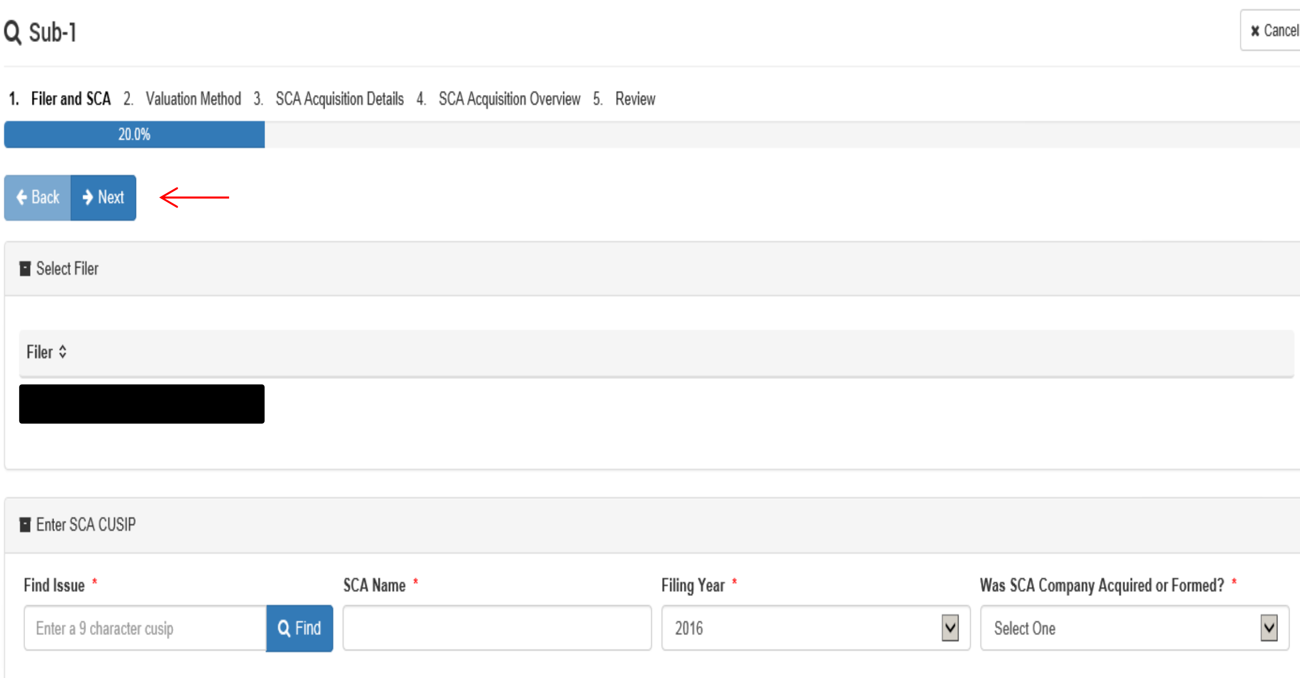
   b. **Find Issue** – Enter the SCA's CUSIP and select "Find"

i. If you do not have a valid CUSIP or PPN, contact CUSIP Global Services at 212-438-6500 or via email at cusip_ppn@cusip.com. This is a requirement to file an SCA.

c. **SCA Name** – Enter the legal name of the SCA

d. **Filing Year** – Enter the year of the audited financials. (Often prior year – 12/31/2015)
e. **Was SCA Company Acquired or Formed? –** Select answer

f. When all of the fields above have been filled in, click **"Next"**



2. <u>**Valuation Method Tab**</u> – *Identify which valuation method the SCA is using*

a. **Select SCA Type** – Refer to *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities* to ensure selection of the correct valuation method:

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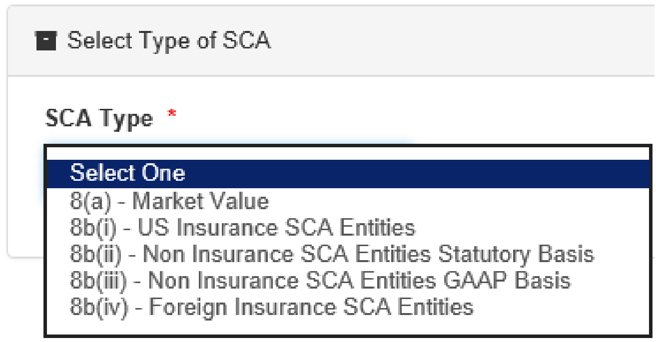

b. *Subsequent questions are tailored based on SCA Type:*

i. <u>8(a) – Market Value</u>

(a) **Discount percentage**: Sliding scale discount based on ownership percentage. (See Appendix C of SSAP No. 97.)

ii. <u>8b(i) – US Insurance SCA Entities – (Must be licensed insurance entity)</u>

(a) **Stock Type** – common or preferred stock ownership

(b) **CoCode** – NAIC company code of the SCA insurance company

iii. <u>8b(ii) – Non Insurance SCA Entities Statutory Basis</u>

(a) **Accounting Standard** – US GAAP or Foreign basis as used in audit support

(b) **Stock Type** – common or preferred stock ownership

<u>iv. 8b(iii) – Non Insurance SCA Entities GAAP Basis</u>

(a) **Accounting Standard** – US GAAP or Foreign basis as used in audit support

(b) **Stock Type** – common or preferred stock ownership

v. <u>8b(iv) – Foreign Insurance SCA Entities</u>

(a) **Stock Type** – Common or preferred stock ownership

c. *When all of the questions have been addressed, click "Next"*

3. <u>SCA Acquisition Details Tab</u> – *Identify what type of business the SCA is, when it was acquired, and report goodwill (if applicable).*

a. **Principal Business** – Identify the principal business of the SCA company

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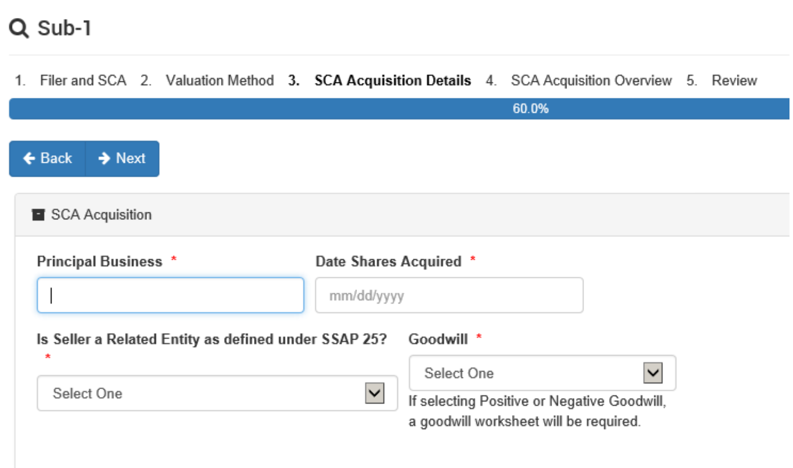
b. **Date Shares Acquired –** Include Month / Date / Year

c. **Is Seller a Related Entity as defined under SSAP 25? –** Select Yes / No
Depending on the answer, there may be a few more questions.

d. **Goodwill** – Based on the acquisition of the SCA, select:

- No Goodwill
- Positive Goodwill
- Negative Goodwill

(If positive or negative goodwill, goodwill worksheet will be a required attachment.)



