Attachment 20

Statutory Accounting Principles (E) Working Group
November 12 Interim Meeting
Comment Letters Received

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September 18, 2020

Mr. Dale Bruggeman, Chairman
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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
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.

[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*

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 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

Have Certain Approval or Veto Rights. The term "participating rights" shall be used consistent with the discussion of substantive participating rights in this EITF.

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;

   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;

[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.

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*

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

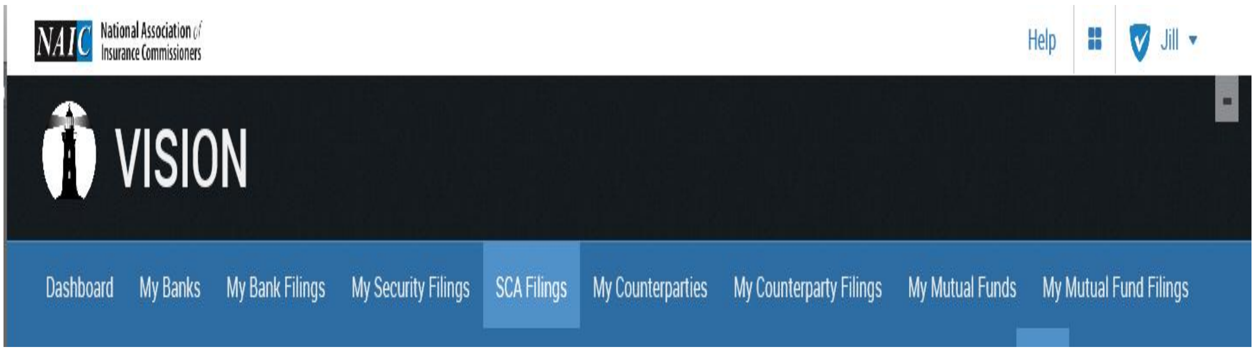
Note: Do NOT hit "Cancel" at any time during the filing process; this will discard your filing and you will have to start over!

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.

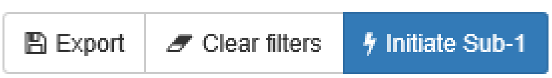
2. Click on the "SCA Filings" tab.



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"

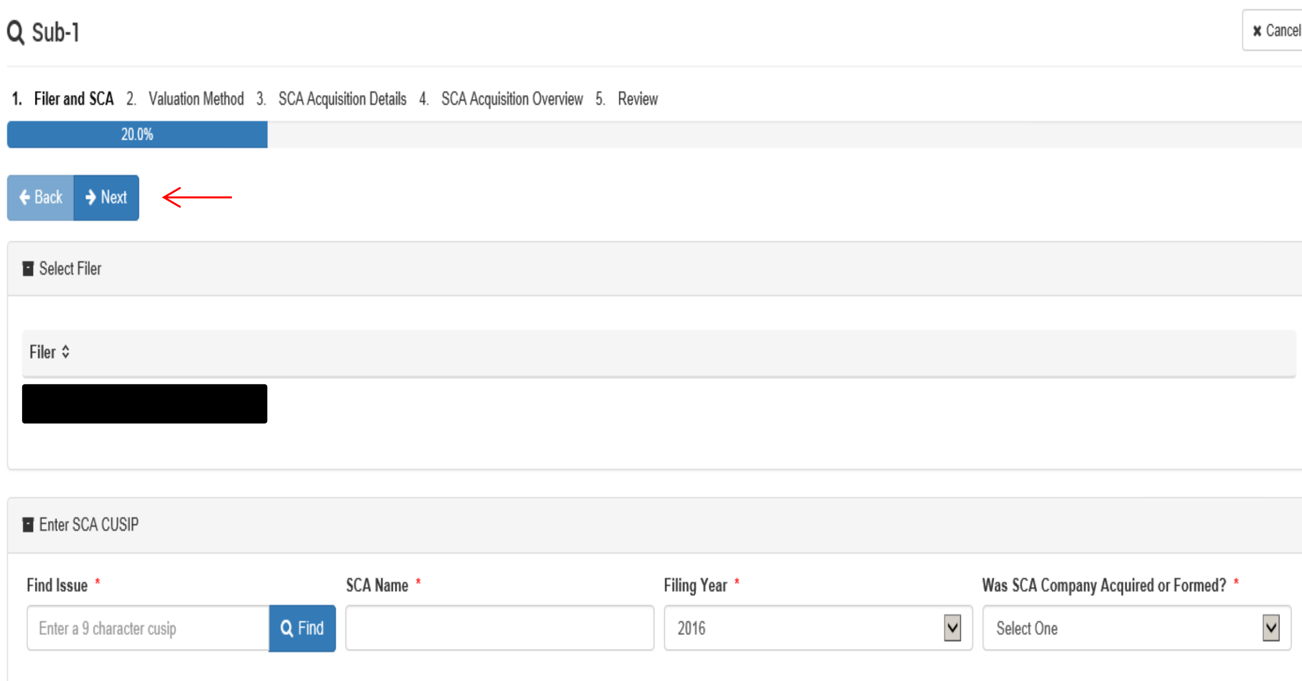
i. If you do not have a valid CUSIP or PPN, contact CUSIP Global Services at 212-438-6500 or via email at cusip_ppn@cusip.com. This is a requirement to file an SCA.

