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

ROLL CALL

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

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

Note: This meeting will be recorded for subsequent use.

REVIEW of COMMENTS on EXPOSED ITEMS

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

1. 2019-21: Proposed Bond Definition

Ref #	Title	Attachment #	Agreement with Exposed Document?	Comment Letter Page Number
2019-21 (Julie)	**Proposed Bond Definition**	**SSAP No. 26R – 1 SSAP No. 43R – 2 Other SSAPs – 3**	**Comments Received**	**SSAPs – Att. 4 Fermat – 1 LBSWG – 2 IP's – 6 Reporting – Att. 5**

Summary:
Pursuant to direction in October 2020, state insurance regulators and key industry representatives, have been working dedicatedly on the bond project to principally define a bond for reporting on Schedule D-1 and to improve accounting and reporting. The intent of this project is to establish principle-based guidance for determining bonds, with a focus of substance over form, in such a manner so that the framework and principles established will be able to work for an increasingly innovative market and will provide regulators and other financial statement users with the transparency for understanding the risks present in an insurer's investment portfolio.

Pursuant to the project, in July and August 2022, the Working Group exposed statutory accounting and reporting revisions to incorporate changes to improve guidance and overall granularity and transparency of bond holdings and is working towards a January 1, 2025, effective date. Detail of exposed items:

July 18, 2022 – Exposed Reporting Changes

- Proposed Reporting Lines – Exposed document proposes annual statement general instructions (reporting line descriptions) for suggested reporting lines to capture issuer credit obligations and asset-backed securities on Schedule D-1. The general classifications that currently exist are proposed to be deleted and new granular reporting lines are suggested.

- Schedule D-1 A/S Instructions – Exposed document details the overall approach to add a new Schedule D-1 schedule specific to asset-backed securities. D-1-1 would reflect issuer credit obligations (items captured in scope of *SSAP No. 26R—Bonds*) and D-1-2 would reflect asset backed securities (items captured in scope of *SSAP No. 43R—Asset-Backed Securities*). This separation of the schedules is supported to enable different reporting columns based on the type of security. Columns that are proposed to be specific to issuer obligations and ABS are noted within the document. In addition to creating new columns, this document also details revisions to existing columns and instructions. There are instances in which columns are proposed to move to electronic only and situations in which the instructions are significantly revised as to what is included.

August 10, 2022 – Exposed Accounting Changes

- Exposed updated principles-based bond definition. (This document had been updated to reflect comments from prior exposures / discussions.)

- Exposed updated issue paper that reflects the prior discussions and decision points.

- Exposed revisions to *SSAP No. 26R—Bonds* and *SSAP No. 43R—Asset Backed Securities* to incorporate the principles-based bond definition in authoritative statutory accounting guidance.

Comments on the exposed items were received from the following:
(Comment Letters have been provided as attachments with a summary of key points raised below.)

SSAP / Bond Definition Comment letters – Attachment 4:

1. **Fermat Capital** – Comment letter requests that the NAIC use the bond project to clarify requirements for Working Capital Finance Investments (WCFI), with notations that WCFI meet the definition of an issuer credit obligation and should be reported on Schedule D-1.

   Response: Revisions are recommended to SSAP No. 26R to exclude investments that are specifically addressed within other SSAPs. Examples include structured settlements in *SSAP No. 21R—Other Admitted Assets*, surplus notes in *SSAP No. 41R—Surplus Notes* and WCFI in scope of *SSAP No. 105R—Working Capital Finance Investments*. The Working Group previously reviewed and rejected requests from the commenter on this topic when SSAP No. 105R was last updated in June 2020. If there is a Working Group request to rediscuss this issue, NAIC staff recommends not commingling the bond proposal with the WCFI discussion. If there is a need to reevaluate the 2020 conclusion, the topic of WCFI should be addressed in a separate agenda item.

2. **Industry Lease-Backed Securities Working Group** – Comment letter requests the inclusion of a new example to clarify that there is a class of asset-backed securities where the ABS Issuer does not own the underlying collateral, but rather has a security interest through loan documents which provides recourse to the collateral in the event of default.

   Response: Revisions are recommended to modify an existing example to address the dynamic when collateral is in the form of a note that has been legally assigned and does not represent ownership interest. Although a

new example is not proposed, as the ABS analysis necessary is similar to an existing example, the modifications proposed intend to capture key elements from the comment letter.

3. **Interested Parties** – Comment letter identifies a variety of elements, some which have been discussed with NAIC staff and regulators throughout the interim. A key element of focus is the language that restricts bond classification when interest or principal can vary based on the performance of an underlying collateral value or variable. A summary of IP comments is provided with the full text related to "embedded derivatives":

Summary of Interested Parties' Comments and NAIC Staff Draft Response:

Bond Definition:

a. Replace reference to "structure" to "investment(s)."

Response – NAIC staff agree with this change. The "structure" reference could imply that all tranches of an ABS would be disqualified from bond treatment if one tranche were determined to lack substantive credit enhancement, which is not the intent. The change to 'investment' has been reflected in the bond definition as recommended by interested parties. Similar edits were made in SSAP No. 26R to also revise instances of "security structures" to just reflect "securities" to use consistent terminology throughout.

b. Incorporate Examples 1&2 of Appendix 1 into the bond definition.

Response – NAIC staff agree with this change. Revisions have been proposed to pull this guidance into the bond definition and not as an Appendix. Furthermore, based on discussions with regulators and industry, SSAP 26R is proposed to be revised to contain the entire bond definition. With these edits, there are no aspects of the bond definition in SSAP No. 43R. This prevents duplication and potential inconsistencies in the language between the two standards. With this change, determination of whether a security is an issuer credit obligation or an asset-backed security will be fully captured within the guidance in SSAP No. 26R. If determined to be an ABS after evaluating under the bond definition in SSAP 26R, then a reporting entity would use SSAP No. 43R for the accounting and reporting guidance.

Note – The IP comments on embedded derivatives from the bond definition are addressed as part of the SSAP No. 26R and SSAP No. 43R discussion.)

Issue Paper:

c. Feeder Fund Language

Response – As noted by industry, NAIC staff and IA have worked together over the interim to refine the feeder fund language. The language is consistent with original intent, that a feeder fund structure that predominantly holds debt may be in substance a debt investment, despite the direct holding being a fund investment. The refined language identifies elements that may call into question the determination that an investment is in substance debt. The guidance also continues to identify that a feeder fund that relies on equity interests for repayment would have to meet the requirements to determine if the structure is in substance debt and permitted for bond reporting. Ultimately, the conclusion is that the presence of a feeder fund should not be automatically used to determine whether an investment qualifies (or does not qualify) as a bond, but that the substance of the transaction shall be the determining factor.

SSAP No. 26R & SSAP No. 43R:

d. Glossary Definitions – Industry comments recommended to delete several new terms that were proposed for the glossary. Although it is recommended to retain the bank loan definition, they also note that other

legacy terms likely do not need to be retained and that the glossary is not needed. The comments suggest that the bank loan definition could be incorporated within the standard.

Response – NAIC staff agree with industry comments to delete the new terms proposed for inclusion in the glossary, particularly as the terms were often duplicated within the standard. NAIC staff also agree that the legacy terms do not need to be retained. Revisions have been proposed to delete the glossary and include the definition of bank loans within a new footnote. The legacy terms proposed to be deleted as no longer necessary include convertible bond, mandatory convertible bond, trust preferred securities, Yankee bonds and zero-coupon bond. These changes will be reflected in the next exposure unless any concerns are raised as part of this discussion. In addition, the comments on using the definition of principal protected securities reflected in the *Purposes and Procedures Manual of the NAIC SVO* has resulted in changes in the guidance.

e. Income Recognition – Industry comments requested clarity to the guidance in the revised SSAP No. 43R pertaining to the assessment of cash flows and changes in cash flow projections.

Response – As detailed by industry, NAIC staff and IA have worked with industry in the interim to refine the proposed language. Key changes from the prior exposure pertain to the use of GAAP language in determining ability to use the prospective method (high credit quality), how the assessment is completed at the time of initial acquisition, and clarification of the OTTI recognition when there is an adverse change in expected cash flows when the investment is impaired (FV is less than AC).

f. Transition Language – Industry identified that transition guidance needs to be further developed, noting questions on the impact to various schedules and the need to align with the new guidance in SSAP No. 21R for securities that do not qualify as bonds.

Response – NAIC staff agree with these comments and guidance for transition has been drafted with a Jan. 1, 2025, effective date. This guidance prescribes the approach for reclassifying securities from Schedule D-1 that do not qualify as bonds and the approach to recognize those securities on a different schedule in a manner that allows the verification schedules to roll. The draft guidance is explicit that unrealized gains should not be recognized as a result of the reclassification. For securities reported at amortized cost on Schedule D-1, if the security is required to be recognized as the lower of amortized cost or fair value on the subsequent schedule, the transition impact would result with an unrealized loss. A disclosure on the surplus impact at transition is proposed as part of the guidance.

ABS investments that will move from DA as short-term / cash equivalent to schedule D-1-2 shall follow the same transition approach as of Jan. 1, 2025. Consideration was given as to whether existing ST/CE investments could be permitted to simply roll-off DA at the next maturity (as they would all be eliminated by year-end 2025), however, as the reporting lines for DA will mirror the reporting lines for Schedule D-1-1 (with a few additional specific short-term lines), there will be no specific reporting lines for ABS. As these items will have to move to a new reporting line (as the current ABS lines will no longer exist), it is proposed to move them to Schedule D-1-2 as part of the overall transition on Jan. 1, 2025. Comments on this approach will be requested as part of the next exposure.

g. Re-Exposure – Industry has identified the need for additional exposure.

Response – NAIC staff agree with these comments. As detailed in the recommendation, NAIC staff recommend exposing the revised SSAP No. 26R and SSAP No. 43R, as well as the proposed changes to other SSAPs at the conclusion of this discussion. (Additional edits or changes from the discussion of comments can be directed to be included with the exposure.) NAIC staff also anticipates presenting a revised issue paper and updated reporting documents at the Fall National Meeting for exposure.

Full Text of Interested Parties' Comments on Embedded Derivatives:

Embedded Derivatives

The newly added language in paragraph 3b of the Bond Definition, and paragraph 9b of SSAP No. 26R, is the most challenging concept the interested parties will be commenting on. It is very important that this concept and language be carefully assessed in terms of consistency and readability, substance, and unintended consequences. We interpret this language to relate to potential embedded derivatives which is very nuanced and complicated as evidenced by the FASB and IASB efforts which took significant time to develop and includes many pages of interpretative guidance. We have made significant progress working with Staff but ultimately believe more time and dialogue is needed to ensure intent is fully understood and captured. Interested parties also believe it may be beneficial for regulators to be part of all, or some of such dialogue, if they so desire. Interested parties include the most salient points below.

Consistency and Readability

Interested parties note that the latter part of paragraph 3b (bond definition) and 9b (SSAP No. 26R) includes language related to certain types of embedded derivatives. If a security runs afoul of such language, it would not be reported as a bond on schedule D. This can have potentially severe consequences. Interested parties make the following comments related to consistency and readability:

1) The paragraph 3b language is embedded within the part of the bond definition that relates only to Asset-Backed Securities (ABS). Yet the Issuer Credit Obligation (ICO) language refers to this language for Treasury Inflation Protected Securities (TIPS). Therefore, as written, it is unclear if this language is applicable to both ABS and ICOs or just ABS. Discussions with Staff have indicated that the intent is it should apply to both. As such, it was agreed that such language should be moved toward the front of the standard as an "exclusion" from the definition of a bond.

2) The structured note guidance, referred to above, is an integral part of the standard and should not be relegated to the glossary. Discussions with Staff have indicated that such language is a subset of the paragraph 3b language, and therefore should be included directly after such language. A key distinction, however, is if a security runs afoul of paragraph 3b, the security would be reported on Schedule BA, whereas a security that runs afoul of the structured note language would be reported as a derivative on Schedule DB. Several other points related to the language also need to be addressed:

    a. The base of the structured note language should be more closely aligned with the existing language within existing SSAP No. 26R.

    b. The guidance related to Cash Components of Replication Synthetic Asset Transactions (RSAT) will likely need to be changed in the P&P Manual to refer to securities that are both bonds to be reported on Schedule D and "bonds" that hereafter may be reported on Schedule BA, to ensure their eligibility will not be in question. Clarifying guidance will also be necessary in relation to the newly added "3b" language in the AP&P Manual to ensure that the adopted updates to the Bond Definition do not unintentionally compromise the eligibility of "Safe Harbor" RSATs, or those RSATs approved by the SVO, as "Effective" RSATs, both as defined in the P&P Manual, or the eligibility of the fixed income Cash Component and Derivative Component of such "Effective" RSATs for statutory accounting measurement and valuation that is consistent with that which would apply to the otherwise permissible bond investments that the Components of "Effective" RSATs combine to replicate synthetically.

c. There will need to be clarifying guidance for when a security runs afoul with both the structured note guidance and the paragraph 3b guidance so as it is clear which takes precedence for reporting (e.g., Schedule DB or Schedule BA, respectively).

3) Example 1 of Appendix 1 essentially deals with a security where the interest or principal moves up or down in accordance with underlying equity appreciation or depreciation. As this is no longer needed (i.e., it is covered in the paragraph 3b language), interested parties recommend the deletion of this example. While example 2 of Appendix 2 is not directly related to this concept, interested parties suggest it be included right prior to the paragraph 3b language. We have shared this in a proposal with Staff, inclusive of some of other proposed changes, and believe we have general agreement on placement as well as the general acknowledgement that more collaboration needs to occur on paragraph 3b itself.

Substance

The language included within paragraph 3b is similar to concepts included within US GAAP and IFRS. However, discussions with Staff have indicated that the intent is not to mirror either of them but to prevent abuses that could occur (e.g., having interest that moves up or down with the performance of an underlying equity asset or derivative that makes the security more equity like than bond like). Trying to thread the needle on preventing abuses, not making needlessly complex and/or having unintended consequences, is nonetheless challenging. A few areas of substance that will need to be addressed include the following:

1) Interested parties have identified three types of securities with embedded derivatives that should be addressed to ensure they will not run afoul of the paragraph 3b language:

    a. Securities where the where variable interest is interest related (e.g., linked to SOFR or other similar benchmark interest rate),

    b. Securities where the variable interest is linked to credit risk characteristics of the issuer, and

    c. Securities where the interest or principal is denominated in a foreign currency.

2) Interested parties have been working with Staff, and have made progress, but additional language changes may need to be made. Both Staff and interested parties are continually thinking through the intent and specific language required with the goal of appropriately threading the needle. Nonetheless, more work needs to be done and interested parties look forward to and anticipate further collaboration with Staff and/or regulators on this topic to clarity both intent and language.

3) Securities that run afoul of paragraph 3b will need to be reported on Schedule BA. This is in addition to any securities that will need to be reported on Schedule BA that otherwise more generally no longer meet the definition of a bond and therefore can also no longer be reported on Schedule D. This is an important point as many states have limits on the aggregate amount of investments that can be reported on Schedule BA. Many of these investments, are not inappropriate investments, but just will not meet the definition of a bond for Schedule D reporting. Interested parties are therefore concerned about the unintended consequences of this language if it is too broad – both from the limits on such investments imposed by statute and inappropriate risk-based capital charges. It is therefore important that the requisite time and commitment be dedicated to both getting this definition appropriately defined and ensuring a concurrent referral for timely risk-based capital factor development for their Schedule BA reporting. This work should be finalized simultaneously when the bond definition gets adopted.

Unintended Consequences

As noted previously, interested parties are continually thinking about this new concept, and working to identify securities that would run afoul of this new language where the intent of the language was not to capture. A few examples are included below:

1) Many insurers hold Environmental, Social and Governance (ESG) bonds where the coupon may change if certain sustainability targets are or are not met (e.g., increase or reduction of interest on CO2 emissions or workplace injuries). Typically, such adjustments are minimal or around 5 basis points.

2) Similarly, there are certain highly rated CLO transactions where the senior tranche may get additional interest if the equity or residual tranche returns meet a certain threshold.

3) Certain public ABS transactions backed by prime student loans have interest payments that vary based on the composition of the underlying pool of loans (e.g., if high interest loans prepay early, the interest due to the senior tranche may decline).

4) Certain ABS include an anticipated repayment date (ARD) function that require a step-up in interest rates payable to the holder if the securitization is not paid in full on or before the ARD.

5) Lastly, at the crux of paragraph 3b is the following sentence:

   "The debt instrument must have pre-determined principal and interest payments (whether fixed interest or variable interest) with contractual amounts that do not vary based on the appreciation or depreciation of any underlying collateral value or other variable."

While interested parties agree with what we understand to be the intent behind this language (i.e., having interest that moves up or down with the performance of an underlying asset or derivative that makes the security more equity like than bond like), there are nuances that interested parties believe still need to be addressed. For example, the "pre-determined principal or interest" language can be interpreted several ways. It could be interpretated to mean that both the magnitude and timing of principal and interest payments must be known in advance, while it could also be interpreted to mean the amounts need to be contractual in nature but can still vary as long as the variability is not dependent on the appreciation/depreciation of an asset or variable. Further, the reference to "other variable" could be interpreted to mean interest is not allowed to vary based on any variable or just the appreciation/depreciation of the variable. See also our comments above as they are often related to this specific language.

Response – NAIC staff and IA have discussed these comments with industry representatives. As a result of these discussions, potential revisions have been drafted. This guidance is included to highlight to the Working Group members, and to solicit comments during the exposure period.