4. <u>**SCA Acquisition Overview Tab**</u> – *Report claimed value of SCA and include filing comments*

a. **Total Value Claimed** – Value of SCA (Include Goodwill)

b. **Shares owned** – Number of shares insurance reporting entity owns

c. **Value Per Share** – Total value claimed divided by the number of shares owned

d. **Percent Outstanding Shares Owned** – Percentage of shares issued and outstanding that the insurance reporting entity owns

e. **Consideration Paid** – Amount paid for SCA

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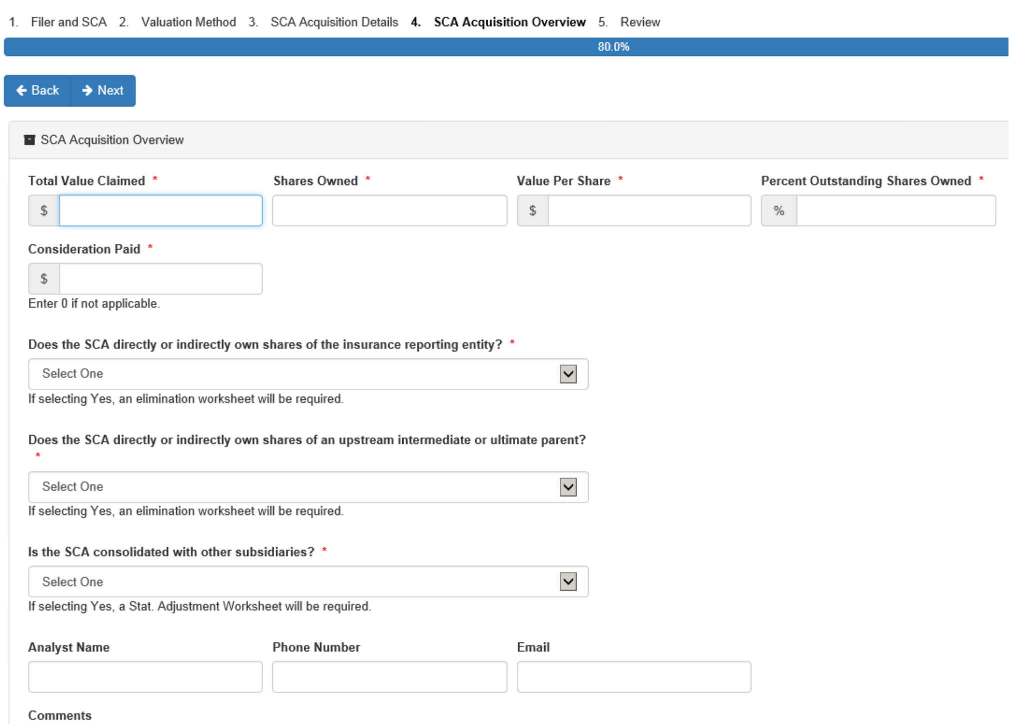
f. **Does the SCA directly or indirectly own shares of the insurance reporting entity?** Relates to reciprocal ownership. *SCA Elimination Worksheet will be required:* http://www.naic.org/sca_subsidiary_controlled_affiliated.htm

g. **Does the SCA directly or indirectly own shares of an upstream intermediate or ultimate parent?** Relates to reciprocal ownership. *SCA Elimination Worksheet will be required:* http://www.naic.org/sca_subsidiary_controlled_affiliated.htm

h. **Is the SCA consolidated with other subsidiaries?** The Stat. Adjustment Worksheet will be required: http://www.naic.org/sca_subsidiary_controlled_affiliated.htm)

i. **Analyst Name / Phone Number / Email** – Name and contact information for Individual who prepared the filing in case SCA reviewer has questions.

j. **Comments** – Available for additional information for reviewing the SCA.



5. **Review tab**

a. Review all fields of the SCA to ensure they are filed correctly.

IMPORTANT NOTES:

If something is not filled out correctly, click "Back" and update!!

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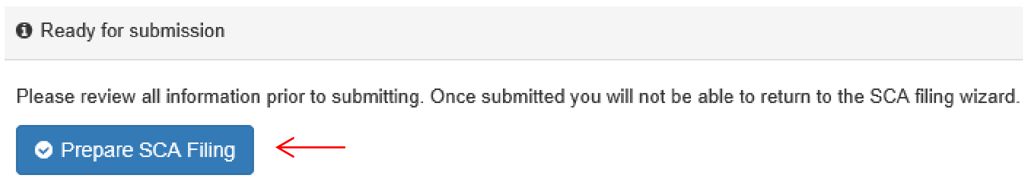
After clicking "Prepare SCA Filing" you __WILL NOT__ be able to make any changes!!

__DO NOT__ *hit cancel at any point during the filing process - This will discard your filing!!*

When finished reviewing, click the "Prepare SCA Filing" button

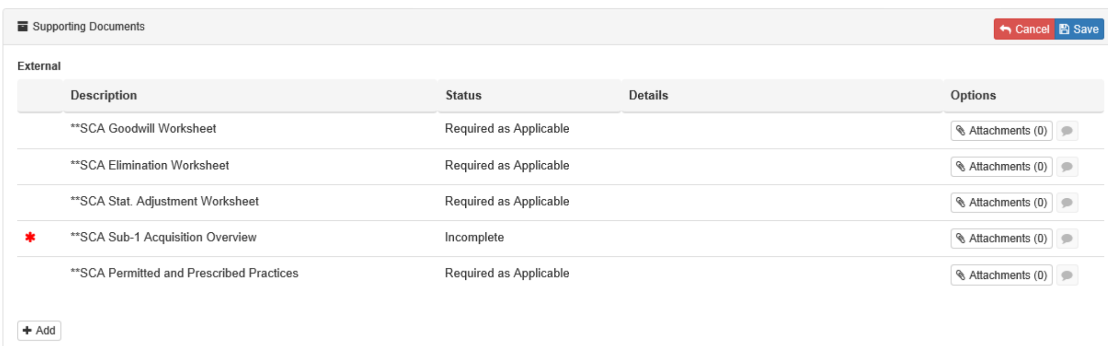


Ref #2020-17

6. <u>SCA Filing Detail Tab</u> – Shows all the filing detail and attach supporting documents

a. To attach a document

- Click “Edit” under Supporting Documents
- Click “Attachments” to the file you want to add
  If you have a document to add that is not listed click “+ Add”
- Find your document and upload
- When finished uploading documents click “Save” under Supporting Documents