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)

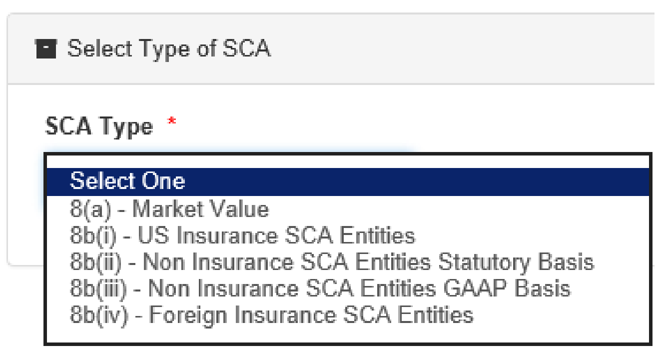
e. **Was SCA Company Acquired or Formed? –** Select answer

f. When all of the fields above have been filled in, click **"Next"**



2. <u>**Valuation Method Tab**</u> – *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:



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. **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** – *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

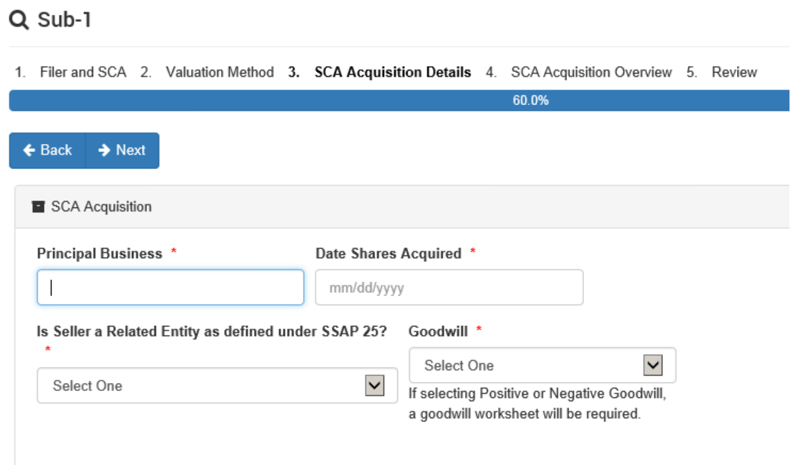
b. **Date Shares Acquired –** Include Month / Date / Year

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. **SCA Acquisition Overview Tab** – 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