Preliminary revisions drafted as part of the interim discussions with industry are shown below:

> In order for a debt instrument to represent a creditor relationship in accordance with Paragraph 6, it must have pre-determined principal and interest payments (whether fixed interest or variable interest) with contractual amounts that do not vary based on the appreciation or depreciation (i.e., performance) of any underlying collateral value or other non-debt variable. For example, an issued security that has varying principal and interest payments based on the appreciation of referenced equity, real estate or other non-debt variable is precluded from bond treatment. This exclusion is not intended to restrict

variables that are commonly related to debt instruments such as but not limited to ~~P~~plain-vanilla[1] inflation or benchmark interest rate adjustments (such as with U.S. TIPs or SOFR-linked coupons, respectively), scheduled interest rate step-ups, or credit rating-related interest rate adjustments. ~~or where variable interest is interest related (e.g., linked to SOFR or other similar benchmark interest rate) are not captured within these appreciation or depreciation adjustment exclusions and therefore are not excluded from bond classification. Additionally, an issued security that has variable interest linked to credit risk characteristics of the issuer (such as an increase in interest rate due to a credit rating decline of the issuer) are not excluded from bond classification~~. For clarification purposes, all returns from a debt instrument in excess of principal are required to be considered as interest. Therefore, investments with "stated" interest and then "additional returns" to which the holder of the debt instrument is entitled are collectively considered as interest and shall be assessed together in determining whether the investment has variable principal or interest due to underlying referenced non-debt variables. Examples of securities excluded from the bond definition under this guidance:

i. Structured Notes, which are securities that otherwise meet the definition of a bond, but for which the contractual amount of the instrument to be paid at maturity (or the original investment) is at risk for other than the failure of the borrower to pay the principal amount due, are excluded from the bond definition. These investments, although in the form of a debt instrument, incorporate the risk of an underlying variable in the terms of the agreement, and the issuer obligation to return the full principal is contingent on the performance of the underlying variable. These investments are addressed in *SSAP No. 86—Derivatives*. Mortgage-referenced securities issued by a government sponsored enterprise are explicit inclusions in scope of SSAP No. 43R. Foreign-denominated bonds subject to variation as a result of foreign currency fluctuations are not structured ~~notes and not subject to exclusion under paragraph 10~~.

ii. Principal-protected securities, as defined in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* are excluded from the bond definition as they have a performance component whose payments originate from, or are determined by, non-fixed income securities. These investments shall follow the guidance for non-bond securities in *SSAP No. 21R—Other Admitted Assets.*

Reporting Proposal Comment letters – Attachment 5

Interested Parties – Interested parties provided marked-up versions of the exposed reporting documents and highlighted key comments. Industry also noted their understanding that there will be additional opportunity to work with insurance regulators and NAIC staff on future changes.

The comments were captured throughout the reporting changes. NAIC staff has created a summary in the documents, which also includes the NAIC staff proposed response, which is also shown below:

Comments on General Instructions - Reporting Lines and Descriptions – Page 4, Attachment 5:

1. Page 3 - Comments indicate that the definitions for SAP Book Value, SAP Carrying Value, Adjusted Carrying Value and Recorded Investments should be reviewed.

   Response: These are legacy definitions and are also captured in the AP&P Manual Glossary, which would be considered the authoritative location. As these definitions are not specific to the bond project, it is recommended that if there is a desire to revisit these definitions, NAIC staff suggest that the interested parties sponsor proposed revisions in a separate agenda item.

[1] Inflation or benchmark interest rate adjustment mechanisms are considered plain-vanilla if based on widely recognized measures of inflation or interest rate benchmarks and excludes those that involve either leverage (such as a multiplier) or an inverse adjustment relationship.

2. Page 6 - Comments propose to clarify that convertible bonds are included with corporate bonds, with the exception of mandatory convertible bonds, which are in a separate category.

   Response: NAIC staff agree with this change.

3. Page 7 - Comments identify the lines for which affiliated investments are not reported. These include government jurisdictions, SVO-Identified Bond ETFs and Certificates of Deposit.

   Response: NAIC staff agree with this change.

4. Page 9 - Comments expand the definition of financial asset-backed securities that are not-self-liquidating. The revised definition is as follows: Include all financial asset-backed securities where the structure does not represent a design where the terms of the underlying collateral has contractual principal and interest that results with a conversion into cash over a period of time (e.g., receivables or other such assets).

   Response: NAIC staff do not oppose this change.

5. Page 9 - Comments clarify the practical expedient in SSAP No. 43R, noting that it may be utilized.

   Response: NAIC staff do not oppose this change.

6. Page 10 - Comments move the definition of affiliated reporting lines. This is a placement change from page 9.

   Response: NAIC staff do not oppose this change.

<u>Comments on Schedule D-1 Columns and Instructions – Page 15, Attachment 5:</u>

1. Page 3 - Comments propose to reorder certain electronic columns. They have also recommended that the numbering begin again for electronic columns. (So, 1-22 for pdf, and then E1-E20 for electronic.)

   Response: NAIC staff do not have concerns with the proposed ordering in the electronic columns. However, the renumbering of the columns would not be feasible as the information is pulled into a single chart within the electronic database. This would also be a change that would have to be considered throughout all reporting schedules and require significant database changes throughout the system.

2. Page 5 - Comments identify the need to provide guidance in *SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments* to exclude asset-backed securities and to ensure consistency between the accounting and reporting for investments that will no longer be captured on Schedule DA – Part 12 (Short-Term Investments) and Schedule E – Part 2 (Cash Equivalents).

   Response: NAIC staff agree with this comment and have proposed edits to SSAP No. 2R. NAIC staff also notes that transition guidance for ABS reported as short-term and cash equivalents as of Jan. 1, 2025, was needed. Clarification to Schedule DA and Schedule E2 is anticipated as part of the broader blanks proposal.

3. Page 6 - Comments request that the redesign of the "code" column, which is proposed to have a column for "restricted asset codes" and another electronic only code for other elements be duplicated on other schedules.

   Response: NAIC staff do not oppose this request, however, this change may be considered outside of the bond proposal. NAIC staff will work with the blanks team on this request.

4. Page 11 - Comments request the inclusion of example references to the retrospective and prospective methods instead of defining the two approaches in the instructions.

Response: NAIC staff do not oppose this change. It was included to assist the schedule preparers as the individuals involved with investment schedule completion may not have immediate access to the SSAP provisions.

5. Page 11 - Comments recommend revisions to data-capture information on interest income due and accrued as a separate project.

   Response: NAIC staff agree with this change. An agenda item is planned for the Fall NM.

6. Page 11 – Comments propose to rearrange the description of 'Interest Received During Year" to move the statement that the column should reflect the combined total of all interest (cash and PIK) received for each reported investment during the year to the start of the paragraph. (This is a placement change.)

   Response: NAIC staff agree with this change.

7. Page 12- Comments propose to change the description of "Acquisition Balloon Payment" to "Origination Balloon Payment" with a comment that the description indicates that it reflects the original outstanding principal amount.

   Response: Although the original intent of this column was to capture acquisition info, it has been identified that logistically this information would need to reflect investment information at the time of origination. Otherwise, the same investment could have different information reported based on when it was acquired. (So, if a reporting entity acquired an investment, and then subsequently acquired more of the same investment, the amount based on acquisition would be different.) For example, an item could have 30% balloon payment at origination, but over the investment duration, as it gets closer to maturity, the balloon payment would reflect a greater amount of the point-in-time principal balance as the principal has been paid down. As such, revisions are anticipated to reflect "origination" instead of acquisition in line with the industry comments.

8. Page 13 - Comments recommend deleting investment characteristic #8 that identifies whether an asset is bifurcated between an insulated and non-insulated separate account as it is used by a very small number of investments.

   Response: NAIC staff agree with this recommendation. From a data pull, it looks like there were zero instances of this code being used to identify bifurcated assets between an insulated and non-insulated separate account blank. NAIC staff did identify that there was 1 property/casualty company that used it 19 times in the general account on Schedule D-1. From further outreach with this company, the wrong code was selected. This code is not attributed to any meaning in the general account.

9. Page 14 - Comments recommend retaining the fair value hierarchy code that identifies that the amount reported was determined by the unit price published in the NAIC Valuation of Securities.

   Response: NAIC staff agree with retaining the code as it is broadly used. However, NAIC staff proposes to clarify that the data comes from AVS+ (and not Valuation of Securities) to reflect the current product. For clarity, the information is not derived from the SVO, but is included in the AVS+ product from information received from the Intercontinental Exchange (ICE). NAIC staff also recommend removing this as an option from Schedule A – Real Estate and Schedule B – Mortgage Loans as the AVS+ product would not include info for those investments. From the data pull, there were instances in which this code was used on Schedule A.) NAIC staff will recommend removal from Schedule A and Schedule B instructions in a separate proposal.

10. Page 17 - Comments recommend deleting the new proposed column for "Current Overcollateralization Percentage" applicable to ABS. The comments indicate that the assessment of substantive credit enhancements

is completed at acquisition, therefore question why this is needed. They also note that it would be operationally challenging for reporting entities to update the info for all ABS every reporting period. Lastly, they identify that ABS securities (such as guaranteed mortgage pass-throughs) would only have credit enhancement in the form of a guarantee and would not have anything to populate in the column.

Response: NAIC staff request input from the Working Group but agrees that this column could be operationally challenging if required for each ABS investment and updated annually. Originally, this column was considered for the 'sub-schedule' which would have been limited to specific ABS structures. With the separation between issuer credit obligations and ABS into a D-1-1 and a D-1-2, this column was proposed to be captured for all ABS. If the Working Group desires this information for certain investments, the reporting instructions could be revised to limit the application of this column to certain investment structures – such as those reported as non-self-liquidating financial asset backed (including equity-backed investments) and non-financial asset backed investments that did not qualify for the practical expedient. Consideration could occur to deleting the column.

11. Page 18 - Comments recommend revising "Acquisition Overcollateralization Percentage" to reflect the "Origination Overcollateralization Percentage" noting that it would be consistent with the instructions that the original collateralization ration shall be based on supporting investment documentation.

    Response: Consistent with the prior column, NAIC staff agree with revising to "Origination."

12. Page 18 – Comments recommend that the description of PIK Interest Due and Accrued be revised to reflect the cumulative amount of PIK interest included in the current principal balance.

    Response: NAIC staff agree with this change.

13. Various Edits – Industry proposed a variety of small edits / formatting changes.

    Response: NAIC staff will include these edits in the document, but the resulting blanks proposal will take the form / format of what is prescribed by the Blanks Working Group.

<u>*Recommended Action:*</u>
NAIC staff recommends that the Working Group expose revised drafts of *SSAP No. 26R—Bonds* and *SSAP No. 43R—Asset-Backed Securities*. These drafts have been updated to reflect revisions from working with industry and IA over the interim as well considering comments received. (A summary of edits is captured on the first page of each document.) If the Working Group would like different or additional edits incorporated, the Working Group can direct NAIC staff to make those changes prior to exposing the documents as part of the motion. **The revised drafts include proposed transition guidance, which includes identification of the Jan. 1, 2025, effective date. In addition, NAIC staff recommends exposing a document that details "Other SSAP Revisions" (attachment 3) that proposes revisions to various SSAPs, including *SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments* to exclude ABS from short-term / cash equivalent classification and *SSAP No. 21R—Other Admitted Assets* to establish guidance for debt securities that do not qualify as bonds. NAIC staff recommends a comment period ending Feb. 10, 2023.**

An updated issue paper as well as updated reporting documents are expected to be presented for exposure at the Fall National Meeting.

The comment letters related to SSAP revisions are detailed in Attachment 4 (14 pages). The comment letters related to reporting revisions are detailed in Attachment 5 (35 pages). *(Note, the comments are included throughout the reporting proposal, so summaries have been provided within the document.)*

Proposed Revisions to SSAP No. 26R – 2022 Fall National Meeting

Summary of Revisions:

1. All Changes Exposed at the Summer NM have been accepted with new edits shown as tracked. (This has been done for readability and to highlight changes from the prior exposure.)

2. Paragraph 4: Revisions on excluded items. This includes modifying the guidance in paragraph 4c and pointing to a new paragraph 10 (with deletion of the footnote) and the addition of a new paragraph 4d to clarify that investments with specific guidance and reporting lines (such as surplus note, WCFI, structured settlements) shall follow the guidance in their specific SSAP and be reported on designated reporting lines.

3. Paragraph 6: Revisions, and the addition of paragraphs 6a-6d, to bring in the guidance for determining whether a security represents a creditor relationship in substance. This guidance was previously in an exhibit and has been revised to clarify application when interest and principal vary based on the performance of an underlying value or variable. This guidance adds language to clarify that the exclusion is not intended to restrict variables that are commonly linted to debt instruments, such as plain-vanilla inflation or benchmark interest rates. Specific reference to exclude structured notes and principal protected securities has been moved to this location with slight modifications. With this language, the footnote for TIPs in paragraph 7a has been deleted.

4. Paragraph 7: Revisions, and the addition of a new footnote, to clarify that the general creditworthiness of an entity can be through direct or indirect recourse and is the primary source of repayment. The term primary is defined in a new footnote. Revisions were also reflected to paragraph 7e to correct reference to 'convertible' to 'corporate.'

5. Paragraphs 8-11: Revisions bring in guidance for meaningful cash flows and substantive credit enhancement related to ABS securities. From comments received, it was noted to be preferred to have the entire bond definition in SSAP No. 26R (for both issuer credit obligations and ABS) with the accounting guidance and disclosures for ABS in SSAP No. 43R. This eliminates duplicate info between the SSAPs and possible future inconsistencies if revisions are not made in tandem. Also incorporates the change from the IP letter to reference 'investment(s)' and not 'structure.'

6. Paragraphs 43-45: Revisions incorporate specialized transition guidance and a transition disclosure. This guidance prescribes how to reclassify securities from Schedule D-1 to the subsequent applicable schedule to ensure that the schedules (verification) continue to roll.

7. Glossary (Old Exhibit A): Revisions delete the glossary and brings the definition of bank loans into a footnote to paragraph 2b.

8. Exhibit – Creditor Relationship (Old Exhibit B): Deleted guidance, which included examples for creditor relationships as that is moved to paragraphs 6a-6d. A new exhibit, moved to SSAP No. 43R, to detail application of analysis for asset-backed securities has been included. This exhibit has been revised to reflect an example where the ABS Issuer does not own the underlying collateral.

9. Note: Although the acronym ICO can be used for issuer credit obligations, in most instances the full phrase has often been used. This has been noted to provide an easier read and is intentional. However, if preferred, further consideration could occur to replace reference with the acronym.

10. Footnote references will be updated when all revisions have been accepted. (This will be an automatic update once deleted footnotes are removed from the guidance.)

SCOPE OF STATEMENT

1. The principles-based definition of a bond within this statement shall be utilized to identify whether security structures should be reported as bonds. Investments that qualify within the principles-based definition as an issuer credit obligation shall follow the accounting guidance within this statement. Investments that qualify within the principles-based definition as an asset-backed security (ABS) shall follow the accounting guidance in *SSAP No. 43R—Asset-Backed Securities*.

2. In addition to security investments that qualify under the principles-based definition as issuer credit obligations, certain specific instruments are also captured in scope of this statement:

a. Certificates of deposit that have a fixed schedule of payments and a maturity date in excess of one year from the date of acquisition;

b. Bank loans that are obligations of operating entities issued directly by a reporting entity or acquired through a participation, syndication or assignment[1];

c. Debt instruments in a certified capital company (CAPCO) (INT 06-02)

d. Exchange Traded Funds (ETFs) that qualify for bond treatment as identified in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* and included in the 'SVO-Identified Bond ETF List' published on the SVO's webpage. (These instruments are referred to as SVO-Identified Bond ETFs.)

e. Mortgage loans in scope of *SSAP No. 37—Mortgage* Loans that qualify under an SVO structural assessment and are identified as SVO-Identified Credit Tenant Loans.

3. Securities that qualify as issuer credit obligations with a maturity date of one year or less from date of acquisition that qualify as cash equivalents or short-term investments shall follow the accounting requirements of this statement. These investments are also captured in *SSAP No. 2R—Cash, Cash*

[1] **Bank Loan** – Fixed-income instruments, representing indebtedness of a borrower, made by a financial institution. Bank loans can be issued directly by a reporting entity or acquired through an assignment, participation or syndication:

- **Assignment** – A bank loan assignment is defined as a fixed-income instrument in which there is the sale and transfer of the rights and obligations of a lender (as assignor) under an existing loan agreement to a new lender (and as assignee) pursuant to an Assignment and Acceptance Agreement (or similar agreement) which effects a novation under contract law, so the new lender becomes the direct creditor of and is in contractual privity with the borrower having the sole right to enforce rights under the loan agreement.

- **Participation –** A bank loan participation is defined as a fixed-income investment in which a single lender makes a large loan to a borrower and subsequently transfers (sells) undivided interests in the loan to other entities. Transfers by the originating lender may take the legal form of either assignments or participations. The transfers are usually on a nonrecourse basis, and the originating lender continues to service the loan. The participating entity may or may not have the right to sell or transfer its participation during the term of the loan, depending on the terms of the participation agreement. Loan Participations can be made on a parri-passu basis (where each participant shares equally) or a senior subordinated basis (senior lenders get paid first and the subordinated participant gets paid if there are sufficient funds left to make a payment).

- **Syndication –** A bank loan syndication is defined as a fixed-income investment in which several lenders share in lending to a single borrower. Each lender loans a specific amount to the borrower and has the right to repayment from the borrower. Separate debt instruments exist between the debtor and the individual creditors participating in the syndication. Each lender in a syndication shall account for the amounts it is owed by the borrower. Repayments by the borrower may be made to a lead lender that then distributes the collections to the other lenders of the syndicate. In those circumstances, the lead lender is simply functioning as a servicer and shall not recognize the aggregate loan as an asset. A loan syndication arrangement may result in multiple loans to the same borrower by different lenders. Each of those loans is considered a separate instrument.

Equivalents, Drafts and Short-Term Investments and shall follow the reporting and disclosure requirements of that statement.