Supporting Documents — Cancel | Save

External

	Description	Status	Details	Options
	**SCA Goodwill Worksheet	Required as Applicable		Attachments (0)
	**SCA Elimination Worksheet	Required as Applicable		Attachments (0)
	**SCA Stat. Adjustment Worksheet	Required as Applicable		Attachments (0)
*	**SCA Sub-1 Acquisition Overview	Incomplete		Attachments (0)
	**SCA Permitted and Prescribed Practices	Required as Applicable		Attachments (0)

+ Add

b. Required Sub-1 Documents

- SCA Sub-1 Acquisition Overview - <u>Always</u> required for Sub-1 - “*”

c. Other Required Documents

- Required depending on answers to questions:
  (a) SCA Goodwill Worksheet – If positive or negative goodwill
  (b) SCA Elimination Worksheet – If “Yes” to the Reciprocal Ownership
  (c) SCA Stat. Adjustment Worksheet – If “Yes” to Consolidated

Note: If applicable, these are required, but there will not be a “”.*

d. Worksheets and other SCA documents available:
http://www.naic.org/sca_subsidiary_controlled_affiliated.htm

<u>After attaching all required documents - Click “Submit” to finalize Sub-1 filing:</u>

Ref #2020-17

After Submitting – You Have Completed the Sub-1 Filing!!!

Upon submission of the Sub 1 filing in VISION, an NAIC analyst will review it. When the filing has been reviewed, the filer can download the final review results from the filing screen. The filer will click on the filing number under the “SCA Filings” tab of the VISION home screen. Once in the filing screen, the “Export State Information” button will be visible on the screen. When the filer clicks this button, the final review results will open. Filer should save this for their records.

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Ref #2020-17

Subsidiary, Controlled and Affiliated Entities (SCA) Filing Procedures – Filing a Sub-2 Form or an Appeal to a Sub-2 Form

Note to filer: Per the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual), Subsidiary, Controlled and Affiliated Entities (SCAs) are required to be filed. A Sub-1 form is required to be filed within 90 days of the acquisition or formation of the investment. A Sub-2 form is required to be filed annually for any existing investment, by August 31st or one month after the audit report date. Prior to September 5, 2016, these filings were completed in ISIS. After September 5, 2016, they will be completed in VISION. These filing instructions help navigate filings through VISION. For additional questions, please contact the individuals below.

Also see "SCA Filing Procedures-Sub 1" for instructions on how to file a Sub-1 form.

Fatima Sediqzad, SCA Valuation & Accounting Policy Advisor	fsediqzad@naic.org	816.783.8894
Jill Youtsey, FRS Insurance Reporting Analyst II	jyoutsey@naic.org	816.783.8419

Note: Do NOT hit "Cancel" at any time during the filing process; this will discard your filing and you will have to start over!

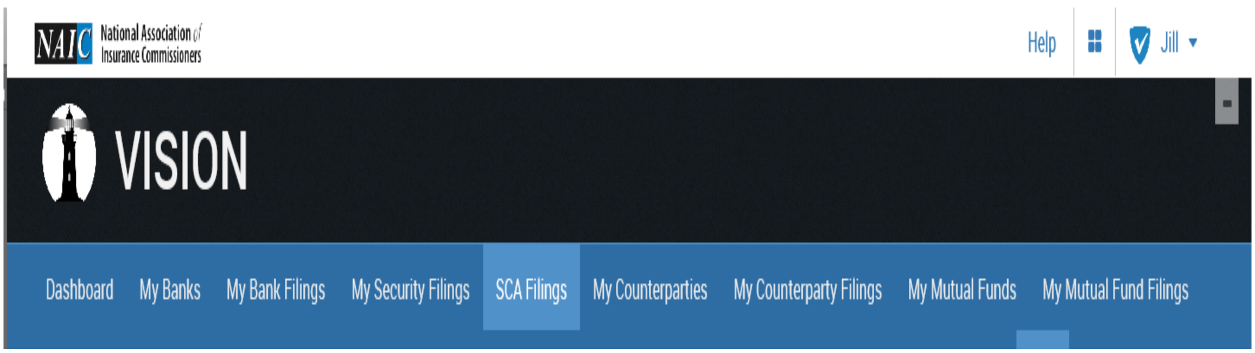
Ref #2020-17

1. Accessing VISION to File a SCA

A. Log on to the filing website https://vision.naic.org

1. If you need a User ID and Password contact the NAIC Help Desk at 816-783-8500 or via email at securitiessupport@naic.org. All first-time VISION users will need a User ID.

2. Click on the "SCA Filings" tab.



a. The "SCA Filings" tab details all prior SCA filings and/or initiate a Sub-1 filing

2. Filing a Sub-2 form (Annual Update)

A. From the "SCA Filings" screen, click on the Filing Number of the most recent filing for the SCA you wish to file

1. You can sort the SCA Filings screen by any of the headers, or even search for a particular SCA

Filing Number	CUSIP	Issuer Name
1007405	G3154#107	CNA EUROPE HLDGS LTD
1006721	142042100	CARIBOU COFFEE INC
1006847	056345408	BACARDI CORP
1005644	530007103	LIBBY CAP PARTNERS INC
1006766	433523107	HIPPO INC

B. Clicking on the Filing Number will bring up SCA Filing Detail

1. Click on the "Initiate Sub-2" button

Ref #2020-17

C. Follow the filing wizard – *the filing wizard automatically populates with what was previously approved by the SCA analyst*

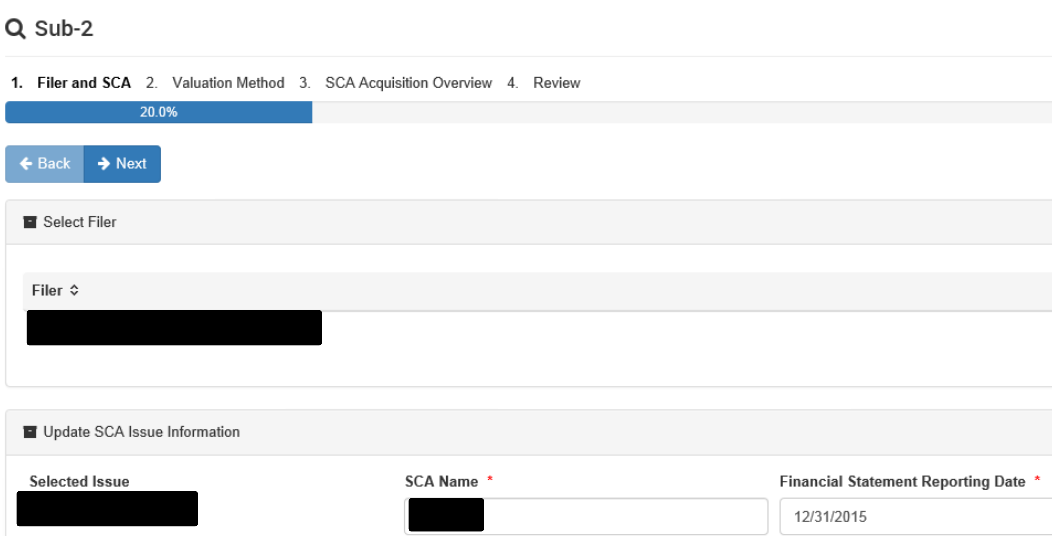
1. **Filer and SCA tab** – *this tab is used to pick the insurance reporting entity and to identify what SCA you are filing*