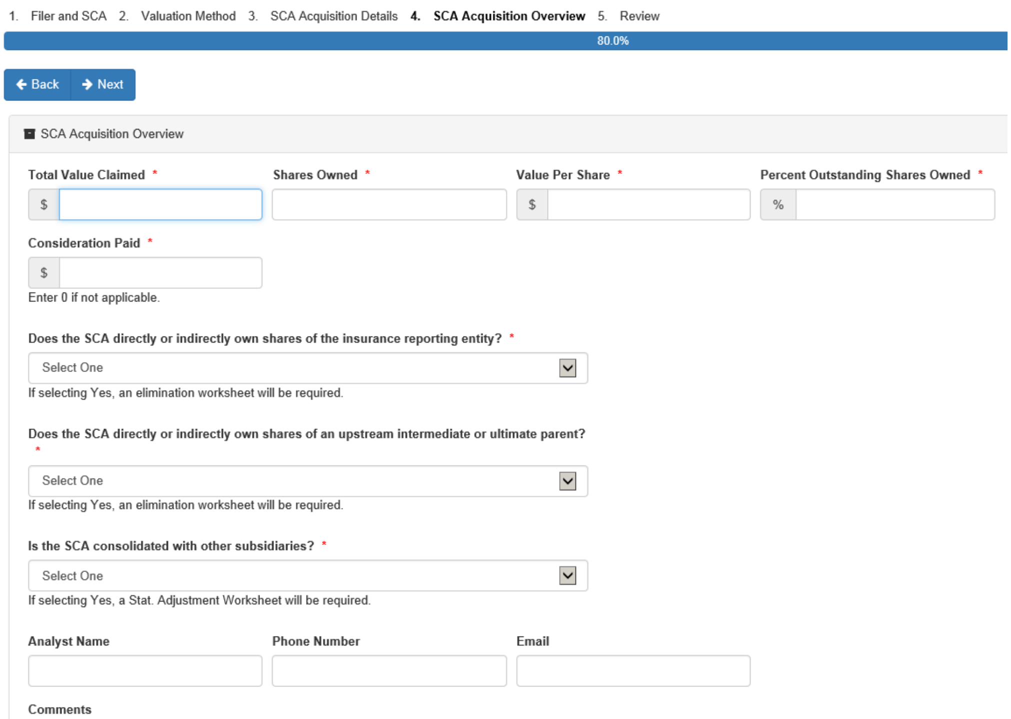
   f. **Does the SCA directly or indirectly own shares of the insurance reporting entity?** Relates to reciprocal ownership. *SCA Elimination Worksheet will be required:* http://www.naic.org/sca_subsidiary_controlled_affiliated.htm

   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.



5. **Review tab**

   a. Review all fields of the SCA to ensure they are filed correctly.

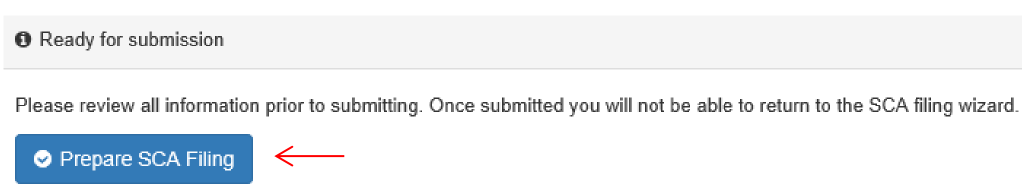
IMPORTANT NOTES:

If something is not filled out correctly, click "Back" and update!!

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!!