4. This statement excludes:

a. Mortgage loans and other real estate lending activities made in the ordinary course of business. These investments are addressed in *SSAP No. 37—Mortgage Loans* and *SSAP No. 39—Reverse Mortgages*.

b. Investments that qualify within the principles-based definition as an ~~asset-backed security (~~ABS~~)~~. These investments shall follow the guidance in *SSAP No. 43R—Asset-Backed Securities*

c. Securities that provide varying principal or interest based on underlying equity appreciation or depreciation, an equity-based derivative, real estate or other ~~referenced~~ non-debt variable, as described in paragraph 10. ~~are excluded under the principles-based bond definition. This includes principal-protected notes (or principal-protected securities) and structured notes[2] that have any components within the structure that can provide returns based on underlying equity influences or other referenced variables. (As detailed in footnote 4, securities with plain-vanilla inflation adjustment mechanisms, such as U.S. TIPs) are excluded from this restriction.)~~

~~c.~~d. Investments that are captured specifically within other SSAPs. For example, reporting entity acquired structured settlements are captured in scope of *SSAP No. 21R—Other Admitted Assets*, held surplus notes are captured in scope of *SSAP No. 41R—Surplus Notes* and working capital finance investments are captured in scope of *SSAP No. 105—Working Capital Finance Investments*. Investments captured in scope of other SSAPs are subject to the measurement and admittance provisions of those SSAPs. Furthermore, investments that have specific reporting lines on dedicated schedules (such as with both surplus notes and WCFI) shall be reported on their dedicated lines.

SUMMARY CONCLUSION

Principal-Based Bond Definition

5. A bond shall be defined as any security[3] representing a creditor relationship, whereby there is a fixed schedule for one or more future payments, and which qualifies as either an issuer credit obligation or an asset-backed security as described in this statement**.**

~~[2] The structural design of principal-protected notes and structured notes precludes these investments from being captured as issuer credit obligations or ABS as such investments do not represent a creditor relationship in substance. The principles-based bond definition is intended to require a structural assessment inclusive of all investment components, therefore it is not permissible to segregate components within a structure, such as bond collateral supporting principal and interest payments when the structure also includes other collateral with the potential to general additional interest or returns. Such structures must be viewed wholistically within the principles-based bond definition, with all potential returns considered in determining whether the structure qualifies as a creditor relationship.~~

[3] This statement adopts the GAAP definition of a security as it is used in FASB Accounting Standards Codification Topics 320 and 860. Evaluation of an investment under this definition should consider the substance of the instrument rather than solely its legal form.

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 by or on behalf of the issuer.

6. Determining whether a security represents a creditor relationship should consider its substance, rather than solely the legal form of the instrument. The analysis of whether a security represents a creditor relationship should consider all other investments the reporting entity owns in the investee as well as any other contractual arrangements. A security that in substance possesses equity-like characteristics or represents an ownership interest in the issuer does not represent a creditor relationship. ~~See Exhibit B for examples of securities that, despite their legal form, do not represent a creditor relationship in substance.~~ While not intended to be all-inclusive, paragraphs 6a-6d discuss specific elements that may introduce equity-like characteristics:

a. Determining whether a debt instrument represents a creditor relationship in substance when the source of cash flows for repayment is derived from underlying equity interests inherently requires significant judgment and analysis. Unlike a debt instrument collateralized by assets with contractual cash flows, debt instruments collateralized by equity interests are dependent on cash flow distributions that are not contractually required to be made and are not controlled by the issuer of the debt. As a result, there is a rebuttable presumption that a debt instrument collateralized by equity interests does not represent a creditor relationship in substance. Notwithstanding this rebuttable presumption, it is possible for such a debt instrument to represent a creditor relationship if the characteristics of the underlying equity interests lend themselves to the production of predictable cash flows and the underlying equity risks have been sufficiently redistributed through the capital structure of the issuer. Factors to consider in making this determination include but are not limited to:

i. Number and diversification of the underlying equity interests
ii. Characteristics of the underlying equity interests (vintage, asset-types, etc.)
iii. Liquidity facilities
iv. Overcollateralization
v. Waiting period for distributions/paydowns to begin
vi. Capitalization of interest
vii. Covenants (e.g., loan-to-value trigger provisions)
~~i.~~viii. Reliance on ongoing sponsor commitments

b. While reliance of the debt instrument on sale of underlying equity interests or refinancing at maturity does not preclude the rebuttable presumption from being overcome, it does require that the other characteristics mitigate the inherent reliance on equity valuation risk to support the transformation of underlying equity risk to bond risk. As reliance on sale or refinancing increases, the more compelling the other factors needed to overcome the rebuttable presumption become.

c. Analysis of whether the rebuttable presumption for underlying equity interests is overcome shall be conducted and documented by a reporting entity at the time such an investment is acquired. The level of documentation and analysis required will vary based on the characteristics of the individual debt instrument, as well as the level of third-party and/or non-insurance company market validation to which the issuance has been subjected. For example, a debt instrument collateralized by fewer, less diversified equity interests would require more extensive and persuasive documented analysis than one collateralized by a larger diversified portfolio of equity interests. Likewise, a debt instrument that has been successfully marketed to unrelated and/or non-insurance company investors, may provide enhanced market validation of the structure compared to one held only by related party

b. It is of a type commonly dealt in on securities exchanges or markets or, when represented by an instrument, is commonly recognized in any area in which it is issued or dealt in as a medium for investment.

c. It is either one of a class or series or by its terms is divisible into a class or series of shares, participations, interests or obligations.

and/or insurance company investors where capital relief may be the primary motivation for the securitization.

d. In order for a debt instrument to represent a creditor relationship in accordance with Paragraph 6, it must have pre-determined principal and interest payments (whether fixed interest or variable interest) with contractual amounts that do not vary based on the appreciation or depreciation (i.e., performance) of any underlying collateral value or other non-debt variable. For example, an issued security that has varying principal and interest payments based on the appreciation of referenced equity, real estate or other non-debt variable is precluded from bond treatment. This exclusion is not intended to restrict variables that are commonly related to debt instruments such as, but not limited to, plain-vanilla[4] inflation or benchmark interest rate adjustments (such as with U.S. TIPs or SOFR-linked coupons, respectively), scheduled interest rate step-ups, or credit rating-related interest rate adjustments.~~or where variable interest is interest related (e.g., linked to SOFR or other similar benchmark interest rate) are not captured within these appreciation or depreciation adjustment exclusions and therefore are not excluded from bond classification. Additionally, an issued security that has variable interest linked to credit risk characteristics of the issuer (such as an increase in interest rate due to a credit rating decline of the issuer) are not excluded from bond classification~~ For clarification purposes, all returns from a debt instrument in excess of principal are required to be considered as interest. Therefore, investments with "stated" interest and then "additional returns" to which the holder of the debt instrument is entitled are collectively considered as interest and shall be assessed together in determining whether the investment has variable principal or interest due to underlying referenced non-debt variables. Examples of securities excluded from the bond definition under this guidance:

i. Structured Notes, which are securities that otherwise meet the definition of a bond, but for which the contractual amount of the instrument to be paid at maturity (or the original investment) is at risk for other than the failure of the borrower to pay the principal amount due, are excluded from the bond definition. These investments, although in the form of a debt instrument, incorporate the risk of an underlying variable in the terms of the agreement, and the issuer obligation to return the full principal is contingent on the performance of the underlying variable. These investments are addressed in *SSAP No. 86—Derivatives*. Mortgage-referenced securities issued by a government sponsored enterprise are explicit inclusions in scope of SSAP No. 43. Foreign-denominated bonds subject to variation as a result of foreign currency fluctuations are not structured notes~~and not subject to exclusion under paragraph 10~~.

ii. Principal-protected securities, as defined in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* are excluded from the bond definition as they have a performance component whose payments originate from, or are determined by, non-fixed income securities. These investments shall follow the guidance for non-bond securities in *SSAP No. 21—Other Admitted Assets*.

~~6.~~7. An issuer credit obligation is a bond, ~~where repayment of the security instrument is supported primarily by~~for which the general creditworthiness of an operating entity or entities through direct or

[4] Inflation or benchmark interest rate adjustment mechanisms are considered plain-vanilla if based on widely recognized measures of inflation or interest rate benchmarks and excludes those that involve either leverage (such as a multiplier) or an inverse adjustment relationship.

indirect recourse, is the primary[5] source of repayment. ~~Support consists of direct or indirect recourse to an o~~Operating entity or entities~~, which~~ includes holding companies with operating entity subsidiaries where the holding company has the ability to access the operating subsidiaries' cash flows through its ownership rights. An operating entity may be any sort of business entity, not-for-profit organization, governmental unit, or other provider of goods or services, but not a natural person or "ABS Issuer" (as defined in paragraph 8). Examples of issuer credit obligations include, but are not limited to:

a. U.S. Treasury securities, including U.S. Treasury Inflation-Indexed Securities[6];(INT 01-25)

b. U.S. government agency securities;

c. Municipal securities issued by the municipality or supported by cash flows generated by a municipally-owned asset or entity that provides goods or services (e.g., airport, toll roads, etc.);

d. Corporate bonds issued by operating entities, including Yankee bonds and zero-coupon bonds;

e. ~~Convertible~~ Corporate bonds, issued by holding companies that own operating entities;

f. Project finance bonds issued by operating entities;

g. Investments in the form of securities for which repayment is fully supported by an underlying contractual obligation of a single operating entity (e.g., Credit Tenant Loans (CTLs), Equipment trust certificates (ETCs), other lease backed securities, Funding Agreement Backed Notes (FABNs), etc.). For purposes of applying this principal concept, repayment is fully-supported by the underlying operating entity obligation if it provides cash flows for the repayment of all interest and at least 95% of the principal of the security.

h. Bonds issued by real estate investment trusts (REITs) or similar property trusts;

i. Bonds issued by business development corporations, closed-end funds, or similar operating entities, in each case registered under the 1940 Act.

j. Convertible bonds issued by operating entities, including mandatory convertible bonds as defined in paragraph 20.b.

[5] "Primary" refers to the first in order of repayment source, not to a majority of the sources of repayment. For example, an issuer obligation may have secondary recourse to collateral upon default of the operating entity but would otherwise be expected to be fully repaid with cash flows of the operating entity. This differs from an asset-backed security for which the primary source of repayment is from cash flows of the collateral.

~~[6] The inclusion of U.S. Treasury Inflation-Indexed Securities clarifies that securities with plain vanilla inflation adjustment mechanisms are not intended to be captured within the provisions that restrict bond classification to securities that have principal and interest payments that vary based on appreciation or depreciation of an underlying referenced variable. Inflation adjustment mechanisms are considered plain vanilla if it is based on a widely recognized measure of inflation and excludes those that involve either leverage (such as a multiplier) or an inverse adjustment relationship. As detailed in paragraph 3b, securities that have principal and interest payment variations due to valuation changes of a referenced variable (such as the appreciation of equity or real estate cause variations of changes in the principle or interest of a security structure) are intended to be precluded from bond treatment under the principles-based bond definition~~

~~7.~~8. An asset[7] backed security is a bond issued by an entity (an "ABS Issuer") created for the primary purpose of raising debt capital backed by financial assets[8] or cash generating non-financial assets owned by the ABS Issuer, for which the primary source ~~whereby~~of repayment is ~~primarily~~ derived from the cash flows associated with the underlying defined collateral rather than the cash flows of an operating entity[9]. In most instances, the ABS Issuer is not expected to continue functioning beyond the final maturity of the debt initially raised by the ABS Issuer. Also, many ABS Issuers are in the form of a trust or special purpose vehicle ("SPV"), although the presence or lack of a trust or SPV is not a definitive criterion for determining that a security meets the definition of an asset-backed security. The provisions in paragraphs 9-10 detail the two defining characteristics that must be present for a security to meet the definition of an asset-backed security.

~~There are two defining characteristics that must be present for a security to meet the definition of an asset backed security:~~

~~8.~~9. The assets owned by the ABS Issuer are either financial assets or cash-generating non-financial assets. Cash-generating non-financial assets are defined as assets that are expected to generate a meaningful~~[10]~~ level of cash flows toward repayment of the bond through use, licensing, leasing, servicing or management fees, or other similar cash flow generation. ~~(~~For the avoidance of doubt, there must be a meaningful level of cash flows to service the debt, other than through the sale or refinancing of the underlying assets held by the ABS Issuer~~)~~. Reliance on cash flows from the sale or refinancing of cash generating non-financial assets does not preclude a security from being classified as an asset-backed security so long as the conditions in this paragraph are met.

a. *Meaningful Level of Cash Flows*: Determining what constitutes a "meaningful" level of cash flows generated to service the debt from sources other than the sale or refinancing of the underlying collateral pursuant to paragraph 9 is specific to each transaction, determined at origination, and shall consider the following factors:

i. The price volatility in the principal market for the underlying collateral;
ii. The liquidity in the principal market for the underlying collateral;
iii. The diversification characteristics of the underlying collateral (i.e., types of collateral, geographic location(s), source(s) of cash flows within the structure, etc.);
iv. The overcollateralization of the underlying collateral relative to the debt obligation; and

[7] The underlying collateral supporting an asset-backed security shall meet the definition of an asset by the ABS Issuer. Certain forms of collateral, such as rights to future cash flows, may not be recognized as assets by the selling entity but may be recognized as assets when sold to an ABS Issuer. These assets are permitted as the collateral supporting an asset-backed security, although they may not represent an asset that can be liquidated to provide payment toward the issued debt obligations (i.e., if the future cash flows do not materialize). The limited ability to liquidate the underlying collateral supporting an asset-backed security does not impact the structural determination of whether an issued security meets the definition of an asset-backed security but may impact the recoverability of the investment, as well as the consideration of whether there is sufficient credit enhancement.

[8] *SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* defines a financial asset as cash, evidence of an ownership interest in an entity, or a contract that conveys to one entity a right (a) to receive cash or another financial instrument from a second entity or (b) to exchange other financial instruments on potentially favorable terms with the second entity. As a point of clarity, for the purposes of this standard, financial assets do not include assets for which the realization of the benefits conveyed by the above rights depends on the completion of a performance obligation (e.g., leases, mortgage servicing rights, royalty rights, etc.). These assets represent non-financial assets, or a means through which non-financial assets produce cash flows, until the performance obligation has been satisfied.

[9] Dedicated cash flows from an operating entity can form the underlying defined collateral in an asset-backed security. This dynamic, perhaps noted in a whole-business securitization, still reflects an asset-backed security and is not an issuer credit obligation.

~~[10] The term "meaningful" is defined in the Glossary.~~

v. The variability of cash flows, from sources other than sale or refinancing, expected to be generated from the underlying collateral.

The factors for price variability and the variability of cash flows are directly related to the "meaningful" requirement. That is, as price volatility or variability of cash flows increase, the required percentage of cash flows generated to service the debt from sources other than the sale or refinancing of the underlying collateral must also increase. The factors for liquidity, diversification and overcollateralization are inversely related to the "meaningful" concept. That is, as liquidity, diversification or overcollateralization increase, the required percentage of cash flows generated to service the debt from sources other than the sale or refinancing of the underlying collateral may decrease.

b. As a practical expedient to determining whether a cash generating non-financial asset is expected to produce meaningful cash flows, a reporting entity may consider an asset for which less than 50% of the original principal relies on sale or refinancing to meet the meaningful criteria. In applying this practical expedient, only contractual cash flows of the non-financial assets may be considered. This practical expedient should not be construed to mean that assets cannot meet the meaningful criteria if they rely on sale or refinancing to service greater than 50% of the original principal or if they rely on cash flows that are not contracted at origination. Rather, such instances would require a complete analysis of the considerations described within the meaningful level of cash flows definition in paragraph 9.

10. The holder of a debt instrument issued by an ABS Issuer is in a different economic position than if the holder owned the ABS Issuer's assets directly. The holder of the debt instrument is in a different economic position if such debt instrument benefits from substantive[11] credit enhancement through guarantees (or other similar forms of recourse), subordination and/or overcollateralization. ~~The debt instrument must have pre-determined principal and interest payments (whether fixed interest or variable interest) with contractual amounts that do not vary based on the appreciation or depreciation (i.e., performance) of any underlying collateral value or other variable. For example, an issued security that has varying principal and interest payments based on the appreciation of referenced equity, real estate or other variable is precluded from bond treatment. Plain-vanilla inflation adjustments (such as with U.S. TIPs) are not captured within these appreciation or depreciation adjustment exclusions and therefore are not excluded from bond classification. (For clarification purposes, all returns from an ABS in excess of principal are required to be considered as interest. Therefore, investments with "stated" interest and then "additional returns" to which the holder of the debt instrument is entitled are collectively considered as interest and shall be assessed together in determining whether the investment has variable principal or interest due to underlying referenced variables.)~~

a. *Substantive Credit Enhancement*: The intent of the criteria requiring the holder to be in a different economic position is to distinguish qualifying bonds from instruments with equity-like characteristics or where the substance of the transaction is more closely aligned with that of the underlying collateral. To qualify as an ABS under this standard, there is a requirement that there are substantive credit enhancements within the structure that absorb losses before the debt instrument being evaluated would be expected to absorb losses. This is inherent in the context of an issuer credit obligation in scope of SSAP No. 26R as the owners of the equity in the operating entity are the first to absorb any variability in performance of the operating entity. The same concept applies to asset-backed securities. If substantive credit enhancement did not exist, the substance of the debt instrument being evaluated would be more closely aligned with that of the underlying collateral than that of a bond. Credit enhancement that is merely nominal or lacks economic substance does not

~~[11] The term "substantive credit enhancement" is defined in the Glossary.~~

put a holder in a different economic position. The substantive credit enhancement required to be in a different economic position is specific to each transaction; determined at origination; and refers to the level of credit enhancement a market participant (i.e., knowledgeable investor transacting at arm's length) would conclude is substantive.

b. The first loss position may be issued as part of a securitization in the form of a debt or equity interest, or it may be retained by the sponsor and not issued as part of the securitization. If the first loss position (or a more senior position(s), if the first loss position(s) lacks contractual payments along with a substantive credit enhancement) is issued as part of the securitization, and does not have contractual principal and interest payments along with substantive credit enhancement and is held by a reporting entity, the ~~structure~~investment(s) does not qualify for reporting as a bond and should be reported as a non-bond security pursuant to *SSAP No. 21R—Other Admitted Assets*.