    a. **Select Filer** – if you have multiple companies you file for pick the correct Insurance Reporting Entity

    b. **SCA Name** – Only change this if there was a name change for the SCA company

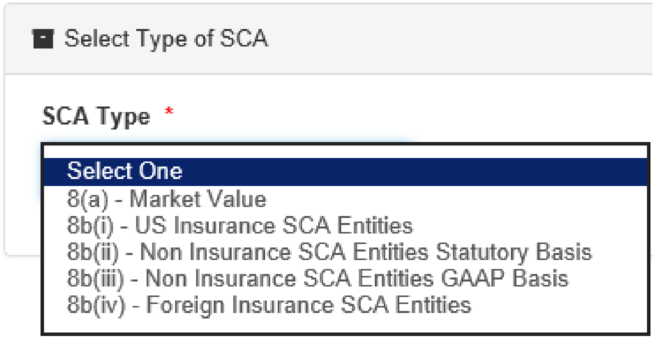
    c. **Financial Statement Reporting Date** – enter the date of the audited financials

    d. When all of the fields above have been filled in, click "**Next**"



2. **Valuation Method tab** – *this tab is used to identify what valuation method the SCA is using*

    a. **Select SCA Type** – Refer to *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities* to ensure you are selecting the correct valuation method (*Depending on valuation method other questions might be asked)*


Select Type of SCA

SCA Type *

Select One
8(a) - Market Value
8b(i) - US Insurance SCA Entities
8b(ii) - Non Insurance SCA Entities Statutory Basis
8b(iii) - Non Insurance SCA Entities GAAP Basis
8b(iv) - Foreign Insurance SCA Entities

b. *Subsequent questions are tailored based on SCA Type:*

i. <u>8(a) – Market Value</u>

(a) **Discount percentage**: Sliding scale discount based on ownership percentage. (See Appendix C of SSAP No. 97.)

ii. <u>8b(i) – US Insurance SCA Entities – (Must be licensed insurance entity)</u>

(a) **Stock Type** – common or preferred stock ownership

(b) **CoCode** – NAIC company code of the SCA insurance company

iii. <u>8b(ii) – Non Insurance SCA Entities Statutory Basis</u>

(a) **Accounting Standard** – US GAAP or Foreign basis as used in audit support

(b) **Stock Type** – common or preferred stock ownership

<u>iv. 8b(iii) – Non Insurance SCA Entities GAAP Basis</u>

(a) **Accounting Standard** – US GAAP or Foreign basis as used in audit support

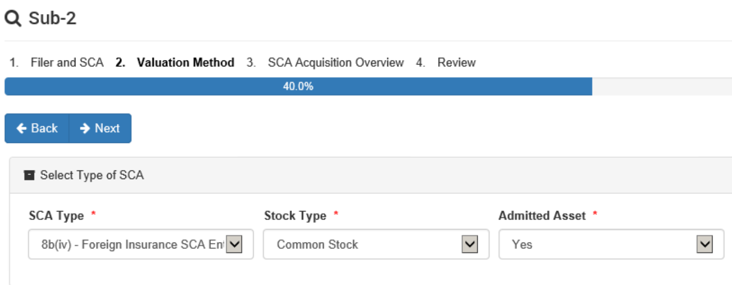
(b) **Stock Type** – common or preferred stock ownership

v. <u>8b(iv) – Foreign Insurance SCA Entities</u>

(a) **Stock Type** – Common or preferred stock ownership

c. **Admitted Asset** – If asset is admitted choose yes (both admitted and nonadmitted SCAs need to be filed)

Ref #2020-17



3. <u>**SCA Acquisition Overview tab**</u> *– this tab is used to show the claimed value of the SCA*

a. **Total Value Claimed** – Value of SCA (Include Goodwill from purchase of SCA)

b. **Shares Owned** - number of shares the insurance reporting entity owns

c. **Value Per Share** - total value claimed divided by the number of shares owned

d. **Percent Outstanding Shares Owned** - percentage of shares issued and outstanding that the insurance reporting entity owns

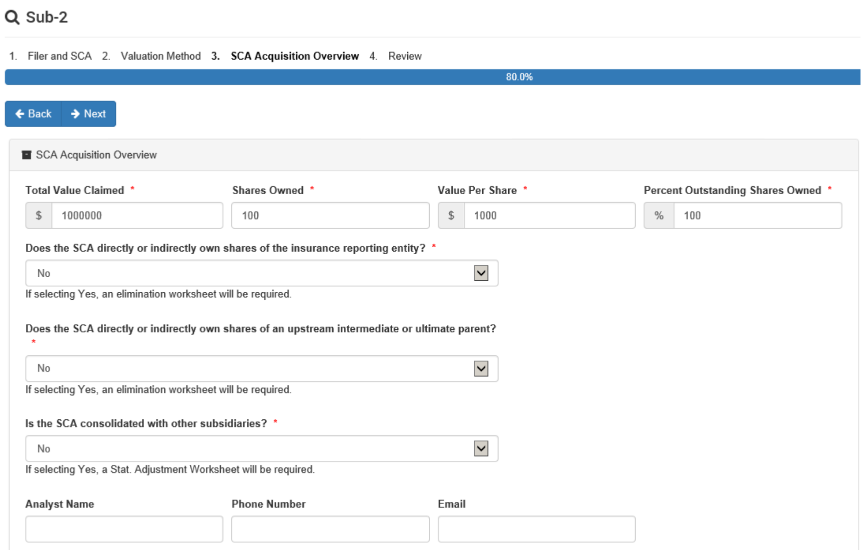
e. **Does the SCA directly or indirectly own shares of the insurance reporting entity?** This relates to reciprocal ownership – refer to SSAP No. 97 for more detail (SCA Elimination Worksheet will need completed – found at http://www.naic.org/sca_subsidiary_controlled_affiliated.htm)

f. **Does the SCA directly or indirectly own shares of an upstream intermediate or ultimate parent?** This relates to reciprocal ownership – refer to SSAP No. 97 for more detail (SCA Elimination Worksheet will need completed – found at http://www.naic.org/sca_subsidiary_controlled_affiliated.htm)

g. **Is the SCA consolidated with other subsidiaries?** The Stat. Adjustment Worksheet will be required and will help tie out an SCA that has been consolidated (Worksheet found at http://www.naic.org/sca_subsidiary_controlled_affiliated.htm)

h. **Analyst Name / Phone Number / Email** – Name and contact information for Individual who prepared the filing in case SCA reviewer has questions.

i. **Comments** – Available for additional information for reviewing the SCA.