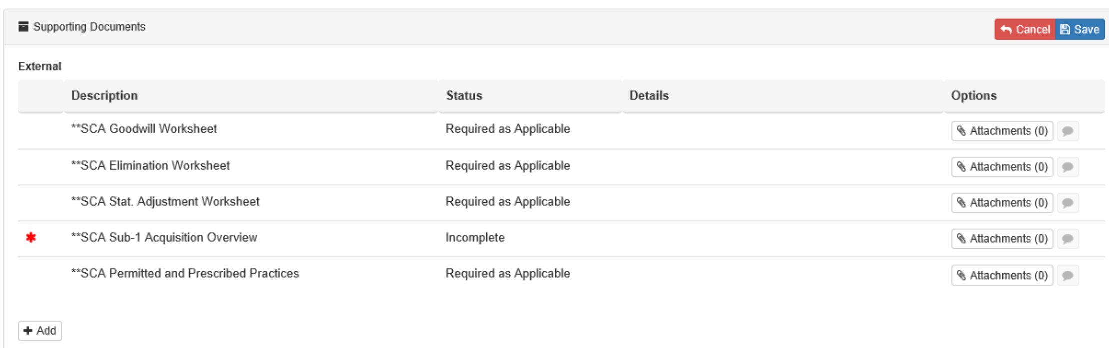
When finished reviewing, click the "Prepare SCA Filing" button



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



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>

<u>After Submitting – You Have Completed the Sub-1 Filing!!!</u>

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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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

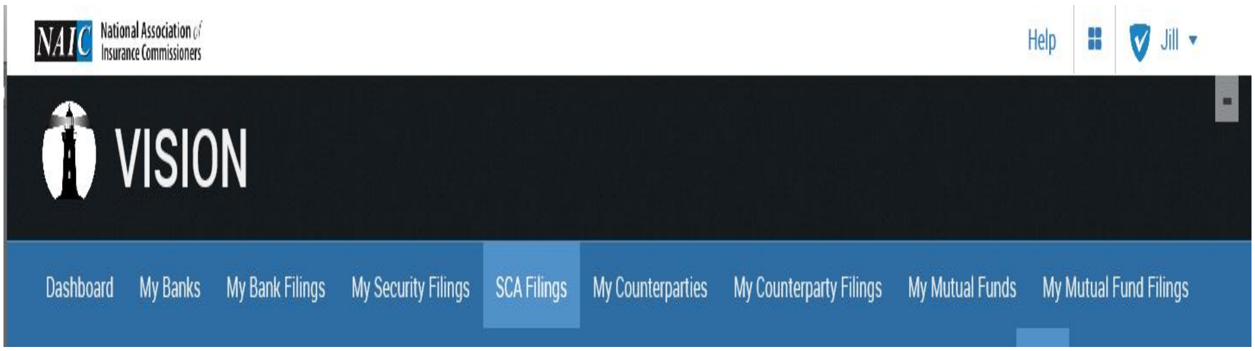
Note: Do NOT hit "Cancel" at any time during the filing process; this will discard your filing and you will have to start over!

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*

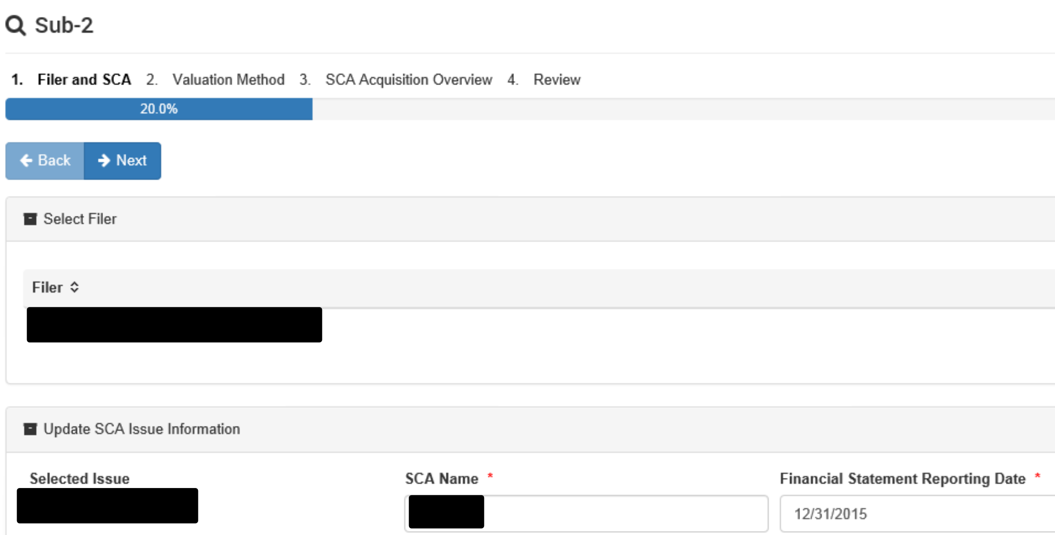
1. ***Filer and SCA tab** – this tab is used to pick the insurance reporting entity and to identify what SCA you are filing*