~~9.~~11. Whether an issuer of debt represents an operating entity or ABS Issuer is unambiguous in most instances, but certain instances may be less clear. For example, an entity may operate a single asset such as a toll road or power generation facility (e.g., project finance) which serves to collateralize a debt issuance, and the cash flows produced by the operation of the assets are pledged to service the debt. In many such instances, the entity is structured as a bankruptcy-remote entity that is separate from the municipality or project sponsor. Such entities have characteristics of operating entities as the operation of the asset constitutes a stand-alone business. They also have many common characteristics of ABS Issuers as they are formed for the purpose of raising debt capital backed by the cash flows from collateral held by a bankruptcy-remote entity. When viewed more holistically, these issuing entities are typically being used to facilitate the financing of an operating component of a project sponsor or municipality. The use of a bankruptcy-remote entity facilitates the efficient raising of debt to finance the operating project, but the primary purpose is to finance an operating project. Therefore, structures in which the issuing entity represents a stand-alone business producing its own operating revenues and expenses, where the primary purpose is to finance an operating project, shall be considered operating entities despite certain characteristics they may share with ABS Issuers.

~~10.~~12. The definition of a creditor relationship, per paragraph 6, does not include equity/fund investments (such as mutual funds or exchanged-traded funds), or securities that possess equity-like characteristics or that represent an ownership interests in the issuer. However, as identified in paragraph 2, exchange traded funds (ETFs), which qualify for bond treatment, as identified in Part Three of the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* and included in the 'SVO-Identified Bond ETF List' published on the SVO's webpage are provided special statutory accounting treatment and are included within the scope of this statement. These investments shall follow the guidance within this statement, as if they were issuer credit obligations, unless different treatment is specifically identified in paragraphs 32-38.

~~11. The first loss position may be issued as part of a securitization in the form of a debt or equity interest, or it may be retained by the sponsor and not issued as part of the securitization. If the first loss position (or a more senior positions(s), if the first loss position(s) lacks contractual payments along with substantive credit enhancement) is issued as part of the securitization, and does not have contractual principal and interest payments along with substantive credit enhancement and is held by a reporting entity, the structure does not qualify for reporting as a bond and shall be reported on Schedule BA: Other Long-Term Invested Assets.~~

~~12.~~13. Investments within the scope of this statement issued by a related party, or acquired through a related party transaction, are also subject to the provisions, admittance assessments and disclosure requirements of *SSAP No. 25—Affiliates and Other Related Parties.*

~~13.~~14. Investments within the scope of this statement meet the definition of assets as defined in *SSAP No. 4—Assets and Nonadmitted Assets* and are admitted assets to the extent they conform to the requirements of this statement and SSAP No. 25.

Accounting and Reporting Guidance for Investments that Qualify as Issuer Credit Obligations[12]

Acquisitions, Disposals and Changes in Unrealized Gains and Losses

~~14.~~15. A bond acquisition or disposal shall be recorded on the trade date (not the settlement date) except for the acquisition of private placement bonds which shall be recorded on the funding date. At acquisition, bonds shall be reported at their cost, including brokerage and other related fees. The reported cost of a bond received as a property dividend or capital contribution shall be the initial recognized value. SSAP No. 25 shall be used to determine whether a transfer is economic or noneconomic for initial recognition.

~~15.~~16. For reporting entities required to maintain an interest maintenance reserve (IMR), the accounting for realized capital gains and losses on sales of bonds shall be in accordance with *SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve*. For reporting entities required to maintain an asset valuation reserve (AVR), the accounting for unrealized gains and losses shall be in accordance with SSAP No. 7.

~~16.~~17. For reporting entities not required to maintain an IMR, realized gains and losses on sales of bonds shall be reported as net realized capital gains or losses in the statement of income. For reporting entities not required to maintain an AVR, unrealized gains and losses shall be recorded as a direct credit or charge to unassigned funds (surplus).

Amortized Cost

~~17.~~18. Amortization of bond premium or discount shall be calculated using the scientific (constant yield) interest method taking into consideration specified interest and principal provisions over the life of the bond.[13] (INT 07-01) Bonds containing call provisions (where the issue can be called away from the reporting entity at the issuer's discretion), except "make-whole" call provisions, shall be amortized to the call or maturity value/date which produces the lowest asset value (yield-to-worst). Although the concept for yield-to-worst shall be followed for all callable bonds, make-whole call provisions, which allow the bond to be callable at any time, shall not be considered in determining the timeframe for amortizing bond premium or discount unless information is known by the reporting entity indicating that the issuer is expected to invoke the make-whole call provision.

Application of Yield-to-Worst

~~18.~~19. For callable bonds[14], the first call date after the lockout period (or the date of acquisition if no lockout period exists) shall be used as the "effective date of maturity". Depending on the characteristics of the callable bonds, the yield-to-worst concept in paragraph 18 shall be applied as follows:

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[12] For all references to "bond" investments beginning in paragraph 15, this term intends to refer to investments that are permitted accounting and reporting treatment within scope of this standard.

[13] For perpetual bonds with an effective call option, any applicable premium shall be amortized utilizing the yield-to-worst method.

[14] Callable bonds within the scope of paragraph 19 excludes bonds with make-whole call provisions unless information is known by the reporting entity indicating that the issuer is expected to invoke the make-whole call provision. Exhibit D includes illustrations for the amortization of callable bonds.

a. For callable bonds with a lockout period, premium in excess of the next call price[15] (subsequent to acquisition[16] and lockout period) shall be amortized proportionally over the length of the lockout period. After each lockout period (if more than one), remaining premium shall be amortized to the call or maturity value/date which produces the lowest asset value.

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

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

Balance Sheet Amount

~~19.~~20. Bonds shall be valued and reported in accordance with this statement, the *Purposes and Procedures Manual of the NAIC Investment Analysis Office*, and the designation assigned in the NAIC *Valuations of Securities* product prepared by the NAIC Securities Valuation Office (SVO).

a. Bonds, except for mandatory convertible bonds: For reporting entities that maintain an asset valuation reserve (AVR), the bonds shall be reported at amortized cost, except for those with an NAIC designation of 6, which shall be reported at the lower of amortized cost or fair value. For reporting entities that do not maintain an AVR, bonds that are designated highest-quality and high-quality (NAIC designations 1 and 2, respectively) shall be reported at amortized cost; all other bonds (NAIC designations 3 to 6) shall be reported at the lower of amortized cost or fair value. For perpetual bonds which do not possess or no longer possess an effective call option, the bond shall be reported at fair value regardless of NAIC designation.

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

~~20.~~21. The premium paid on a zero coupon convertible bond that produces a negative yield as a result of the value of a warrant exceeding the bond discount shall be written off immediately so that a negative yield is not produced. The full amount of the premium should be recorded as amortization within investment income on the date of purchase.

[15] Reference to the "next call price" indicates that the reporting entity shall continuously review the call dates/prices to ensure that the amortization (and resulting BACV) follows the yield-to-worst concept throughout the time the reporting entity holds the bond.

[16] The reporting entity shall only consider call dates/prices that occur after the reporting entity acquires the bond. If all of the call dates had expired prior to the reporting entity acquiring the bond, the reporting entity would consider the bond continuously callable without a lockout period.

Impairment

~~21.~~22. An other-than-temporary(INT 06-07) impairment shall be considered to have occurred if it is probable that the reporting entity will be unable to collect all amounts due according to the contractual terms of a debt security in effect at the date of acquisition.[17] A decline in fair value which is other-than-temporary includes situations where a reporting entity has made a decision to sell a security prior to its maturity at an amount below its carrying value. If it is determined that a decline in the fair value of a bond is other-than-temporary, an impairment loss shall be recognized as a realized loss equal to the entire difference between the bond's carrying value and its fair value at the balance sheet date of the reporting period for which the assessment is made. The measurement of the impairment loss shall not include partial recoveries of fair value subsequent to the balance sheet date. For reporting entities required to maintain an AVR/IMR, the accounting for the entire amount of the realized capital loss shall be in accordance with SSAP No. 7. The other-than-temporary impairment loss shall be recorded entirely to either AVR or IMR (and not bifurcated between credit and non-credit components) in accordance with the annual statement instructions.

~~22.~~23. In periods subsequent to the recognition of an other-than-temporary impairment loss for a bond, the reporting entity shall account for the other-than-temporarily impaired security as if the security had been purchased on the measurement date of the other-than-temporary impairment. The fair value of the bond on the measurement date shall become the new cost basis of the bond and the new cost basis shall not be adjusted for subsequent recoveries in fair value. The discount or reduced premium recorded for the security, based on the new cost basis, shall be amortized over the remaining life of the security in the prospective manner based on the amount and timing of future estimated cash flows. The security shall continue to be subject to impairment analysis for each subsequent reporting period. Future declines in fair value which are determined to be other-than temporary shall be recorded as realized losses.

Income

~~23.~~24. Interest income for any period consists of interest collected during the period, the change in the due and accrued interest between the beginning and end of the period as well as reductions for premium amortization and interest paid on acquisition of bonds, and the addition of discount accrual. In accordance with *SSAP No. 34—Investment Income Due and Accrued*, investment income shall be reduced for amounts which have been determined to be uncollectible. Contingent interest may be accrued if the applicable provisions of the underlying contract and the prerequisite conditions have been met.

~~24.~~25. A bond may provide for a prepayment penalty or acceleration fee in the event the bond is liquidated prior to its scheduled termination date. Such fees shall be reported as investment income when received.

~~25.~~26. The amount of prepayment penalty and/or acceleration fees to be reported as investment income or loss shall be calculated as follows:

a. For called or tendered bonds in which the total proceeds (consideration) received exceeds par:

   i. The amount of investment income reported is equal to the consideration received less the par value of the investment; and

[17] If a bond has been modified from original acquisition, the guidance in *SSAP No. 36—Troubled Debt Restructuring* and paragraph 22 of *SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* shall be followed, as applicable. After modification of original terms, future assessments to determine other-than-temporary impairment shall be based on the modified contractual terms of the debt instrument.

ii. Any difference between the book adjusted carrying value (BACV) and the par value at the time of disposal shall be reported as realized capital gains and losses, subject to the authoritative literature in SSAP No. 7.

b. For called or tendered bonds in which the consideration received is less than par[18]:

i. To the extent an entity has in place a process to identify explicit prepayment penalty or acceleration fees, these should be reported as investment income. (An entity shall consistently apply their process. Once a process is in place, an entity is required to maintain a process to identify prepayment penalties for called bonds in which consideration received is less than par.)

ii. After determining any explicit prepayment penalty or acceleration fees, the reporting entity shall calculate the resulting realized gain as the difference between the remaining consideration and the BACV, which shall be reported as realized capital gain, subject to the authoritative literature in SSAP No. 7.

Origination Fees

~~26.~~27. Origination fees represent fees charged to the borrower in connection with the process of originating or restructuring a transaction such as the private placement of bonds. The fees include, but are not limited to, points, management, arrangement, placement, application, underwriting and other fees pursuant to such a transaction. Origination fees shall not be recorded until received in cash. Origination fees intended to compensate the reporting entity for interest rate risks (e.g., points) shall be amortized into income over the term of the bond consistent with paragraph 18 of this statement. Other origination fees shall be recorded as income upon receipt.

Origination, Acquisition and Commitment Costs

~~27.~~28. Costs related to origination when paid in the form of brokerage and other related fees shall be capitalized as part of the cost of the bond, consistent with paragraph 15 of this statement. All other costs, including internal costs or costs paid to an affiliated entity related to origination, purchase or commitment to purchase bonds shall be charged to expense when incurred.

Commitment Fees

~~28.~~29. Commitment fees are fees paid to the reporting entity that obligate the reporting entity to make available funds for future borrowing under a specified condition. A fee paid to the reporting entity to obtain a commitment to make funds available at some time in the future, generally, is refundable only if the bond is issued. If the bond is not issued, then the fees shall be recorded as investment income by the reporting entity when the commitment expires.

~~29.~~30. A fee paid to the reporting entity to obtain a commitment to be able to borrow funds at a specified rate and with specified terms quoted in the commitment agreement, generally, is not refundable unless the commitment is refused by the reporting entity. This type of fee shall be deferred, and amortization shall depend on whether or not the commitment is exercised. If the commitment is exercised, then the fee shall be amortized in accordance with paragraph 18 of this statement over the life of the bond as an adjustment

[18] This guidance applies to situations in which consideration received is less than par but greater than the book adjusted carrying value (BACV). Pursuant to the yield-to-worst concept, bonds shall be amortized to the call or maturity date that produces the lowest asset value. In the event a bond has not been amortized to the lowest value prior to the call, or in cases of an accepted tender bond offer (BACV is greater than the consideration received), the entire difference between consideration received and the BACV shall be reported to investment income.

to the investment income on the bond. If the commitment expires unexercised, the commitment fee shall be recognized in income on the commitment expiration date.

Exchanges and Conversions

~~30.~~31. If a bond is exchanged or converted into other securities (including conversions of mandatory convertible securities addressed in paragraph 20.b.), the fair value of the bond surrendered at the date of the exchange or conversion shall become the cost basis for the new securities with any gain or loss realized at the time of the exchange or conversion. However, if the fair value of the securities received in an exchange or conversion is more clearly evident than the fair value of the bond surrendered, then it shall become the cost basis for the new securities.

SVO-Identified Bond Exchange-Traded Funds

~~31.~~32. SVO-identified bond exchange-traded fund (ETF) investments, as discussed in paragraph 2, are captured within the scope of this statement for accounting and reporting[19] purposes only. The inclusion of these investments within this statement is not intended to contradict state law regarding the classification of these investments and does not intend to provide exceptions to state investment limitations involving types of financial instruments (e.g., equity/fund interests), or with regards to concentration risk (e.g., issuer).

~~32.~~33. SVO-identified bond ETF investments shall be initially reported at cost, including brokerage and other related fees. Subsequently, SVO-identified bond ETF investments shall be reported at fair value,[20] with changes in fair value recorded as unrealized gains or losses) unless the reporting entity has elected use[21] of a documented systematic approach to amortize or accrete the investment in a manner that represents the expected cash flows from the underlying bond holdings. This special measurement approach is referred to as the "systematic value" measurement method and shall only be used for the SVO-identified bond ETF investments within the scope of this statement.

~~33.~~34. Use of the systematic value for SVO-identified bond ETF investments is limited as follows:

a. Systematic value is only permitted to be designated as the measurement method for AVR filers acquiring qualifying investments that have an NAIC designation of 1 to 5, and for non-AVR filers acquiring qualifying investments with an NAIC designation of 1 or 2. SVO-identified investments that have an NAIC designation of 6 for AVR filers or 3-6 for non AVR filers shall be measured at fair value.

b. Designated use of a systematic value is an irrevocable election per qualifying investment (by CUSIP) at the time investment is originally acquired[22]. Investments owned prior to being identified by the SVO as a qualifying SSAP No. 26R investment are permitted to be subsequently designated to the systematic value measurement method. This designation

[19] With the inclusion of these SVO-identified investments as bonds, specific guidelines are detailed in the annual statement instructions for reporting purposes.

[20] For these investments, net asset value (NAV) is allowed as a practical expedient to fair value.

[21] The election to use systematic value is not a permitted or prescribed practice as it is an accounting provision allowed within this SSAP. Similarly, this election does not override state statutes, and if a state does not permit reporting entities the election to use systematic value as the measurement method, this is also not considered a permitted or prescribed practice. SVO-identified investments reported at fair value (NAV) or systematic value, if in accordance with the provisions of this standard, are considered in line with SSAP No. 26R and do not require permitted or prescribed disclosures under *SSAP No. 1—Accounting Policies, Risks & Uncertainties and Other Disclosures*.

[22] This guidance requires investments purchased in lots to follow the measurement method established at the time the investment was first acquired.

shall be applied as a change in accounting principle pursuant to *SSAP No. 3—Accounting Changes and Corrections of Errors*, which requires the reporting entity to recognize a cumulative effect to adjust capital and surplus as if the systematic value measurement method had been applied retroactively for all prior periods in which the investment was held. The election to use systematic value for investments shall be made before the year-end reporting of the investment in the year in which the SVO first identifies the investment as a qualifying SSAP No. 26R investment.

c. Once designated for a particular investment, the systematic value measurement method must be retained as long as the qualifying investment is held by the reporting entity and the investment remains within the scope of this statement with an allowable NAIC designation per paragraph 34.a. Upon a full sale/disposal of an SVO-identified investment (elimination of the entire CUSIP investment), after 90 days the reporting entity can reacquire the SVO-identified investment and designate a different measurement method. If the reporting entity was to reacquire the same investment within 90 days after it was sold/disposed, the reporting entity must utilize the measurement method previously designated for the investment. Subsequent/additional purchases of the same SVO-identified investment (same CUSIP) already held by a reporting entity must follow the election previously made by the reporting entity. If an investment no longer qualifies for a systematic value measurement because the NAIC designation has declined, then the security must be subsequently reported at the lower of "systematic value" or fair value. If the security has been removed from the SVO-identified listings, and is no longer in scope of this statement, then the security shall be measured and reported in accordance with the applicable SSAP.

d. Determination of the designated systematic value must follow the established[23] approach, which is consistently applied for all SVO-identified bond ETF investments designated for a systematic value. In all situations, an approach that continuously reflects "original" or "historical cost" is not an acceptable measurement method. The designated approach shall result with systematic amortization or accretion of the equity/fund investment in a manner that represents the expected cash flows from the underlying bond holdings.

~~34.~~35. Income distributions received from SVO-identified bond ETF investments (cash or shares) shall be reported as interest income in the period in which it is earned. For those SVO-identified bond ETF investments where the systematic value method is applied, interest income shall be recognized based on the book yield applied to the carrying value each period, similar to bonds.