4. <u>Review tab</u>

a. Review all fields of the SCA to ensure they are filed correctly

i. *If something is not filled out correctly, go back and update at this point because you won't be able to after you click "Prepare SCA Filing"*

ii. When finished reviewing, click the "Prepare SCA Filing" button

<u>IMPORTANT NOTES:</u>

If something is not filled out correctly, click "Back" and update!!

After clicking "Prepare SCA Filing" you <u>WILL NOT</u> be able to make any changes!!

<u>DO NOT</u> *hit cancel at any point during the filing process - This will discard your filing!!*

When finished reviewing, click the "Prepare SCA Filing" button

Ready for submission

Please review all information prior to submitting. Once submitted you will not be able to return to the SCA filing wizard.

Prepare SCA Filing

5. **<u>SCA Filing Detail tab</u>** *– This tab will show all the filing details and this is where you will attach all your supporting documents*

   a. To attach a document:

      1. Click "Edit" under Supporting Documents

      2. Click "Attachments" to the file you want to add

         - *If you have a document to add that is not listed click the "+ Add" button and attach from there*

      3. Find your document and upload – when finished uploading documents click "Save" under Supporting Documents

Supporting Documents — Cancel | Save

External

	Description	Status	Details	Options
	**SCA Goodwill Worksheet	Required as Applicable		Attachments (0)
	**SCA Elimination Worksheet	Required as Applicable		Attachments (0)
	**SCA Stat. Adjustment Worksheet	Required as Applicable		Attachments (0)
	**SCA Permitted and Prescribed Practices	Required as Applicable		Attachments (0)
*	**SCA Prior Year Audited Financial Statements	Incomplete		Attachments (0)

+ Add

   b. Required Sub-2 Documents

      1. SCA Prior Year Audited Financial Statements – attach the audit for the SCA filing – <u>Always</u> required for Sub-2 – "*"

   c. Other Required Documents

      1. Required depending on answers to questions:

Ref #2020-17

(a) SCA Goodwill Worksheet – If you chose Positive or Negative Goodwill, this will need to be included
(b) SCA Elimination Worksheet – If you answered Yes to the Reciprocal Ownership questions, this will need to be included
(c) SCA Stat Adj. Worksheet – If you answered Yes to the Consolidated SCA question, this will need to be included

Note: If applicable, these are required, but there will not be a ***"*"***.

d. Worksheets and other SCA documents can be found at http://www.naic.org/sca_subsidiary_controlled_affiliated.htm

After attaching all required documents - Click "Submit" to finalize Sub-1 filing:

After Submitting – You Have Completed the Sub-2 Filing!!!

Upon submission of the Sub 2 filing in VISION, an NAIC analyst will review it. When the filing has been reviewed, the filer can download the final review results from the filing screen. The filer will click on the filing number under the "SCA Filings" tab of the VISION home screen. Once in the filing screen, the "Export State Information" button will be visible on the screen. When the filer clicks this button, the final review results will open. Filer should save this for their records.

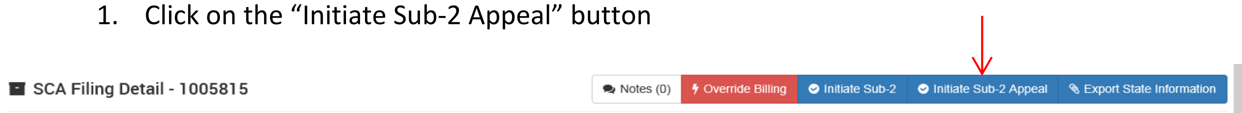
3. Filing an Appeal to a Sub-2 Filing

A. From the "SCA Filings" screen, click on the Filing Number of the SCA you wish to file an appeal for
   1. You can sort the "SCA Filings" screen by any of the headers, or even search for a particular SCA

Filing Number	CUSIP	Issuer Name
1007405	G3154#107	CNA EUROPE HLDGS LTD
1006721	142042100	CARIBOU COFFEE INC
1006847	056345408	BACARDI CORP
1005644	530007103	LIBBY CAP PARTNERS INC
1006766	433523107	HIPPO INC

Ref #2020-17

B. Clicking on the “Filing Number” will bring up SCA Filing Detail
   1. Click on the “Initiate Sub-2 Appeal” button



   2. **Analyst Name / Phone Number / Email** – Name and contact information for Individual who prepared the filing in case SCA reviewer has questions.

   3. **Please provide your company’s preferred conclusion and rationale** – enter information to be considered during the appeal process

C. When all of the fields above have been filled in, click “Next”

D. Review the details and click “Prepare SCA Filing”

E. On the “SCA Filing Detail” tab, include any supporting documents that go with the appeal.

F. Click “Submit” to finalize Sub-2 appeal filing.

Upon submission of the Sub 2 filing in VISION, an NAIC analyst will review it. When the filing has been reviewed, the filer can download the final review results from the filing screen. The filer will click on the filing number under the “SCA Filings” tab of the VISION home screen. Once in the filing screen, the “Export State Information” button will be visible on the screen. When the filer clicks this button, the final review results will open. Filer should save this for their records.

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Ref #2020-20

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

Issue: Disclosure of Rolled Cash Equivalent Investments

Check (applicable entity):

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

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

The scope of agenda item 2019-20 covered both cash equivalents and short-term investments and although cash equivalent investments were referenced throughout the agenda item, the adopted disclosure only specifically stated that disclosure was required for short-term investments (or substantially similar investments) that remain on the short-term schedule for more than one year. Due to the importance of identifying certain rolled or renewed cash equivalent investments, the SAPWG requested that an agenda item be drafted to clarify that the disclosure elements as adopted for short-term investments shall also apply to cash equivalent investments.

Additionally, at the request of interested parties, clarification of the disclosure requirements is proposed to identify that the disclosure is satisfied through the use of an identifier code as specified in the applicable reporting instructions in the investments schedules of the statutory financial statements (i.e. Blanks) and not required in a narrative format.