    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

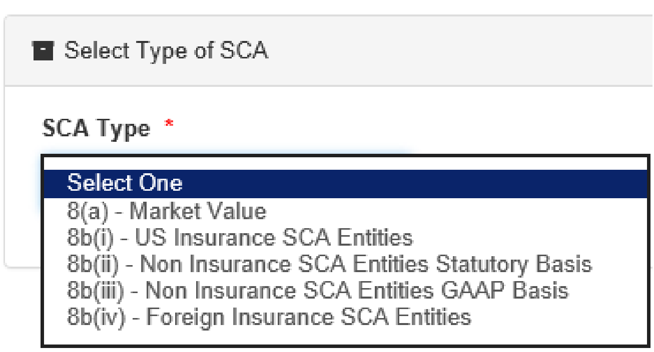
    c. **Financial Statement Reporting Date** – enter the date of the audited financials

    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)*



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>

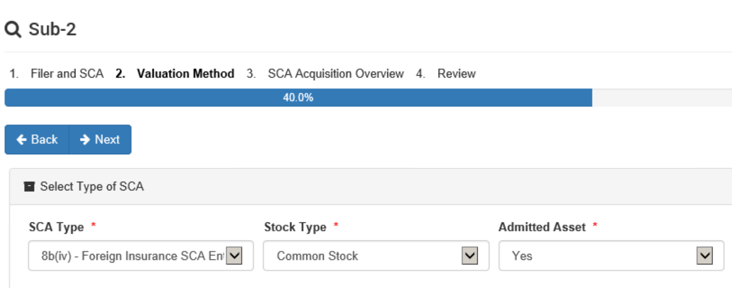
(a) **Accounting Standard** – US GAAP or Foreign basis as used in audit support

(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

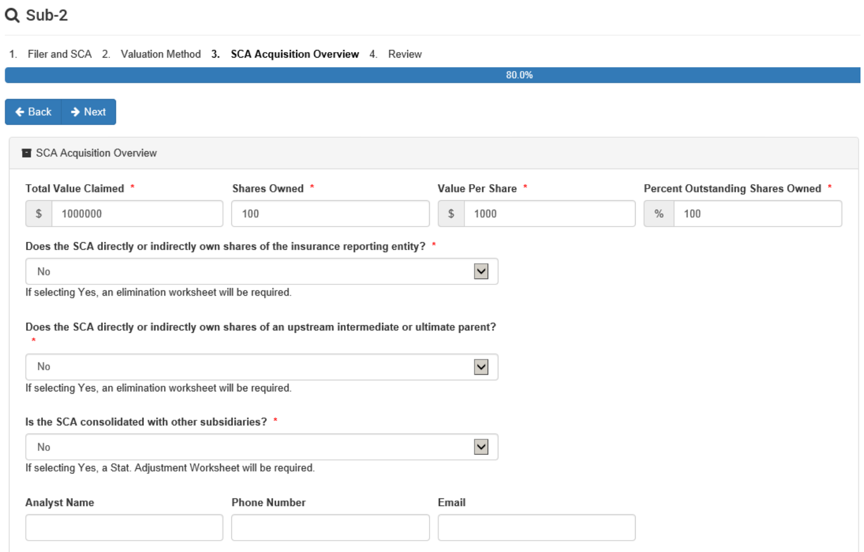
e. **Does the SCA directly or indirectly own shares of the insurance reporting entity?** This relates to reciprocal ownership – refer to SSAP No. 97 for m ore detail (SCA Elimination Worksheet will need completed – found at http://www.naic.org/sca_subsidiary_controlled_affiliated.htm)