~~35.~~36. For reporting entities required to hold an IMR and AVR reserve, realized and unrealized gains and losses for the SVO-identified bond ETF investments shall be consistent with bonds within the scope of this standard. With this guidance, recognition of gains/losses (and corresponding AVR/IMR impacts) will be based on the ETF, and not activity that occurs within the ETF (e.g., such as changes in the underlying bonds held within the ETF). Also consistent with the guidance for bonds, recognized losses from other-than-temporary impairments shall be recorded entirely to either AVR or IMR (and not bifurcated between credit and non-credit components) in accordance with the annual statement instructions.

~~36.~~37. SVO-identified bond ETF investments reported at systematic value shall recognize other-than-temporary impairments in accordance with the following guidance:

a. A decision to sell an SVO-identified bond ETF investment that has a fair value less than systematic value results in an other-than-temporary impairment that shall be recognized.

b. In situations in which an SVO-identified bond ETF investment has a fair value that is less than systematic value, the reporting entity must assess for other-than-temporary

[23] Exhibit B details the established systematic value approach.

impairment. For these investments, a key determinant, along with other impairment indicators in *INT 06-07: Definition of Phrase "Other Than Temporary*," shall be whether the net present value of the projected cash flows for the underlying bonds in the SVO-identified investment have materially[24] declined from the prior reporting period (most recent issued financial statements) or from the date of acquisition. In calculating the net present value of the projected cash flows for each reporting period, entities shall discount cash flows using a constant purchase yield, which is the initial book yield at acquisition. Consistent with INT 06-07, a predefined threshold to determine whether the decline in projected cash flows (e.g., percentage change) shall result in an other than temporary impairment has not been set, as exclusive reliance on such thresholds removes the ability of management to apply its judgement.

c. Upon identification of an SVO-identified investment as OTTI, the reporting entity shall recognize a realized loss equal to the difference between systematic value and the current fair value. (Although the determination of OTTI is likely based on projected cash flows, the realized loss recognized for the OTTI is based on the difference between systematic value and fair value.) The fair value of the SVO-identified investment on the date of the OTTI shall become the new cost basis of the investment.

d. Subsequent to recognition of an OTTI, the SVO-identified bond ETF investment is required to be reported at the lower of the then-current period systematic value or fair value. As the underlying bonds can be replaced within an ETF, it is possible for a subsequent period systematic value and fair value to recover above the fair value that existed at the time an OTTI was recognized. As such, the requirement for subsequent reporting at the lower of systematic value or fair value is intended to be a current period assessment. For example, in reporting periods after an OTTI, the systematic value for an SVO-identified investment may exceed the fair value at the time of the OTTI, but in no event shall the reported systematic value exceed the then-current period fair value. If current calculated systematic value is lower than the current fair value, systematic value is required.

~~37.~~38. Impairment guidance for SVO-identified bond ETF investments reported at fair value is consistent with impairment guidance for investments captured under SSAP No. 30R. Pursuant to this guidance, realized losses are required to be recognized when a decline in fair value is considered to be other-than-temporary. Subsequent fluctuations in fair value shall be recorded as unrealized gains or losses. Future declines in fair value which are determined to be other-than-temporary shall be recorded as realized losses. A decision to sell an impaired security results with an other-than-temporary impairment that shall be recognized.

Disclosures

~~38.~~39. The financial statements shall include the following disclosures:

a. Fair value in accordance with *SSAP No. 100R—Fair Value*;

b. Concentrations of credit risk in accordance with *SSAP No. 27—Off-Balance-Sheet and Credit Risk Disclosures*;

[24] The net present value of cash flows will decline in a declining interest rate environment. Reporting entities shall use judgment when assessing whether the decline in cash flows is related to a decline in interest rates or the result of a non-interest related decline, and determine whether the decline represents an OTTI pursuant to INT 06-07.

c. The basis at which the bonds, mandatory convertible securities, and SVO-identified bond ETF investments identified in paragraph 2, are stated;

d. Amortization method for bonds and mandatory convertible securities, and if elected by the reporting entity, the approach for determining the systematic value for SVO-identified securities per paragraph 33. If utilizing systematic value measurement method approach for SVO-identified investments, the reporting entity must include the following information:

i. Whether the reporting entity consistently utilizes the same measurement method for all SVO-identified investments[25] (e.g., fair value or systematic value). If different measurement methods are used[26], information on why the reporting entity has elected to use fair value for some SVO-identified investments and systematic value for others.

ii. Whether SVO-identified investments are being reported at a different measurement method from what was used in an earlier current-year interim and/or in a prior annual statement. (For example, if reported at systematic value prior to the sale, and then reacquired and reported at fair value.) This disclosure is required in all interim reporting periods and in the year-end financial statements for the year in which an SVO-identified investment has been reacquired and reported using a different measurement method from what was previously used for the investment. (This disclosure is required regardless of the length of time between the sale/reacquisition of the investments, but is only required in the year in which the investment is reacquired.)

iii. Identification of securities still held that no longer qualify for the systematic value method. This should separately identify those securities that are still within the scope of SSAP No. 26R and those that are being reported under a different SSAP.

e. For each balance sheet presented, the book/adjusted carrying values, fair values, excess of book/carrying value over fair value or fair value over book/adjusted carrying values for each pertinent bond or assets in scope of this statement.

f. For the most recent balance sheet, the book/adjusted carrying values and the fair values of bonds and assets in scope of this statement, reported in statutory Annual Statement Schedule D – Part 1A due:

i. In one year or less (including items without a maturity date which are payable on demand and in good standing);

ii. After one year through five years;

iii. After five years through ten years;

iv. After ten years (including items without a maturity date which are either not payable on demand or not in good standing).

[25] As identified in paragraph 34.d., a consistent approach must be followed for all investments designated to use the systematic value method. As such, this disclosure is limited to situations in which a reporting entity uses both fair value and systematic value for reported SVO-identified investments.

[26] The guidance in this statement allows different measurement methods by qualifying investment (CUSIP), but it is anticipated that companies will generally utilize a consistent approach for all qualifying investments.

g. For each period for which results of operations are presented, the proceeds from sales of bonds and assets in scope of this Statement and gross realized gains and gross realized losses on such sales.

h. For each balance sheet presented, all items in scope of this Statement in an unrealized loss position for which other-than-temporary declines in value have not been recognized:

i. The aggregate amount of unrealized losses (that is, the amount by which cost or amortized cost exceeds fair value) and

ii. The aggregate related fair value of bonds with unrealized losses.

i. The disclosures in paragraphs 39.h.i. and 39.h.ii. should be segregated by items that have been in a continuous unrealized loss position for less than 12 months and those that have been in a continuous unrealized loss position for 12 months or longer using fair values determined in accordance with SSAP No. 100R.

j. As of the most recent balance sheet date presented, additional information should be included describing the general categories of information that the investor considered in reaching the conclusion that the impairments are not other-than-temporary.

k. When it is not practicable to estimate fair value in accordance with SSAP No. 100R, the investor should disclose the following additional information, if applicable, as of each date for which a statement of financial position is presented in its annual financial statements:

i. The aggregate carrying value of the investments not evaluated for impairment, and

ii. The circumstances that may have a significant adverse effect on the fair value.

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

~~39.~~40. Refer to the Preamble for further discussion regarding disclosure requirements. The disclosures in paragraphs 39.b., 39.e., 39.f., 39.g., 39.h., 39.i., 39.j. and 39.k. shall be included in the annual audited statutory financial reports only.

Relevant Literature

~~40.~~41. This statement adopts *AICPA Statement of Position 90-11, Disclosure of Certain Information by Financial Institutions About Debt Securities Held as Assets,* and *AICPA Practice Bulletin No. 4, Accounting for Foreign Debt/Equity Swaps*. This statement also adopts *FASB Staff Position 115-1/124-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*, paragraph 16, with modification to be consistent with statutory language in the respective statutory accounting statements. This statement adopts the GAAP definition of "security" as it is used in FASB Codification Topic 320 and 860. This statement refers to the definition of "financial assets" captured in SSAP No. 103R adopted from U.S. GAAP. As noted in footnote 7, for purposes of this statement, and in applying the principles-based bond definition, financial assets do not include assets that depend on the completion of a performance obligation. When there is a performance obligation, the asset represents non-financial assets, or a means through which non-financial assets produce cash flows, until the performance obligation has been satisfied.

~~41.~~42. This statement rejects the GAAP guidance for debt securities, which is contained in *ASU 2020-08, Codification Improvements to Subtopic 310-20, Receivables – Nonrefundable Fees and Other Costs*, *ASU*

2018-03, Recognition and Measurement of Financial Assets and Financial Liabilities, ASU 2017-08, Premium Amortization on Purchased Callable Debt Securities, ASU *2016-01, Financial Instruments – Overall*, *FASB Statement No. 115, Accounting for Certain Investments in Debt and Equity Securities, FASB Statement No. 91, Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases, FASB Emerging Issues Task Force No. 89-18, Divestitures of Certain Investment Securities to an Unregulated Commonly Controlled Entity under FIRREA,* and *FASB Emerging Issues Task Force No. 96-10, Impact of Certain Transactions on Held-to-Maturity Classifications Under FASB Statement No. 115.*

Effective Date and Transition

~~42.~~43. Revisions to SSAP No. 26R to incorporate the principle-based bond concepts are effective January 1, 2025. These revisions incorporate principle concepts on what should be reported as a long-term bond. Securities that qualify as issuer credit obligations within the principle concepts are captured within scope of SSAP No. 26R. Securities that qualify as asset-backed securities ~~(ABS)~~ within the principle concepts are captured within scope of SSAP No. 43R. Securities that do not qualify as issuer credit obligations or ABS, unless specifically permitted in scope of these statements, are not permitted to be reported as a bond.

44. At the time of transition, reporting entities shall make their best efforts to assess investments to determine whether they qualify within the bond definition for reporting on Schedule D-1. The bond definition requires assessments at the time of acquisition, and it is recognized that reporting entities may not have the means to complete historical assessments for securities held at the time of transition. For these instances, if information is not readily available for reporting entities to assess a security as of the date at acquisition, reporting entities may utilize current information in concluding that a security qualifies for reporting as a bond as either an issuer obligation or asset-backed security.

45. Investments that were reported as a bond on Schedule D-1: Long-Term Bonds as of December 31, 2024 that do not qualify under the principle-based bond concepts shall be reported as a disposal from that schedule, with a reacquisition on the appropriate reporting schedule as of January 1, 2025. These investments shall be accounted for in accordance with the resulting SSAP that addresses the specific investment structure. For securities that are reported at the lower of amortized cost or fair value under the new applicable guidance, ~~T~~this could result with ~~either a gain or~~an unrealized loss in the measurement of the investment at the time of the reclassification. ~~A change resulting from the application of this statement shall be accounted for as a change in accounting principle in accordance with SSAP No. 3.~~ Although the adoption of this guidance is considered a change in accounting principle under SSAP No. 3, the following transition guidance shall be applied on January 1, 2025, to ensure consistency in reporting and to allow investment schedules to roll appropriately:

a. Securities reclassified from Schedule D-1 as they no longer qualify under the bond definition shall be reported as a disposal from Schedule D-1 at amortized cost. Although no proceeds are received, amortized cost at the time of disposal shall be reported as consideration on Schedule D-4.

i. For securities held at amortized cost at the time of disposal, book adjusted carrying value and amortized cost shall agree, preventing gain or loss recognition at the time of reclassification.

ii. For securities held at fair value under the lower of amortized cost or fair value measurement method, previously reported unrealized losses shall be reversed on Jan. 1, 2025, prior to disposal, resulting with a reported value that mirrors amortized cost at the time of disposal. This action prevents realized loss recognition at time of reclassification.

b. Securities reclassified from Schedule D-1 shall be recognized on the subsequent schedule (e.g., Schedule BA) with an actual cost that agrees to the disposal value (amortized cost). Immediately subsequent to recognition on the resulting schedule, the securities shall be reported in accordance with the measurement method prescribed by the applicable SSAP:

i. For securities previously reported at fair value on Schedule D-1 (under a lower of amortized cost or fair value measurement method), the reporting entity will recognize an unrealized loss to match the previously reported book adjusted carrying value. Subsequently, the security will continue to reflect a lower of amortized cost or fair value measurement method.

ii. For securities previously reported at amortized cost on Schedule D-1, if the subsequent statement requires a lower of amortized cost or fair value measurement method, then the reporting entity shall recognize an unrealized loss to the extent fair value is less than amortized cost.

iii. After application of paragraph 45b.i and 45b.ii all securities shall reflect either the same reported value as of December 31, 2024 (amortized cost or fair value) or a lower reported value (if the security is subject to the lower of amortized cost or fair value measurement method). There should be no instances that result with a security having a greater reported value than what was presented on December 31, 2024. Subsequent to transition, securities reported at fair value may incur unrealized gains or losses due to fair value fluctuations, but should never have unrealized gains that result with a book adjusted carrying value that exceeds amortized cost.

46. With this transition guidance, changes in measurement for securities reclassified under the bond definition will be reported as a change in unrealized capital gains (losses) in the first quarter 2025 financial statements (unless sold in the interim with a realized gain or loss) and not as a change in accounting principle. To enable regulators the ability to identify the impact of securities reclassified under the bond definition, the following disclosure for the 2025 first quarter financial statement is required:

a. Aggregate book adjusted carrying value for all securities reclassified off Schedule D-1.

b. Aggregate book adjusted carrying value after transition for all securities reclassified off Schedule D-1 that resulted with a change in measurement basis. (This shall be a subset of paragraph 46a and captures the securities that moved from an amortized cost to a fair value measurement method under the lower of amortized cost or fair value approach.)

c. Aggregate surplus impact for securities reclassified off Schedule D-1. This shall include the difference between book adjusted carrying value as of December 31, 2024 and book adjusted carrying value after transition for those securities that moved from an amortized cost to a fair value measurement method under the lower of amortized cost or fair value approach.

Historical Adoption and Revisions of SSAP No. 26R:

~~43.~~47. For historical reference, the original adoption, and subsequent revisions to SSAP No. 26R prior to the adoption of the principles-based bond definition are detailed below:

a. SSAP No. 26R was originally effective for years beginning January 1, 2001.

b. Guidance for the accounting of securities subsequent to other than temporary impairments was originally effective for reporting periods beginning on January 1, 2009, with early adoption permitted. This guidance was incorporated from *SSAP No. 99—Accounting for Securities Subsequent to an Other-Than-Temporary Impairment* in 2010. The original impairment guidance included in this standard, and the substantive revisions reflected in SSAP No. 99 are retained for historical purposes in Issue Paper No. 131.

c. Guidance pertaining to the accounting for zero-coupon convertible bonds was originally effective December 8, 2002 and was subsequently incorporated into this statement from *INT 02-05: Accounting for Zero Coupon Convertible Bonds*.

d. Guidance adopted in December 2013 clarifying the 'yield-to-worst' concept for bonds with make-whole call provisions was initially effective January 1, 2014, unless the company had previously been following the guidance. (Companies that have previously been following the original intent, as clarified in the revisions, were not impacted by these changes.)

e. The guidance on the calculation of investment income for prepayment penalties and/or acceleration fees was effective January 1, 2017, on a prospective basis and was required for interim and annual reporting periods thereafter, with early application permitted.

f. In April 2017, revisions were incorporated in accordance with the investment classification project. These revisions are detailed in Issue Paper No. 156 and were effective December 31, 2017. These revisions clarified the scope of the bond definition as well as incorporated new guidance for SVO-Identified Bond ETFs identified in scope of this statement. Retained transition / application guidance is captured as follows:

    i. For situations in which there is an interval of time between when a company purchases an investment and when the investment is designated as an SVO-identified investment eligible for systematic value, the book yield should be calculated by equating the book/adjusted carrying value at that time to the portfolio's aggregate cash flows (ACF). For these situations, the ETF shall be reported as a disposed security on the prior reporting schedule and reported as an acquisition.

    ii. In accordance with the systematic value methodology, at the next reporting period date, the reporting entity shall amortize or accrete the carrying value by the difference between the effective interest using the initial book yield, and the distributions received, and shall recalculate the new effective book yield using the new carrying value and ACF as of the last day of the reporting period.

    iii. As the necessary historical ACF data is not available for calculating the initial book yield at acquisition for the net present value constant purchase yield (NPV-CPY) method for impairment recognition, reporting entities shall use recently published yield-to-maturity (YTM) as their constant purchase yield to be applied for NPV-CPY impairment recognition.

    iv. If the investment no longer qualifies as an SVO-Identified Bond ETF in scope of statement, this change shall be reflected prospectively from the effective date. Investments previously included this statement, that will move within the scope of another SSAP and reporting schedule shall be shown as dispositions on and shown as an acquisition on the schedule for which it will be subsequently reported.

b. The guidance to explicitly exclude securities for which the contract amount of the instrument to be paid at maturity (or the original investment) is at risk for other than failure of the borrower to pay the contractual amount due, were effective December 31, 2019.

c. Revisions to clarify existing guidance that all prepayment penalty and acceleration fees for when a bond is liquidated prior to its scheduled maturity date, including those from tendered bonds, shall follow the guidance in SSAP No. 26R was effective January 1, 2021. Reporting entities that have historically applied this guidance shall not change historical practices, but the effective date of January 1, 2021, with early application permitted, was allowed for reporting entities to make systems changes to capture tendered bonds in scope of this guidance.