Existing Authoritative Literature:

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

Disclosures

12. The following disclosures shall be made for short-term investments in the financial statements:

    a. Fair values in accordance with *SSAP No. 100R—Fair Value*;

    b. Concentrations of credit risk in accordance with *SSAP No. 27—Off-Balance-Sheet and Credit Risk Disclosures*;

    c. Basis at which the short-term investments are stated.

    d. The items in the scope of this statement are also subject to the annual audited disclosures in *SSAP No. 26R—Bonds*, paragraph 30.f.

e. **Identification of short-term investments or substantially similar investments in which remain on the short-term schedule for more than one year.**

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

- Agenda item 2019-20: Rolling Short-Term Investments. As referenced in the “Description of Issue” section, this agenda item was adopted by the SAPWG in May 2020, incorporating additional principle concepts that would restrict the classification of certain related party or affiliated investments as a cash equivalent or short-term investments. These restrictions apply for items in scope of *SSAP No. 26R—Bonds*, *SSAP No. 43R—Loan-Backed and Structured Securities*, or that would be reported as “Other Invested Assets.” With adoption, an additional disclosure element was required, incorporating language stating that short-term investments (or substantially similar investments) which remain on the short-term schedule for more than one consecutive year (i.e. a re-underwritten investment that is renewed) shall be disclosed in the financial statements.

- Agenda item 2019-42: Cash Equivalents – Cash & Liquidity Pools. This agenda item was adopted by the SAPWG in May 2020, incorporating additional provisions that direct certain cash / liquidity pools, meeting defined criteria, to be reported as cash equivalents.

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

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

Staff Recommendation:
NAIC Staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to *SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments* to require the identification/disclosure of cash equivalents and short-term investments, or substantially similar investments, which remain on the same reporting schedule for more than one consecutive reporting period. (This revision expands current disclosure requirements to include cash equivalent investments.) Furthermore, the revisions clarify that the disclosure is satisfied through the use of the code on the investment schedules.

SSAP No. 2R – Proposed Updates

18. The following disclosures shall be made for short-term investments in the financial statements:

a. Fair values in accordance with *SSAP No. 100R—Fair Value*;

b. Concentrations of credit risk in accordance with *SSAP No. 27—Off-Balance-Sheet and Credit Risk Disclosures*;

c. Basis at which the short-term investments are stated.

d. The items in the scope of this statement are also subject to the annual audited disclosures in *SSAP No. 26R—Bonds*, paragraph 30.f.

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

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

Status:
On July 30, 2020, the Statutory Accounting Principles (E) Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to *SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments*, as shown above, to require the identification/disclosure of cash equivalents and short-term investments, or substantially similar investments, which remain on the same reporting schedule for more than one consecutive reporting period. (This revision expands current disclosure requirements to include cash equivalent investments.) Furthermore, the revisions clarify that the disclosure is satisfied through the use of the code on the investment schedules.

On November 12, 2020, the Statutory Accounting Principles (E) Working Group adopted, as final, revisions to *SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments*, as shown below. The adopted revisions reflect the exposed revisions to include cash equivalents in the disclosure~~,~~ but incorporate interested parties' proposed edits to exclude money market mutual funds.

18. The following disclosures shall be made for short-term investments in the financial statements:

    a. Fair values in accordance with *SSAP No. 100R—Fair Value*;

    b. Concentrations of credit risk in accordance with *SSAP No. 27—Off-Balance-Sheet and Credit Risk Disclosures*;

    c. Basis at which the short-term investments are stated.

    d. The items in the scope of this statement are also subject to the annual audited disclosures in *SSAP No. 26R—Bonds*, paragraph 30.f.

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

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Ref #2020-21

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

Issue: SSAP No. 43R - Designation Categories for RMBS/CMBS Investments

Check (applicable entity):

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

Description of Issue: This agenda item reflects updated NAIC designation guidance recently adopted by the Valuation of Securities (E) Task Force (VOSTF) for the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual), for residential mortgage-backed securities (RMBS) / commercial mortgage-backed securities (CMBS).

As adopted by the VOSTF, a new designation category will be utilized when reporting RMBS/CMBS investments. The current financial modeling process remains unaffected, however the NAIC designations, as produced by the financial model (and as previously used for reporting), will now be mapped to a final NAIC designation category. Reporting entities will then utilize the new NAIC designation category for accounting and reporting purposes. The edits proposed in this agenda item update the NAIC designation category mapping instructions in *SSAP No. 43R—Loan-Backed and Structured Securities* for RMBS/CMBS investments.

For historical reference, the VOSTF originally proposed to eliminate the multi-step modeling ("financial modeling") practice for RMBS/CMBS investments – primarily in response to the implementation of NAIC designation categories, which would have required 19 additional price breakpoints for RMBS/CMBS investments. The multi-step modeling practice for these instruments is the only remaining approach that utilizes breakpoints to determine NAIC designations. Since its original exposure, the VOSTF modified its proposal and on May 14, adopted revised guidance to the *P&P Manual,* continuing the financial modeling practice, but in lieu of implementing additional price breakpoints, the output of the financial model will be mapped to a specific NAIC designation category. As an example, the prior modeled NAIC 1 with risk of loss will be mapped to a NAIC 1.D and a NAIC 2 will be mapped to a NAIC 2.B.

Existing Authoritative Literature:

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

Designation Guidance

27. For RMBS/CMBS securities within the scope of this statement, the initial NAIC designation used to determine the carrying value method and the final NAIC designation for reporting purposes is determined using a multi-step process. The *Purposes and Procedures Manual of the NAIC Investment Analysis Office* provides detailed guidance. A general description of the processes is as follows:

a. Financial Modeling: The NAIC identifies securities where financial modeling must be used to determine the NAIC designation. NAIC designation based on financial modeling incorporates the insurers' carrying value for the security. For those securities that are financially modeled, the insurer must use NAIC CUSIP specific modeled breakpoints provided by the modelers in determining initial and final designation for these identified securities. Securities where modeling results in zero expected loss in all scenarios are automatically considered to have a final NAIC designation of

NAIC 1, regardless of the carrying value. The three-step process for modeled securities is as follows:

i. Step 1: Determine Initial Designation – The current amortized cost (divided by remaining par amount) of a loan-backed or structured security is compared to the modeled breakpoint values assigned to the six (6) NAIC designations for each CUSIP to establish the **initial** NAIC designation.

ii. Step 2: Determine Carrying Value Method – The carrying value method, either the amortized cost method or the lower of amortized cost or fair value method, is then determined as described in paragraph 26 based upon the initial NAIC designation from Step 1.

iii. Step 3: Determine Final Designation – The final NAIC designation that shall be used for investment schedule reporting is determined by comparing the carrying value (divided by remaining par amount) of a security (based on paragraph 27.a.ii.) to the NAIC CUSIP specific modeled breakpoint values assigned to the six (6) NAIC designations for each CUSIP. This final NAIC designation shall be applicable for statutory accounting and reporting purposes (including establishing the AVR charges). The final designation is not used for establishing the appropriate carrying value method in Step 2 (paragraph 27.a.ii.).