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. 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

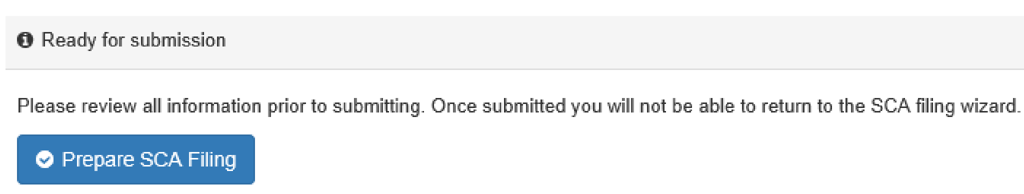
IMPORTANT NOTES:

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. SCA Filing Detail tab – *This tab will show all the filing details and this is where you will attach all your supporting documents*

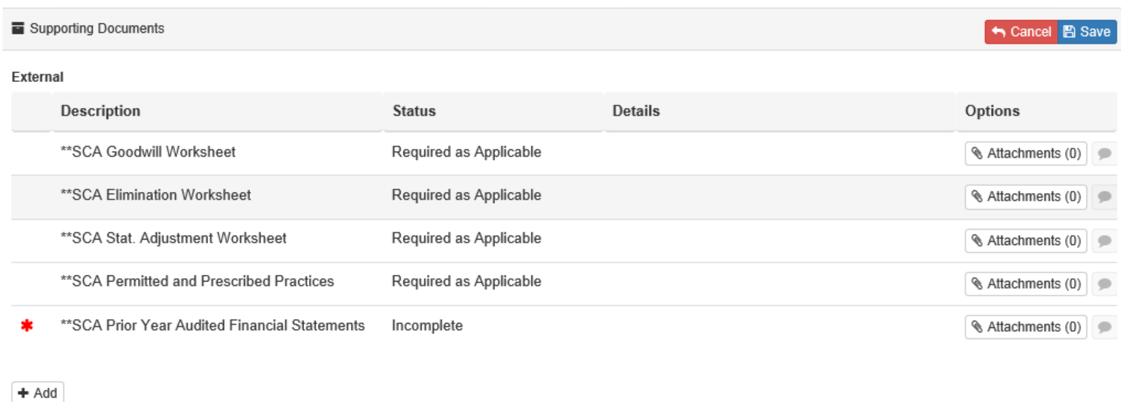
a. To attach a document:

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:
   (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:

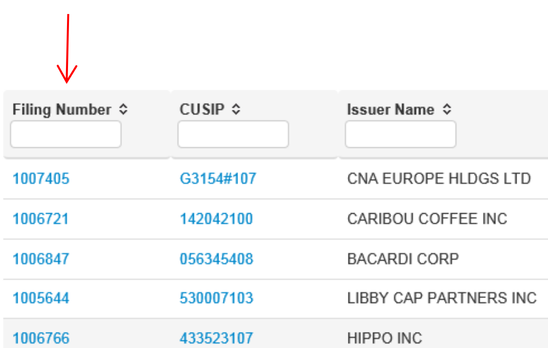
After Submitting – You Have Completed the Sub-2 Filing!!!

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

[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.

payment or residual asset risk of greater than 5%. There is nothing exotic or alternative about conforming CTLs.

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

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

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

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

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

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

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

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

555 12th Street, NW, Suite 550, Washington, DC 20004 | 202-828-7100
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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".

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

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

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

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

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

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

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

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

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

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

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

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

Moreover, Option 2 in the Exposure: moving even "conforming" CTLs to Schedule BA, is especially surprising considering that **<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 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

September 18, 2020
Page 5 of 5

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.

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[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

[2] *2003-2015 Credit Loss Experience Study: Private Placement Bonds*, Society of Actuaries, April 2019.

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 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

New York Life

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Jersey City, NJ 07302
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robertgardner@newyorklife.com

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