REFERENCES

Other

- *Purposes and Procedures Manual of the NAIC Investment Analysis Office*
- NAIC Valuation of Securities product prepared by the Securities Valuation Office

Relevant Issue Papers

- *Issue Paper No. 26—Bonds, Excluding Loan-Backed and Structured Securities*
- *Issue Paper No. 131—Accounting for Certain Securities Subsequent to an Other-Than-Temporary Impairment*
- *Issue Paper No. 156—Bonds*
- *Issue Paper No. XX—Principles-Based Bond Definition*

~~**EXHIBIT A – GLOSSARY**~~

~~**Asset-Backed Security** – An asset-backed security is a bond issued by an entity (an "ABS Issuer") created for the primary purpose of raising debt capital backed by financial assets or cash-generating non-financial assets owned by the ABS Issuer, whereby repayment is primarily derived from the cash flows associated with the underlying defined collateral rather than the cash flows of an operating entity. Many ABS Issuers are in the form of a trust or special purpose vehicle ("SPV"), though the presence or lack of a trust or SPV is not a definitive criterion for determining that a security meets the definition of an asset backed security. There are two defining characteristics that must be present for a security to meet the definition of an asset backed security:~~

- ~~Assets owned by the ABS Issuer are either financial assets or cash-generating non-financial assets.~~
- ~~The holder of a debt instrument issued by an ABS Issuer is in a different economic position than if the holder owned the ABS Issuer's assets directly. The holder of the debt instrument is in a different economic position if such debt instrument benefits from sufficient credit enhancement through guarantees (or other similar forms of recourse), subordination and/or overcollateralization.~~

~~**Bank Loan** – Fixed income instruments, representing indebtedness of a borrower, made by a financial institution. Bank loans can be issued directly by a reporting entity or acquired through an assignment, participation or syndication:~~

- ~~**Assignment** – A bank loan assignment is defined as a fixed-income instrument in which there is the sale and transfer of the rights and obligations of a lender (as assignor) under an existing loan agreement to a new lender (and as assignee) pursuant to an Assignment and Acceptance Agreement (or similar agreement) which effects a novation under contract law, so the new lender becomes the direct creditor of and is in contractual privity with the borrower having the sole right to enforce rights under the loan agreement.~~
- ~~**Participation** – A bank loan participation is defined as a fixed-income investment in which a single lender makes a large loan to a borrower and subsequently transfers (sells) undivided interests in the loan to other entities. Transfers by the originating lender may take the legal form of either assignments or participations. The transfers are usually on a nonrecourse basis, and the originating lender continues to service the loan. The participating entity may or may not have the right to sell or transfer its participation during the term of the loan, depending on the terms of the participation agreement. Loan Participations can be made on a parri-passu basis (where each participant shares equally) or a senior subordinated basis (senior lenders get paid first and the subordinated participant gets paid if there are sufficient funds left to make a payment).~~
- ~~**Syndication** – A bank loan syndication is defined as a fixed-income investment in which several lenders share in lending to a single borrower. Each lender loans a specific amount to the borrower and has the right to repayment from the borrower. Separate debt instruments exist between the debtor and the individual creditors participating in the syndication. Each lender in a syndication shall account for the amounts it is owed by the borrower. Repayments by the borrower may be made to a lead lender that then distributes the collections to the other lenders of the syndicate. In those circumstances, the lead lender is simply functioning as a servicer and shall not recognize the aggregate loan as an asset. A loan syndication arrangement may result in multiple loans to the same borrower by different lenders. Each of those loans is considered a separate instrument.~~

~~**Bond** – Securities that qualify under the principles-based bond definition as an issuer credit obligation or asset-backed security. The application of guidance to "bonds" in this standard also encompasses the non-bond items detailed in paragraph 2 specifically identified to receive bond accounting and reporting treatment. SSAP No. 43R includes qualifying asset-backed securities.~~

~~**Cash-Generating Non-Financial Assets** – Assets that are expected to generate a meaningful level of cash flows toward repayment of the bond through use, licensing, leasing, servicing or management fees, or other similar cash flow generation, other than through the sale or refinancing of the assets.~~

~~**Convertible Bond** – A bond that can be converted into a different security, typically shares of common stock.~~

~~**Financial Asset** – SSAP No. 103R defines a financial asset as cash, evidence of an ownership interest in an entity, or a contract that conveys to one entity a right (a) to receive cash or another financial instrument from a second entity or (b) to exchange other financial instruments on potentially favorable terms with the second entity. For the purposes of this standard, financial assets do not include assets for which the realization of the benefits conveyed by the above rights depends on the completion of a performance obligation (e.g., leases, mortgage servicing rights, royalty rights, etc.). These assets represent non-financial assets, or a means through which non-financial assets produce cash flows, until the performance obligation has been satisfied.~~

~~**Issuer Credit Obligation** – An issuer credit obligation is a bond, the repayment of which is supported primarily by the general creditworthiness of an operating entity or entities. Support consists of direct or indirect recourse to an operating entity or entities, which includes holding companies with operating entity subsidiaries where the holding company has the ability to access the operating subsidiaries' cash flows through its ownership rights. An operating entity may be any sort of business entity, not-for-profit organization, governmental unit, or other provider of goods or services, but not a natural person or ABS Issuer.~~

~~**Mandatory Convertible Bonds** – A type of convertible bond that has a required conversion or redemption feature. Either on or before a contractual conversion date, the holder must convert the mandatory convertible bond into the underlying common stock.~~

~~**Meaningful** – What constitutes a "meaningful" level of cash flows generated to service the debt from sources other than the sale or refinancing of the underlying collateral is specific to each transaction, determined at origination, and should consider the following factors:~~

~~1. The price volatility in the principal market for the underlying collateral;~~
~~1. The liquidity in the principal market for the underlying collateral;~~
~~2. The diversification characteristics of the underlying collateral (i.e., types of collateral, geographic location(s), source(s) of cash flows within the structure, etc.);~~
~~3. The overcollateralization of the underlying collateral relative to the debt obligation; and~~
~~4. The variability of cash flows, from sources other than sale or refinancing, expected to be generated from the underlying collateral.~~

~~Factors #1 and #5 are directly related to the "meaningful" requirement. That is, as price volatility or variability of cash flows increase, the required percentage of cash flows generated to service the debt from sources other than the sale or refinancing of the underlying collateral must also increase. Factors #2, #3 and #4 are inversely related to the "meaningful" concept. That is, as liquidity, diversification or overcollateralization increase, the required percentage of cash flows generated to service the debt from sources other than the sale or refinancing of the underlying collateral may decrease.~~

~~**Meaningful Practical Expedient** – As a practical expedient to determining whether a cash generating non-financial asset is expected to produce meaningful cash flows, a reporting entity may consider an asset for which less than 50% of the original principal relies on sale or refinancing to meet the meaningful criteria.~~

~~In applying this practical expedient, only contractual cash flows of the non-financial asset may be considered. This practical expedient should not be construed to mean that assets cannot meet the meaningful criteria if they rely on sale or refinancing to service greater than 50% of the original principal or if they rely on cash flows that are not contracted at origination. Rather, such instances would require a complete analysis of the considerations described within the Meaningful definition.~~

~~**Principal Protected Note / Security**—A principal-protected note / security generally includes a high-quality traditional bond (such as a U.S. Treasury) that is used to safeguard principal repayment at the structure's maturity, but the structure also incorporates other investments, at origination or over the life of the structure, that are intended to generate returns or other assets to the reporting entity note holder. These returns, often based on underlying equity factors or other referenced variables, prevents these structures from qualifying as a creditor relationship. In addition to the traditional design of principal-protected notes, other designs have been identified that may provide "interest" payments in the form of tax-credits based on underlying equity exposures. (So, a high-quality bond still safeguards principal returns, but the structure acquires equity elements that provide tax-credits to the note holder as a form of interest.) Although the classification of a creditor-relationship may not be as clear in this example, such designs would further be disqualified from bond reporting as they would not qualify as issuer credit obligations due to the different forms of collateral within the structure (considering both the bond and equity items) and such structures would not qualify as ABS as there is generally no credit enhancement.~~

~~**Security**—Adopts the GAAP definition of a security as it is used in FASB Codification Topic 320 and 860: 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 by or on behalf of the issuer.~~

~~b. It is of a type commonly dealt in on securities exchanges or markets or, when represented by an instrument, is commonly recognized in any area in which it is issued or dealt in as a medium for investment.~~

~~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.~~

~~**Structured Note**—A structured note is an instrument in which the terms make it possible that the reporting entity holder could lose all or a portion of its original investment amount for a reason other than failure of the issuer to pay the contractual amounts due. These instruments incorporate both the credit risk of the issuer, as well as the risk of an underlying variable/interest, such as the performance of an equity index or the performance of an unrelated security or referenced variable. Due to the underlying variable that determines principal repayment, these structures (regardless of if in a trust/SPV) do not qualify as creditor relationships and do not qualify for bond reporting. Existing guidance identifies that structured notes shall be captured in *SSAP No. 86—Derivatives*~~

~~**Trust Preferred Securities**—With these securities, there is a trust funded by debt where shares of the trust are then sold to investors in the form of preferred stock. The shares held are referred to as "trust preferred" securities. These securities have characteristics of both stock and debt. While the trust is funded with debt, the shares are considered to be preferred stocks and pay dividends like preferred stock. However, since the trust hold's the bank's debt as the funding vehicle, the payments received by investors are considered interest payments. These securities are considered equities under U.S. GAAP, but are taxed as debt obligations by the IRS. With the Dodd-Frank reforms, the incentives for banks to issue trust-preferred securities decreased, resulting with a significant reduction in the issuance of these securities. If these securities continue to be held by insurers, they should be assessed for reporting as a bond under the~~

~~principal-based bond proposal. If these securities do not qualify for bond reporting, presumably, these securities would be reported as preferred stock in scope of SSAP No. 32R.~~

~~**Yankee Bonds** – A bond denominated in U.S. dollars that is publicly issued in the U.S. by foreign banks and corporations. According to the Securities Act of 1933, these bonds must first be registered with the Securities and Exchange Commission (SEC) before they can be sold. Yankee bonds are often issued in tranches.~~

~~**Zero Coupon Bond** – A bond that does not pay interest during the life of the bond. Instead, investors buy zero coupon bonds at a deep discount from their face value, which is the amount a bond will be worth when it "matures" or comes due. When a zero coupon bond matures, the investor will receive one lump sum equal to the initial investment plus the imputed interest, which is discussed below. The maturity dates on zero coupon bonds are usually long-term. Because zero coupon bonds pay no interest until maturity, their prices fluctuate more than other types of bonds in the secondary market. In addition, although no payments are made on zero coupon bonds until they mature, investors may still have to pay federal, state, and local income tax on the imputed or "phantom" interest that accrues each year.~~

~~Exhibit B: Investment Examples – Structure Does Not Represent a Creditor Relationship~~

~~1. As detailed in paragraphs 5-6, the initial determinant in the principles-based bond definition is whether the investment is a security that represents a creditor relationship in substance. Examples included in this exhibit intend to identify scenarios that do not reflect an in-substance creditor relationship.~~

~~2. **Example 1: Debt Instrument from SPV with Large Number of Diversified Equity Interests**: A reporting entity invests in a debt instrument issued by a SPV that holds a large number of diversified equity interests with characteristics that support the production of predictable cash flows. The structure contains sufficient overcollateralization and liquidity provisions to ensure the production of adequate cash flows to service both principal and interest payments without significant reliance on refinancing or sale of the underlying equity investments. The debt instrument's periodic principal or interest payments, or both, contractually vary based on the appreciation or depreciation of the equity interests held in the SPV.~~

~~3. **Example 1 Rationale**: Because the instrument's principal or interest payments, or both, contractually vary with the appreciation or depreciation of the underlying equity interests, it contains an equity-like characteristic that is not representative of a creditor relationship. It would be inappropriate to conclude that a security with any variation in principal or interest payments, or both, due to underlying equity appreciation or depreciation, an equity-based derivative, or other referenced variable, is a bond under this standard as such security would contain equity-like characteristics. A bond under this standard is required to have pre-determined principal and interest payments (whether fixed interest or variable interest).~~

~~4. **Example 2: Debt Instrument from SPV with Few Equity Interests, Not an Issuer Credit Obligation:** A reporting entity invests in a debt instrument issued from a SPV that owns a portfolio of equity interests, and the debt instrument does not meet the definition of an issuer credit obligation~~

~~5. **Example 2 Rationale:** Determining of whether a debt instrument represents a creditor relationship in substance when the source of cash flows for repayment is derived from underlying equity interests inherently requires significant judgment and analysis. Unlike a debt instrument collateralized by assets with contractual cash flows, debt instruments collateralized by equity interests are dependent on cash flow distributions that are not contractually required to be made and are not controlled by the issuer of the debt. As a result, there is a rebuttable presumption that a debt instrument collateralized by equity interests does not represent a creditor relationship in substance. Notwithstanding this rebuttable presumption, it is possible for such a debt instrument to represent a creditor relationship if the characteristics of the underlying equity interests lend themselves to the production of predictable cash flows and the underlying equity risks have been sufficiently redistributed through the capital structure of the issuer. Factors to consider in making this determination include but are not limited to:~~

~~a. Number and diversification of the underlying equity interests~~

~~b. Characteristics of the underlying equity interests (vintage, asset-types, etc.)~~

~~c. Liquidity facilities~~

~~d. Overcollateralization~~

~~e. Waiting period for distributions/paydowns to begin~~

~~f. Capitalization of interest~~

~~g. Covenants (e.g., loan-to-value trigger provisions)~~

~~h. Reliance on ongoing sponsor commitments~~

~~6. While reliance of the debt instrument on sale of underlying equity interests or refinancing at maturity does not preclude the rebuttable presumption from being overcome, it does require that the other characteristics mitigate the inherent reliance on equity valuation risk to support the transformation of~~

~~underlying equity risk to bond risk. As reliance on sale or refinancing increases, the more compelling the other factors needed to overcome the rebuttable presumption become.~~

~~7. Furthermore, this analysis should be conducted and documented by a reporting entity at the time such an investment is acquired. The level of documentation and analysis required will vary based on the characteristics of the individual debt instrument, as well as the level of third party and/or non-insurance company market validation to which the issuance has been subjected. For example, a debt instrument collateralized by fewer, less diversified equity interests would require more extensive and persuasive documented analysis than one collateralized by a larger diversified portfolio of equity interests. Likewise, a debt instrument that has been successfully marketed to unrelated and/or non-insurance company investors, may provide enhanced market validation of the structure compared to one held only by related party and/or insurance company investors where capital relief may be the primary motivation for the securitization.~~

EXHIBIT A - EXAMPLES OF ANALYSIS FOR ASSET-BACKED SECURITIES

1. As detailed in paragraphs 9-10~~4-5~~, the holder of an asset-backed securities is 1) required to be in a different economic position than if the holder owned the ABS Issuer's assets directly, and 2) if the assets owned by the ABS Issuer are cash generating non-financial assets, then the assets are expected to generate a meaningful level of cash flows towards repayment of the bond through use, licensing, leasing servicing or management fees, or other similar cash flow generation. (This guidance requires a meaningful level of cash flows to service the debt other than through the sale or refinancing of the assets.) This appendix details example analysis for these meaningful cash flow and substantive credit enhancements.

2. **Example 1:** A reporting entity invests in debt instruments issued from a SPV sponsored by the Government National Mortgage Association (GNMA), the Federal National Mortgage Association (FNMA) and the Federal Home Loan Mortgage Corporation (Freddie Mac) (collectively, "Agency or Agencies"). These debt instruments pass through principal and interest payments received from underlying mortgage loans held by the SPV to the debtholders proportionally, with principal and interest guaranteed by the Agencies. While there is prepayment and extension risk associated with the repayment of the underlying mortgage loans, the credit risk associated with the mortgage loans is assumed by the Agencies.

3. **Example 1 Rationale:** Although the reporting entity participates on a proportional basis in the cash flows from the underlying mortgage loans held by the SPV, the reporting entity is in a different economic position than if it owned the underlying mortgage loans directly because the credit risk has been redistributed and assumed by the Agencies. This is a substantive credit enhancement because a market participant (i.e., a knowledgeable investor transacting at arm's length) would conclude the Agency guarantee is expected to absorb all losses before the debt instrument being evaluated. Therefore, the holder of the debt instrument is in a substantively different economic position than if the holder owned the ABS Issuer's unguaranteed assets directly, in accordance with the requirements in paragraph 10~~3b~~. When guarantees do not cover 100% of principal and interest as the Agency guarantees do in this example, it is still appropriate to determine if the guarantee is substantive in accordance with the requirements in paragraph 10~~3.b.~~, to determine if the holder is in a substantively different economic position that if the holder held the ABS Issuer's assets directly.

4. **Example 2:** A reporting entity invested in a debt instrument issued by a SPV. Payments under the instrument are secured by a note, a legal assignment from the borrower of a lease for real property and an assignment of the lease payments from an operating entity tenant. Additional security is provided by a mortgage on the leased property (the "underlying collateral"). The leased property is owned by the borrower under the note -- the SPV does not have any ownership interest in the underlying collateral, though it has legal recourse to it through the mortgage. The tenant makes contractually-fixed payments over the life of the lease to the borrower, who has assigned both the lease and the lease payments to the SPV as security for the debt. ~~that owns equipment which is leased to an equipment operator. The equipment operator makes lease payments to the SPV, which are passed through to service the SPV's debt obligation.~~ While the debt

is outstanding, the lease, the lease payments, and the mortgage all serve as security~~the equipment and lease are held in trust and pledged as collateral~~ for the debtholders. Should a default occur, the debtholders can foreclose on and liquidate the ~~equipment~~ real property as well as submit an unsecured lease claim in the lessee's bankruptcy for any defaulted lease payments. The loan-to-value (as a percentage of property value) at origination is 70%.

5. The existing lease payments are sufficient to cover all interest payments and all scheduled debt amortization payments over the life of the debt instrument. However, at debt maturity, there is a balloon payment due, totaling 50% of the original outstanding debt principal amount. The corresponding lease has no balloon payment due at lease maturity, so the SPV will either need to refinance the debt or sell the underlying ~~equipment~~ collateral to service the final debt balloon payment. The property has a high probability of appreciating in value over the term, however ignoring any potential for appreciation, the 50% loan-to-value at maturity is the expected figure at the end of the debt term based solely on scheduled amortization payments.~~The loan-to-value at maturity is expected to decline to 40% considering the scheduled principal amortization payments net of the expected economic depreciation in the equipment value over the term of the debt.~~ The real property~~equipment~~ is expected to be subject to some market value volatility and periods of lower liquidity at certain points in time but has a predictable value range and ready market over a longer period of time, such that the ~~equipment~~ property could be liquidated over a reasonable period of time, if necessary.