b. All Other Loan-Backed and Structured Securities: For loan-backed and structured securities not subject to paragraphs 27.a. (financial modeling) follow the established designation procedures according to the appropriate section of the *Purposes and Procedures Manual of the NAIC Investment Analysis Office*. The NAIC designation shall be applicable for statutory accounting and reporting purposes (including determining the carrying value method and establishing the AVR charges). The carrying value method is established as described in paragraph26. Examples of these securities include, but are not limited to, mortgage-referenced securities, equipment trust certificates, credit tenant loans (CTL), 5*/6* securities, interest only (IO) securities, securities with CRP ratings (excluding RMBS/CMBS), and loan-backed and structured securities with SVO assigned NAIC designations.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): In accordance with a Valuation of Securities (E) Task Force referral, agenda item 2018-19 eliminated the multi-step designation guidance for modified filing exempt (MFE) securities. The elimination of MFE was effective March 31, 2019, with early application permitted for year-end 2018. With the elimination of MFE, for securities that are filing exempt, the NAIC designation reported will correspond to the CRP rating without adjustment based on carrying value. Also, in agenda item 2018-03, the Working Group clarified that securities acquired in lots shall not be reported with weighted average designations. With the adopted guidance, If a SSAP No. 43R security (by CUSIP) has different NAIC designations by lot, the reporting entity shall either 1) report the aggregate investment with the lowest applicable NAIC designation or 2) report the investment separately by purchase lot on the investment schedule. If reporting separately, the investment may be aggregated by NAIC designation. With the elimination of MFE, the instances of different designations by lot is not expected to be prevalent, but it could still occur with the financial modeling process for RMBS and CMBS securities.

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

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

Staff Recommendation: NAIC Staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to *SSAP No. 43R—Loan-backed and Structured Securities* to reflect the updated final designation guidance for RMBS/CMBS securities. This update will reflect the guidance recently adopted for the *Purposes and Procedures Manual of the NAIC Investment Analysis Office*.

Proposed Revisions to *SSAP No. 43R—Loan-backed and Structured Securities*

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

Designation Guidance

27. For RMBS/CMBS securities within the scope of this statement, the initial NAIC designation used to determine the carrying value method and the final NAIC designation for reporting purposes is determined using a multi-step process. The *Purposes and Procedures Manual of the NAIC Investment Analysis Office* provides detailed guidance. A general description of the processes is as follows:

a. Financial Modeling: The NAIC identifies securities where financial modeling must be used to determine the NAIC designation. NAIC designation based on financial modeling incorporates the insurers' carrying value for the security. For those securities that are financially modeled, the insurer must use NAIC CUSIP specific modeled breakpoints provided by the modelers in determining initial and final designation for these identified securities. Securities where modeling results in zero expected loss in all scenarios are automatically considered to have a final NAIC designation of NAIC 1, regardless of the carrying value. The three-step process for modeled securities is as follows:

i. Step 1: Determine Initial Designation – The current amortized cost (divided by remaining par amount) of a loan-backed or structured security is compared to the modeled breakpoint values assigned to the six (6) NAIC designations for each CUSIP to establish the **initial** NAIC designation.

ii. Step 2: Determine Carrying Value Method – The carrying value method, either the amortized cost method or the lower of amortized cost or fair value method, is then determined as described in paragraph 26 based upon the initial NAIC designation from Step 1.

iii. Step 3: Determine Final Designation – The final NAIC designation, as determined by the modeled price range, ~~designation that shall be used for investment schedule reporting~~ is determined by comparing the carrying value (divided by remaining par amount) of a security (based on paragraph 27.a.ii.) to the NAIC CUSIP specific modeled breakpoint values assigned to the six (6) NAIC designations for each CUSIP. These six (6) NAIC designations are mapped to NAIC designation categories as shown in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office,* along with instructions for tranches that have no expected loss under any of the selected modeling scenarios and instructions for non-modeled securities. This final NAIC designation and NAIC designation category shall be applicable for statutory accounting and reporting purposes (including investment schedule reporting and establishing RBC and AVR charges). The final NAIC designation is not used for establishing the appropriate carrying value method in Step 2 (paragraph 27.a.ii.).

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

Staff Review Completed by: Jim Pinegar, NAIC Staff – June 2020
Status:
On July 30, 2020, the Statutory Accounting Principles (E) Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to *SSAP No. 43R—Loan-backed and Structured Securities*, as shown above, to reflect the updated final designation guidance for RMBS/CMBS securities. This update will reflect the guidance recently adopted for the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P manual).

On November 12, 2020, the Statutory Accounting Principles (E) Working Group adopted, as final, revisions to *SSAP No. 43R—Loan-backed and Structured Securities*, as shown below, to reflect the updated final designation guidance for RMBS/CMBS securities recently adopted by the Valuation of Securities (E) Task Force. in the P&P manual. The revisions reflect the exposed edits from NAIC SVO staff, further modified to reflect interested parties' proposed edits to remove redundant language and improve readability.

Adopted Revisions to SSAP No. 43R:

Designation Guidance

27. For RMBS/CMBS securities within the scope of this statement, the initial NAIC designation used to determine the carrying value method and the final NAIC designation for reporting purposes is determined using a multi-step process. The *Purposes and Procedures Manual of the NAIC Investment Analysis Office* *(P&P Manual)* provides detailed guidance. A general description of the processes is as follows:

a. Financial Modeling: The NAIC identifies securities where financial modeling must be used to determine the NAIC designation. NAIC designation based on financial modeling incorporates the insurers' carrying value for the security. For those securities that are financially modeled, the insurer must use NAIC CUSIP specific modeled breakpoints provided by the modelers in determining initial and final designation for these identified securities. As specified in the P&P manual, ~~S~~securities where modeling results in zero expected loss in all scenarios and that would be equivalent to an NAIC Designation and NAIC Designation Category of NAIC 1 and NAIC 1.A, respectively, if the filing exemption process in the P&P Manual was applied, are automatically considered to have a final NAIC designation of NAIC 1 and NAIC Designation Category of NAIC 1.A, regardless of the carrying value. The three-step process for modeled securities is as follows:

i. Step 1: Determine Initial Designation – The current amortized cost (divided by remaining par amount) of a loan-backed or structured security is compared to the modeled breakpoint values assigned to the six (6) NAIC designations for each CUSIP to establish the **initial** NAIC designation.

ii. Step 2: Determine Carrying Value Method – The carrying value method, either the amortized cost method or the lower of amortized cost or fair value method, is then determined as described in paragraph 26 based upon the initial NAIC designation from Step 1.

iii. Step 3: Determine Final Designation – The final NAIC designation ~~that shall be used for investment schedule reporting~~ is determined by comparing the carrying value (divided by remaining par amount) of a security (based on paragraph 27.a.ii.) to the NAIC CUSIP specific modeled breakpoint values assigned to the six (6) NAIC designations for each CUSIP. The final designation is mapped to an NAIC designation category according to the instructions in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office.* This final NAIC designation shall be applicable for statutory accounting and reporting purposes and the NAIC designation category will be used for ~~(including~~ investment schedule reporting and establishing RBC and AVR charges~~)~~. The final NAIC designation is not used for establishing the appropriate carrying value method in Step 2 (paragraph 27.a.ii.).