6. **Example 2 Rationale:** The ~~equipment~~ lease is a cash generating non-financial asset which is expected to generate a meaningful level of cash flows for the repayment of the bonds ~~via the existing lease that~~which covers all interest payments and 50% of the principal payments. The level of reliance on the collateral value for sale or refinancing is just over the cutoff for using the practical expedient (<50%), so a full analysis is required. In reaching ~~this~~ its determination, the reporting entity considered the predictable nature of the cash flows, which are contractually fixed for the life of the debt instrument, as well as the ability of the underlying collateral value to provide for the balloon payment through sale or refinancing in light of its characteristics. While the ~~equipment~~ real property may have some market value volatility and periods of lower liquidity at points in time, the cash flows produced by the lease were concluded to reduce the loan balance to a level (~~4~~50% loan-to-value) that would be able to be recovered by sale or refinancing at the maturity of the loan~~even if it were to mature at such point in time~~.

7. The reporting entity also determined that the structure provides substantive credit enhancement in the form of overcollateralization to conclude that investors are in a different economic position than holding the ~~equipment~~ real property directly, in accordance with the requirements in paragraph ~~3.b~~10. In reaching this conclusion, the reporting entity noted that although the debt instrument starts with a ~~70~~100% loan-to-value (not including the value of the contractually required lease payments), contractual fixed payments from the lease provide additional security such that the reporting entity is in a different economic position than owning the property directly. Lease cash flows are sufficient to cover the payment of all interest and 50% of the outstanding principal over the term of the lease.~~which continues to improve over the life of the debt as the loan balance amortizes more quickly than the expected economic depreciation on the underlying equipment.~~ In the context of the predictable nature of the cash flows and collateral value range over time, the reporting entity concluded that a market participant (i.e., knowledgeable investor transacting at arm's length) would consider this level of overcollateralization to put the investor in a substantively different economic position than owning the underlying ~~equipment~~ property directly.

8. For the purposes of determining whether there is substantive overcollateralization, it is appropriate to consider any expected economic depreciation, if it is reasonably expected, but it is not appropriate to consider any expected economic appreciation. Note that a debt instrument with a loan-to- value that is expected to decrease over time is not necessarily deemed to have substantive overcollateralization.

9. **Example 3:** A reporting entity invested in a debt instrument with the same characteristics as described in Example 2, except that the existing ~~equipment~~ lease at the time of origination has a contractual term that is shorter than that of the debt instrument. It is expected with a high degree of probability that the

lease will be renewed, and a substantial leasing market exists to replace the lessee should they not renew. However, in the unlikely circumstance that the ~~equipment~~ property cannot be re-leased, there would not be enough cash flows to service the scheduled principal and interest payments, and the ~~equipment~~ property would have to be liquidated to pay off the debt upon default.

10. **Example 3 Rationale:** All details of Example 3, including the expected collateral cash flows, are consistent with those in Example 2, except that the cash flows in Example 2 are contractually fixed for the duration of the debt while the cash flows in Example 3 are subject to re-leasing risk. Notwithstanding the involvement of re-leasing risk, the reporting entity concluded that the ability to re-lease the ~~equipment~~ property was highly predictable and supported the conclusion that the ~~equipment~~ underlying collateral was expected to produce meaningful cash flows to service the debt.

11. This distinction is to highlight that the expected cash flows of a cash-generating non-financial asset may or may not be contractually fixed for the term of the bond. Certain securitized cash flow streams may not by their nature lend themselves to long-term contracts (e.g., single-family home rentals), but may nevertheless lend themselves to the production of predictable cash flows. While the non-contractual nature of the cash flows is an important consideration in determining whether a non-financial asset is expected to produce meaningful cash flows to service the debt, it does not, in and of itself, preclude a reporting entity from concluding that the assets are expected to produce meaningful cash flows.

12. **Example 4:** A reporting entity invested in a debt instrument issued by a SPV that owns equipment which is leased to an equipment operator. The equipment operator makes lease payments to the SPV, which are passed through to service the SPV's debt obligation. While the debt is outstanding, the equipment and lease are held in trust and pledged as collateral for the debtholders. Should a default occur, the debtholders can foreclose on and liquidate the equipment as well as submit an unsecured lease claim in the lessee's bankruptcy for any defaulted lease payments. The loan-to-value at origination is 70%.

13. The existing lease payments are sufficient to cover all interest payments and all scheduled debt amortization payments over the life of the debt instrument. However, at maturity, there is a balloon payment due, totaling 80% of the original outstanding principal amount. The corresponding lease has no balloon payment due at lease maturity, so the SPV will either need to refinance the debt or sell the underlying equipment to service the final debt balloon payment. The loan-to-value at maturity is expected to increase to 95% considering the scheduled principal amortization payments net of the expected economic depreciation in the equipment value over the term of the debt. The equipment is expected to be subject to some market value volatility and periods of lower liquidity at certain points in time, but has a predictable value range and ready market over a longer period of time, such that the equipment could be liquidated over a reasonable period of time, if necessary.

14. **Example 4 Rationale:** The equipment is a cash generating non-financial asset which is not expected to generate a meaningful level of cash flows for the repayment of the bonds via the existing lease that covers all interest payments and 20% of principal payments. In reaching this determination, the reporting entity considered that, while the cash flows being produced are predictable, the ability to recover the principal of the debt investment is almost entirely reliant on the equipment retaining sufficient value to sell or refinance to satisfy the debt.

15. The reporting entity also determined that the structure lacks substantive credit enhancement to conclude that investors are in a different economic position than holding the equipment directly, in accordance with the requirements are in paragraph 10~~3.b~~. In reaching this conclusion, the reporting entity noted that the debt starts with a 70% loan-to-value, but the overcollateralization is expected to deteriorate over the term of the debt as the equipment economically depreciates more quickly than the debt amortizes. This results in a high loan-to-value (i.e., 95%) at maturity, relative to the market value volatility of the underlying collateral. Despite the predictable nature of the cash flows, the reporting entity concluded that the debt instrument lacked a substantive level of overcollateralization to conclude that the investor is in a

different economic position than owning the underlying equipment directly. It was determined that the level of overcollateralization , as determined by a market participant (i.e., a knowledgeable investor transacting at arm's length), is nominal. Therefore, the reporting entity concluded that it was in a substantively similar position as if it owned the equipment directly.

16. For the purposes of determining whether there is substantive overcollateralization, it is appropriate to consider any expected economic depreciation, if it is reasonably expected, but it is not appropriate to factor in any expected economic appreciation. Note that a debt instrument with a loan-to- value that is expected to increase over time is not necessarily deemed to have nominal overcollateralization.

EXHIBIT ~~C~~B – SYSTEMATIC VALUE CALCULATION

The established systematic value method is considered an "aggregated cash flow" (ACF) method in which the cash flow streams from the individual bond holdings are aggregated into a single cash flow stream. These cash flows are scaled such that, when equated with the market price at which the ETF was purchased or sold, an internal rate of return is calculated, representing the investor's initial book yield for the ETF. Although the initial book yield is utilized to determine the current period effective yield, and the resulting adjustments to the ETF's reported (systematic) value, the book yield is recalculated at least quarterly in order to adjust the investor's book yield to reflect current cash flow projections of the current bond holdings within the ETF.

The following calculation shall be followed by reporting entities electing systematic value:

1. Download **cash flows** file from ETF provider website.

NAV:	$115.07	(Official end-of-day NAV found on ETF provider website)
Maturity:	12/8/2027	= SUMPRODUCT (CASHFLOW_DATE column, PRINCIPAL column)/SUM (PRINCIPAL column)
When Paid:	Monthly	
Par Value:	2,500	# shares purchased
Monthly Effective Interest:	$0.40	= (Recalculated Effective Book Yield from prior month x Prior Month Ending Book Value /12)
Distribution:	$0.34	Found on provider website
Net Amortization/Accretion:	$0.06	= (Monthly Effective Interest) – (Distribution)
Prior Month Ending Book Value:	$115.35	
NPV Constant Yield Method:	$117.10	= XNPV (Initial Book Yield, CASHFLOW column, CASHFLOW_DATE column) / 1000000
Initial Book Yield:	4.15%	
Book (Systematic) Value:	$115.41	= (Prior Period Ending Book Value) + (Net "amortization/ accretion")
Expense Ratio:	0.1500%	
Recalculated Effective Book Yield:	4.1639%	=XIRR(CASHFLOW column, CASHFLOW_DATE column, 0.05)

All formulas on the left are at a per share level (excepting "Par Value" which represents the number of shares purchased for this lot).

The resulting values calculated on the left are aggregated to reflect the total number of shares held on the previous tabs reflecting how one might populate the reporting schedule with these values.

Additionally, the cash flows in the data file are based on 1 million shares. This was done in order to make the cash flows easier to observe and work wih (i.e., at a single share level, cash flows would be at fractional dollar levels). Therefore, in order to calculate the yield, investors must multiply the price of the ETF by 1 million shares and then use that value as a cash outflow against the positive cash inflows from the bond portfolio in order to calculate the IRR.

CUSIP	ASOF_DATE	CALL_TYPE	CASHFLOW_DATE	INTEREST	PRINCIPAL	CASHFLOW
2. Insert a row in between the column headings and the cash flow data.		3. Filter for "Call Type" is WORST. (Click "Data" at the top of Excel sheet, then click "Filter" and click the new dropdown box in the "Call Type" cell and select only "WORST.")	4. Enter the date of the cash flow data file underneath cash flow date. **8/31/20X1**			5. Under the column "CASHFLOW" enter the following formula in Excel: =(-Ending Book Value)*1000000 **(115,414,059.56)**
"Ticker"	8/31/20X1	WORST	9/8/20X1	136,538.564	81,472.372	218,010.937
"Ticker"	8/31/20X1	WORST	9/9/20X1	5,990.106	0	5,990.106
"Ticker"	8/31/20X1	WORST	9/10/20X1	9,706.324	0	9,706.324

EXHIBIT ~~D~~C – AMORTIZATION TREATMENT FOR CALLABLE BONDS

Example 1: Call Price Less Than BACV Throughout the Life of the Bond

12/31/2008 – Issuance of Bond. Par = 100/10-Year Bond (Matures 12/31/2018)
01/01/2009 – Call Date/Call Price 107
12/15/2010 – Reporting Entity Acquires Bond. Cost = 106
01/01/2012 – Scheduled Call Date Subsequent to Reporting Entity Acquisition. Call Price 104
01/01/2014 – Scheduled Call Date Subsequent to Reporting Entity Acquisition. Call Price 103
01/01/2016 – Scheduled Call Date Subsequent to Reporting Entity Acquisition. Call Price 102

General Note for Examples: The reporting entity purchased the bond at a premium (cost was greater than par). The 1/1/2009 call date and price is ignored as it occurred prior to the reporting entity acquiring the bond. The bolded numbers represent the lowest asset value at each reporting period. The bond is amortized to the lowest asset value, which in this scenario is amortizing to the call dates and prices. (The standard amortization to the maturity date is shown as it should be compared to the amortization to the call date/price to verify that the BACV at any given reporting date reflects the lowest asset value.)

Date	Action	Cost	Call Price	BACV (Under Call Date/Price)	Amortization to the Lowest Value	BACV Under Standard Amortization
12/15/2010	Acquired	106		106		106
12/31/2011	Lockout Period			**104**	2	105.25
01/01/2012	Call Date		104	**104**		
12/31/2012	Year-End Reporting			**103.5**	0.5	104.50
12/31/2013	Year-End Reporting			**103**	0.5	103.75
01/01/2014	Call Date		103	**103**		
12/31/2014	Year-End Reporting			**102.5**	0.5	103
12/31/2015	Year-End Reporting			**102**	0.5	102.25
01/01/2016	Call Date Exercised		102	**102**		

Standard Amortization
This table shows the amortization with a purchase date of 12/15/2010 at $106 through the maturity date of 12/31/2018.

12/15/2010	12/31/2011	12/31/2012	12/31/2013	12/31/2014	12/31/2015	12/31/2016	12/31/2017	12/31/2018
Amortization	.75	.75	.75	.75	.75	.75	.75	.75
BACV	105.25	104.50	103.75	103	102.25	101.50	100.75	100

	Consideration	Par Value	BACV at Disposal Date	Realized Gain/Loss*
01/01/2016 Call Exercised	102	100	102	(2)

* Per paragraph 26, the entity would recognize a $(2) loss (BACV less par), and investment income of $2 (consideration less par).

Example 2: Call Price Could be Greater Than BACV

12/31/2008 – Issuance of Bond. Par = 100/10-Year Bond (Matures 12/31/2018)
01/01/2009 – Call Date/Call Price 107
12/15/2010 – Reporting Entity Acquires Bond. Cost = 104
01/01/2012 – Scheduled Call Date Subsequent to Reporting Entity Acquisition. Call Price 106
01/01/2014 – Scheduled Call Date Subsequent to Reporting Entity Acquisition. Call Price 103
01/01/2016 – Scheduled Call Date Subsequent to Reporting Entity Acquisition. Call Price 102

The bolded numbers represent the lowest asset value:

Date	Action	Cost	Call Price	BACV (Under Call Date / Price)	Amortization To the Lowest Asset Value	BACV Under Standard Amortization
12/15/2010	Acquired	104		104		104
12/31/2011	Lockout Period		106	104	0.5	**103.50**
01/01/2012	Call Date		106	104		**103.50**
12/31/2012	Year-End Reporting			103.5	0.5	**103**
12/31/2013	Year-End Reporting			103	0.5	**102.50**
01/01/2014	Call Date		103	103		**102.50**
12/31/2014	Year-End Reporting			102.5	0.5	**102**
12/31/2015	Year-End Reporting			102	0.5	**101.50**
01/01/2016	Call Date Exercised		102	102		**101.50**

Standard Amortization
This table shows the amortization with a purchase date of 12/15/2010 at $104 through the maturity date of 12/31/2018.

12/15/2010	12/31/2011	12/31/2012	12/31/2013	12/31/2014	12/31/2015	12/31/2016	12/31/2017	12/31/2018
Amortization	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
BACV	103.50	103	102.50	102	101.50	101	100.50	100

	Consideration	Par Value	BACV at Disposal Date	Realized Gain/Loss*
01/01/2016 Call Exercised	102	100	101.50	(1.50)

* Per paragraph 26, the entity would recognize a $(1.50) loss (BACV less par), and investment income of $2 (consideration less par).

Example 3: Call Price Could be Greater Than BACV

12/31/2008 – Issuance of Bond. Par = 100/10-Year Bond (Matures 12/31/2018)
01/01/2009 – Call Date/Call Price 107
12/15/2010 – Reporting Entity Acquires Bond. Cost = 104
01/01/2012 – Scheduled Call Date Subsequent to Reporting Entity Acquisition. Call Price 106
01/01/2014 – Scheduled Call Date Subsequent to Reporting Entity Acquisition. Call Price 102
01/01/2016 – Scheduled Call Date Subsequent to Reporting Entity Acquisition. Call Price 101

Note – This illustration shows that the evaluation of whether standard amortization (to the maturity date) or the call date price may change over the time. The bolded numbers represent the lowest asset value:

Date	Action	Cost	Call Price	BACV (Under Call Date / Price)	Amortization To the Lowest Asset Value	BACV Under Standard Amortization
12/15/2010	Acquired	104		104		
12/31/2011	Lockout Period		106	104	0.5	**103.50**
01/01/2012	Call Date		106	104		**103.50**
12/31/2012	Year-End Reporting			103	0.5	**103**
12/31/2013	Year-End Reporting			**102**	1	102.50
01/01/2014	Call Date		102	**102**		102.50
12/31/2014	Year-End Reporting			**101.5**	0.5	102
12/31/2015	Year-End Reporting			**101**	0.5	101.50
01/01/2016	Call Date Exercised		101	**101**		101.50

Standard Amortization
This table shows the amortization with a purchase date of 12/15/2010 at $104 through the maturity date of 12/31/2018.

12/15/2010	12/31/2011	12/31/2012	12/31/2013	12/31/2014	12/31/2015	12/31/2016	12/31/2017	12/31/2018
Amortization	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
BACV	103.50	103	102.50	102	101.50	101	100.50	100

	Consideration	Par Value	BACV at Disposal Date	Realized Gain/Loss*
01/01/2016 Call Exercised	101	100	101	(1)

* Per paragraph 26, the entity would recognize a $(1) loss (BACV less par), and investment income of $1 (consideration less par).

Example 4: Continuously Callable Bond – Callable at Par After Initial Lockout Period

12/31/2008 – Issuance of Bond. Par = 100/10-Year Bond (Matures 12/31/2018)
01/01/2009 – Call Date / Call Price 107 – Continuously Callable Thereafter at Par
12/15/2010 – Reporting Entity Acquires Bond. Cost = 104

The bolded numbers represent the lowest asset value:

Date	Action	Cost	Call Price	BACV (Under Call Date/Price)	Amortization To the Lowest Asset Value	BACV Under Standard Amortization
12/15/2010	Acquired	104		100	4	
12/31/2010	Year-End Reporting		100	**100**	There is no subsequent amortization as the premium was fully expensed at acquisition.	104
12/31/2011	Year-End Reporting		100	**100**		103.50
12/31/2012	Year-End Reporting		100	**100**		103
12/31/2013	Year-End Reporting		100	**100**		102.50
12/31/2014	Year-End Reporting		100	**100**		102
12/31/2015	Year-End Reporting		100	**100**		101.50
01/01/2016	Year-End Reporting		100	**100**		101.50

Standard Amortization
This table shows the amortization with a purchase date of 12/15/2010 at $104 through the maturity date of 12/31/2018.

12/15/2010	12/31/2011	12/31/2012	12/31/2013	12/31/2014	12/31/2015	12/31/2016	12/31/2017	12/31/2018
Amortization	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
BACV	103.50	103	102.50	102	101.50	101	100.50	100

	Consideration	Par Value	BACV at Disposal Date	Realized Gain/Loss*
01/01/2016 Call Exercised	100	100	100	0

* Since the call price is par and could occur immediately after acquisition, the premium is immediately expensed. When the bond is called, there is no gain or loss as the consideration received equals the BACV.