Ref #2020-18

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

Issue: SSAP No. 97 Update

Check (applicable entity):

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

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

This agenda item provides a minor revision to the end of paragraph 9 to corroborate the revisions adopted in agenda item 2018-26 and remove a lingering reference that guarantees or commitments can result in a negative equity value for the SCA.

Existing Authoritative Literature:

SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities:
<u>(Bolded and underlined for emphasis)</u>

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

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

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

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

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

iv. *SSAP No. 20—Nonadmitted Assets*

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

vi. *SSAP No. 29—Prepaid Expenses*

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

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

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

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

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

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

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

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

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

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

13. On at least a quarterly basis, the procedures set forth below shall be followed by a reporting entity in applying an equity method of accounting (as described in paragraphs 8.b.i. through 8.b.iv.), as applicable, to investments in SCA entities:

e. For entities subject to 8.b.i., 8.b.iii. and 8.b.iv. a reporting entity's share of losses of an investee may equal or exceed the carrying amount of an investment accounted for by an equity method plus advances made by the investor**. The reporting entity shall discontinue applying an equity method when the investment (including advances) is reduced to zero[1] and shall not provide for additional losses unless the reporting entity has guaranteed obligations of the investee or is otherwise committed to provide further financial support for the investee (guaranteed obligations meeting the definition of liabilities in *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets* shall be recorded as liabilities).** If the investee subsequently reports net income, the reporting entity shall resume applying an equity method only after its share of that net income equals the share of net losses not recognized during the period that an equity method was suspended;

Footnote 2: **Although the SCA is reported at zero in the investment schedule, a guarantee liability (either contingent or noncontingent) may be required to be reported under SSAP No. 5R. Additionally, refer to the guidance related to discontinuance of an equity method in paragraphs 15-17 and *INT 00-24: EITF 98-13: Accounting by an Equity Method Investor for Investee Losses When the Investor Has Loans to and Investments in Other Securities of the Investee* and *EITF 99-10: Percentage Used to Determine the***

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[1] Refer to the additional guidance related to discontinuance of an equity method in paragraphs 15-17 and *INT 00-24: EITF 98-13: Accounting by an Equity Method Investor for Investee Losses When the Investor Has Loans to and Investments in Other Securities of the Investee* and *EITF 99-10: Percentage Used to Determine the Amount of Equity Method Losses*.

***Amount of Equity Method Losses*. As detailed in INT 00-24, a reporting entity's share of losses in an SCA shall be applied to other investments held in the SCA once the SCA (common stock) investment has been reduced to zero.**
<u>Note that the outcome of these adjustments, as well as guarantees or commitments of the parent entity to provide additional funding, can result in a negative equity valuation of the investment.</u>

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

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

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

Staff Recommendation:
Staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*, as illustrated below, to update language to remove the statement that guarantees or commitments from the insurance reporting entity to the SCA can result in a negative equity valuation of the SCA.

SSAP No. 97:

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

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

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

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

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

iv. *SSAP No. 20—Nonadmitted Assets*

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

vi. *SSAP No. 29—Prepaid Expenses*

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

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

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

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

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

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

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

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

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

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

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

Staff Review Completed by:
Fatima Sediqzad - NAIC Staff
March 2020

Status:
On July 30, 2020, the Statutory Accounting Principles (E) Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*, as shown above, removing the statement that guarantees or commitments from the insurance reporting entity to the SCA can result in a negative equity valuation of the SCA. This update reflects recently adopted guidance from agenda item 2018-27 which state that reported equity losses of an SCA shall not go negative (thus the reported basis will stop at zero), however to the extent there is a financial guarantee or commitment, that liability would be recognized in *SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets.*

On November 12, 2020, the Statutory Accounting Principles (E) Working Group adopted, as final, revisions to *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities,* as well as additional clarifying edits to Exhibit C, question 7, as shown below, to remove a superseded statement that guarantees or commitments from the insurance reporting entity to the SCA could result in a negative equity valuation of the SCA. The Working Group also directed NAIC staff to draft a separate agenda item to review if some of the provisions (i.e. potential negative valuation) of SSAP No. 97, paragraph 9 (requiring limited statutory basis of accounting adjustments) should no longer apply to 8.b.iv. entities.

Adopted Revisions:

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

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

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

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

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

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

iv. *SSAP No. 20—Nonadmitted Assets*

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

vi. *SSAP No. 29—Prepaid Expenses*

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

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

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

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

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

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

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

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

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

g. Adjust the U.S. GAAP annuity account value reserves of a foreign insurance SCA, with respect to the business it wrote directly, using the commissioners' annuity reserve valuation method (CARVM) as defined in paragraphs 14 and 15 of Appendix A-820 (including the reserving provisions in the various Actuarial Guidelines which support CARVM). The valuation interest rate and mortality tables to be used in applying CARVM should be that prescribed by the foreign insurance SCA's country of domicile. If the

Foreign SCA's country of domicile does not prescribe the necessary tables and/or rates, no reserve adjustment shall be made.

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

SSAP No. 97, Exhibit C:

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

7.1 **A –** Yes, the equity method noninsurance SCA could have a negative equity. For example, SSAP No. 97, paragraph 8.b.ii., relating to noninsurance SCA entities, may require~~s~~ some assets to be reported as a negative value (nonadmitted) in paragraph 9. In this ~~For~~ example, a paragraph 8.b.ii. SCA subsidiary that is only holding furniture, which is nonadmitted, would be reflected with negative equity to the extent the value of the nonadmitted asset(s) exceed(s) reported equity. It should be noted that although SSAP No. 97, paragraph 13.e., discusses some situations in which the equity method should be discontinued, this does not apply to SCA entities, which meet the requirements of paragraph 8.b.ii. In addition, SSAP No. 97, paragraph 13.e., lists some situations where the equity method for 8.b.ii and 8.b.iv entities would result in a valuation that is less than zero.~~; examples are if reporting entity has guaranteed obligations of the investee or is otherwise committed to provide further financial support for the investee, in these cases, the valuation of the investment in subsidiary could be a negative value.~~

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