Example 5: Determination of Prepayment Penalty When Call Price is Less Than Par

Call Price Less than Par					
Entity 1				**Entity 2**	
Par	100			Par	100
BACV	24			BACV	25
Consideration	26			Consideration	26
Explicit fee	1			Explicit fee	1
Remaining consideration	25			Remaining consideration	25
Gain	2			Gain	0
Income*	0			Income**	1

*Entity 1 does not have in place a process to identify explicit prepayment penalty or acceleration fees.

**Entity 2 has in place a process to identify explicit prepayment penalty or acceleration fees.

Proposed Revisions to SSAP No. 43R

Summary of Revisions:

1. All Changes Exposed at the Summer NM have been accepted with new edits shown as tracked. (This has been done for readability and to highlight changes from the prior exposure.)

2. Paragraphs 1: Revisions to clarify that the guidance for determining whether a security complies with the bond definition is in SSAP No. 26R.

3. Paragraphs 2: Revisions to include Freddie-Mac When-Issued Trust Certificates in INT 22-01.

4. Paragraph 4: Revisions to reference SSAP No. 26R for determining qualifying ABS and to only reference "securities" and not "security structures".

5. Paragraphs 5-9: Deleted. This guidance was pulling in aspects of the bond definition specific to ABS. With the pointer to SSAP No. 26R, which will capture the entire bond definition, the guidance has been removed. Paragraphs have been renumbered accordingly.

6. Paragraph 18: Revisions reference 'high credit quality' investments for the retrospective method and specifies that determination is made at the time of acquisition. This also has a revised footnote.

7. Paragraphs 21-25: Revisions to clarify guidance on the assessment of cash flows. This guidance includes revisions to specify that if a security is in an unrealized loss position and there is an adverse change in cash flows, this requires recognition of an OTTI. Also, prior references to 'reference amount' or 'carrying value' have been revised to reflect 'amortized cost.'

8. Paragraph 26: Clarification on application unless an OTTI has occurred.

9. Paragraph 30: Reference to guidance included for when an OTTI has occurred.

10. Paragraphs 47-51: Revisions incorporate specialized transition guidance and a transition disclosure. This guidance prescribes how to reclassify securities to the subsequent applicable schedule to ensure that the schedules (verification) continue to roll. This also includes moving from DA / E2.

11. Appendix A: Deleted. This previously included guidance from the principles-based bond definition on examples for the analysis of asset-backed securities. This has been moved to SSAP No. 26R.

12. Q&A Implementation Guide – Updated for ABS (instead of LBSS), paragraph references and deleted paragraph 5.2 (page 25.)

13. Other: Lingering references to 'loan-backed and structured security' have been revised to 'asset-backed security' throughout the document.

14. Note: Although the acronym ABS can be used for asset-backed securities, consistent with the prior SSAP, in most instances the full phrase asset-backed security has often been used. This has been noted to provide an easier read and is intentional. However, if preferred, further consideration could occur to replace with the acronym.

15. Footnote references will be updated when all revisions have been accepted. (This will be an automatic update once deleted footnotes are removed from the guidance.)

Statement of Statutory Accounting Principles No. 43 - Revised

Asset-Backed Securities

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for each security investment that qualifies as an asset-backed security (ABS) under the principles-based bond definition detailed in *SSAP No. 26R—Bonds*. Each security shall be individually assessed under the bond definition to determine applicability as an asset-backed security and reported separately regardless of whether the security was issued in combination or as a unit with other investments. Items captured in scope of this statement are collectively referred to as asset-backed securities.

2. In addition to security investments that qualify under the principles-based definition as an asset-backed security, certain specific investments are also captured in scope of this statement:

a. Mortgage Referenced Securities that do not meet the definition of an asset-backed security. In order to qualify as a mortgage-referenced security, the security must be issued by a government sponsored enterprise[1] or by a special purpose trust in a transaction sponsored by a government sponsored enterprise in the form of a "credit risk transfer." In these situations, the issued security is tied to a referenced pool of mortgages and the payments received are linked to the credit and principal payment risk of the underlying mortgage loan borrowers captured in the referenced pool of mortgages. For these instruments, reporting entity holders may not receive a return of their full principal as principal repayment is contingent on repayment by the mortgage loan borrowers in the referenced pool of mortgages. Unless specifically noted, the provisions within this standard apply to mortgage-referenced securities. (P5)

~~a.~~b. Freddie-Mac When Issued K-Deal (WI Trust) Certificates fully guaranteed by Freddie Mac are included in scope of this statement from original acquisition, and not initially reported as a derivative forward contract. (INT 22-01)

3. Securities captured in scope of this statement are not permitted to be reported as cash equivalents or short-term investments in scope of *SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments* even if acquired within one year or less from the maturity date. Investments captured in scope of SSAP No. 2R are intended to reflect situations in which limited risk remains, either from changes in credit-quality or interest rates, due the short-duration until maturity. As ultimate cash flows from asset-backed securities may have other risks beyond default risk or interest rate risk (such as performance factors, balloon payments, collateral quality) reporting as a cash equivalent or short-term investment is not permitted to prevent inappropriate assumptions of the investment's remaining potential risk.

4. This statement excludes:

a. Securities~~y structures~~ captured in scope of *SSAP No. 26R—Bonds*.

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

b. Mortgage loans in scope of *SSAP No. 37—Mortgage Loans* that qualify under an SVO structural assessment as SVO-Identified Credit Tenant Loans. These investments are excluded as these are captured as issuer credit obligations under SSAP No. 26R.

c. Securities~~y structures~~ that do not qualify as Asset-Backed Securities per the bond definition in *SSAP No. 26R—Bonds*.~~, including structures that provide varying principal or interest based on underlying equity appreciation or depreciation, an equity-based derivative, or other referenced variable. This includes principal-protected notes (or principal-protected securities) and structured notes[2] that have any components within the structure that provide returns based on underlying reference variables.~~

SUMMARY CONCLUSION

Principles-Based Bond Definition - Asset-Backed Security

~~5. An asset[3]-backed security is a bond issued by an entity (an "ABS Issuer") created for the primary purpose of raising debt capital backed by financial assets[4] or cash-generating non-financial assets owned by the ABS Issuer, whereby repayment is primarily derived from the cash flows associated with the underlying defined collateral rather than the cash flows of an operating entity[5]. In most instances, the ABS Issuer is not expected to continue functioning beyond the final maturity of the debt initially raised by the ABS Issuer. Also, many ABS Issuers are in the form of a trust or special purpose vehicle ("SPV"), though the presence or lack of a trust or SPV is not a definitive criterion for determining that a security meets the definition of an asset backed security.~~

~~a. Pursuant to SSAP No. 26R, a bond is any security representing a creditor relationship, whereby there is a fixed schedule for one or more future payments, and which qualifies as either an issuer credit obligation or an asset backed security. (Bonds that qualify as issuer credit obligations are in scope of SSAP No. 26R.)~~

~~[2] The structural design of principal-protected notes and structured notes precludes these investments from being captured as issuer credit obligations or ABS on Schedule D-1 as such investments do not represent a creditor relationship in substance. The principles-based bond definition is intended to require a structural assessment inclusive of all investment components, therefore it is not permissible to segregate components within a structure, such as bond collateral supporting principal and interest payments when the structure also includes other collateral with the potential to general additional interest or returns. Such structures must be viewed wholistically within the principles-based bond definition, with all potential returns considered in determining whether the structure qualifies as a creditor relationship.~~

~~[3] The underlying collateral supporting an asset backed security shall meet the definition of an asset by the ABS Issuer. Certain forms of collateral, such as rights to future cash flows, may not be recognized as assets by the selling entity but may be recognized as assets when sold to an ABS Issuer. These assets are permitted as the collateral supporting an asset-backed security, although they may not represent an asset that can be liquidated to provide payment toward the issued debt obligations (i.e., if the future cash flows do not materialize). The limited ability to liquidate the underlying collateral supporting an asset-backed security does not impact the structural determination of whether an issued security meets the definition of an asset backed security but may impact the recoverability of the investment, as well as the consideration of whether there is substantive credit enhancement.~~

~~[4] *SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* defines a financial asset as cash, evidence of an ownership interest in an entity, or a contract that conveys to one entity a right (a) to receive cash or another financial instrument from a second entity or (b) to exchange other financial instruments on potentially favorable terms with the second entity. As a point of clarity, for the purposes of this standard, financial assets do not include assets for which the realization of the benefits conveyed by the above rights depends on the completion of a performance obligation (e.g., leases, mortgage servicing rights, royalty rights, etc.). These assets represent non-financial assets, or a means through which non-financial assets produce cash flows, until the performance obligation has been satisfied.~~

~~[5] Dedicated cash flows from an operating entity can form the underlying defined collateral in an asset-backed security. This dynamic, perhaps noted in a whole-business securitization, still reflects an asset backed security in scope of this statement and not an issuer credit obligation in scope of SSAP No. 26R.~~

~~b. Determining whether a security represents a creditor relationship should consider its substance, rather than solely the legal form of the instrument. The analysis of whether a security represents a creditor relationship should consider all other investments the reporting entity owns in the investee as well as any other contractual arrangements. A security that in substance possesses equity-like characteristics or represents an ownership interest in the issuer does not represent a creditor relationship.~~

~~c. Whether a structure qualifies as a security that reflects an in-substance creditor relationship, and whether it represents an issuer credit obligation or ABS pursuant to the principles-based bond definition detailed in SSAP No. 26R shall be determined prior to the application of the ABS guidance within this statement.~~

~~6. There are two defining characteristics that must be present for a security to meet the definition of an asset backed security[6]:~~

~~a. The assets owned by the ABS Issuer are either financial assets or cash-generating non-financial assets. Cash-generating non-financial assets are defined as assets that are expected to generate a meaningful level of cash flows toward repayment of the bond through use, licensing, leasing, servicing or management fees, or other similar cash flow generation. (For the avoidance of doubt, there must be a meaningful level of cash flows to service the debt, other than through the sale or refinancing of the underlying assets held by the ABS Issuer). Reliance on cash flows from the sale or refinancing of cash generating non-financial assets does not preclude a security from being classified as an asset-backed security so long as the conditions in this paragraph are met.~~

~~b. The holder of a debt instrument issued by an ABS Issuer is in a different economic position than if the holder owned the ABS Issuer's assets directly. The holder of the debt instrument is in a different economic position if such debt instrument benefits from substantive credit enhancement through guarantees (or other similar forms of recourse), subordination and/or overcollateralization. The debt instrument must have pre-determined principal and interest payments (whether fixed interest or variable interest) with contractual amounts that do not vary based on the appreciation or depreciation (i.e., performance) of any underlying collateral value or other variable. For example, an issued security that has varying principal and interest payments based on the appreciation of referenced equity, real estate or other variable is precluded from bond treatment. Plain vanilla adjustments (such as U.S. TIPs in scope of SSAP No. 26R) are not captured within these appreciation or depreciation adjustment exclusions and therefore are not excluded from bond classification. (For clarification purposes, all returns from an ABS are required to be considered as interest. Therefore, investments with "stated" interest and then "additional returns" to which the holder of the debt instrument is entitled are collectively considered as interest and shall be assessed together in determining whether the investment has variable principal or interest due to underlying reference variables.)~~

~~7. *Meaningful Level of Cash Flows*: Determining what constitutes a "meaningful" level of cash flows generated to service the debt from sources other than the sale or refinancing of the underlying collateral pursuant to paragraph 6a is specific to each transaction, determined at origination, and shall consider the following factors:~~

~~1. The price volatility in the principal market for the underlying collateral;~~

~~[6] Appendix ___ includes examples of analysis for asset backed securities.~~

~~1. The liquidity in the principal market for the underlying collateral;~~
~~2. The diversification characteristics of the underlying collateral (i.e., types of collateral, geographic location(s), source(s) of cash flows within the structure, etc.);~~
~~3. The overcollateralization of the underlying collateral relative to the debt obligation; and~~
~~4. The variability of cash flows, from sources other than sale or refinancing, expected to be generated from the underlying collateral.~~

~~Factors #1 (price variability) and #5 (variability of cash flows) are directly related to the "meaningful" requirement. That is, as price volatility or variability of cash flows increase, the required percentage of cash flows generated to service the debt from sources other than the sale or refinancing of the underlying collateral must also increase. Factors #2 (liquidity), #3 (diversification) and #4 (overcollateralization) are inversely related to the "meaningful" concept. That is, as liquidity, diversification or overcollateralization increase, the required percentage of cash flows generated to service the debt from sources other than the sale or refinancing of the underlying collateral may decrease.~~

~~8. As a practical expedient to determining whether a cash generating non-financial asset is expected to produce meaningful cash flows, a reporting entity may consider an asset for which less than 50% of the original principal relies on sale or refinancing to meet the meaningful criteria. In applying this practical expedient, only contractual cash flows of the non-financial assets may be considered. This practical expedient should not be construed to mean that assets cannot meet the meaningful criteria if they rely on sale or refinancing to service greater than 50% of the original principal or if they rely on cash flows that are not contracted at origination. Rather, such instances would require a complete analysis of the considerations described within the meaningful level of cash flows definition in paragraph 7.~~

~~9. *Substantive Credit Enhancement:* Pursuant to paragraph 6b, the intent of the criteria requiring the holder to be in a different economic position is to distinguish qualifying bonds from instruments with equity-like characteristics or where the substance of the transaction is more closely aligned with that of the underlying collateral. To qualify as an ABS under this standard, there is a requirement that there are substantive credit enhancements within the structure that absorb losses before the debt instrument being evaluated would be expected to absorb losses. This is inherent in the context of an issuer credit obligation in scope of SSAP No. 26R as the owners of the equity in the operating entity are the first to absorb any variability in performance of the operating entity. The same concept applies to asset-backed securities. If substantive credit enhancement did not exist, the substance of the debt instrument being evaluated would be more closely aligned with that of the underlying collateral than that of a bond. Credit enhancement that is merely nominal or lacks economic substance does not put a holder in a different economic position. The substantive credit enhancement required to be in a different economic position is specific to each transaction; determined at origination; and refers to the level of credit enhancement a market participant (i.e., knowledgeable investor transacting at arm's length) would conclude is substantive.~~

~~a. The first loss position may be issued as part of a securitization in the form of a debt or equity interest, or it may be retained by the sponsor and not issued as part of the securitization. If the first loss position (or a more senior position(s), if the first loss position(s) lacks contractual payments along with a substantive credit enhancement) is issued as part of the securitization, and does not have contractual principal and interest payments along with substantive credit enhancement and is held by a reporting entity, the structure does not qualify for reporting as a bond and should be reported on Schedule BA: Other Long-Term Invested Assets.~~

~~10.~~5. Investments within the scope of this statement issued by a related party or acquired through a related party transaction or arrangement are also subject to the provisions, admittance assessments and disclosure requirements *of SSAP No. 25—Affiliates and Other Related Parties.* In determining whether a security is a related party investment, consideration should be given to the substance of the transaction, and the parties

whose action or performance materially impacts the insurance reporting entity holding the security. Asset-backed securities meet the definition of assets as defined in *SSAP No. 4—Assets and Nonadmitted Assets* and are admitted assets to the extent they conform to the requirements of this statement and SSAP No. 25.

a. Although an asset-backed security may be acquired from a non-related issuer, if the assets held in trust predominantly[7] reflect assets issued by affiliates of the insurance reporting entity, and the insurance reporting entity only has direct recourse to the assets held in trust, the transaction shall be considered an affiliated investment. In such situations where the underlying collateral assets are issued by related parties that do not qualify as affiliates, these securities shall be identified as related party investments in the investment schedules.

b. An asset-backed security may involve a relationship with a related party but not be considered an affiliated investment. This may be because the relationship does not result in direct or indirect control of the issuer or because there is an approved disclaimer of control or affiliation. Regardless of whether investments involving a related party relationship are captured in the affiliated investment reporting lines, these securities shall be identified as related party investments in the investment schedules. Examples of related party relationships would include involvement of a related party in sponsoring or originating the ~~loan-backed or structured~~asset-backed security or any type of underlying servicing arrangement. For the avoidance of doubt, investments from any arrangement that results in direct or indirect control, including control through a servicer or other controlling arrangement, shall be reported as affiliated in accordance with *SSAP No. 25—Affiliates and Other Related Parties*.

Initial Reporting Value and Recognition of Origination and Commitment Fees & Costs

~~11.~~6. Items in scope of this statement shall initially be reported at cost, including brokerage and related fees, unless otherwise detailed in paragraph ~~13~~8. Acquisitions and dispositions shall be recorded on the trade date, not the settlement date, except for the acquisition of private placement asset-backed securities which shall be recorded on the funding date. For securities where all information is not known as of the trade date (e.g., actual payment factors and specific pools), a reporting entity shall make its best estimate based on known facts. (P8)

~~12.~~7. For assets that qualify in scope of this statement that result from a securitization or transfer of assets by the reporting entity captured in SSAP No. 103R, the guidance in that SSAP determines the initial reporting value:

a. For asset-backed securities resulting from transfers of participating interests that qualify as a sale, the participating interests in financial assets that continue to be held by the reporting entity transferor shall be measured and reported at the date of transfer by allocating the previous carrying amount between the participating interests transferred and sold, and the participating interests that are not transferred and continue to be held by the reporting entity, based on their relative fair values.

[7] In applying this guidance, a reporting entity is not required to complete a detailed review of the assets held in trust to determine the extent, if any, the assets were issued by related parties. Rather, this guidance is a principle concept intended to prevent situations in which related party transactions (particularly those involving affiliates) is knowingly captured in a SSAP No. 43R structure and not identified as a related party transaction (or not reported as an affiliated investment on the investment schedule) because of the involvement of a non-related trustee or SSAP No. 43R security issuer. As identified in *SSAP No. 25—Affiliates and Other Related Parties*, it is erroneous to conclude that the inclusion of a non-related intermediary, or the presence of non-related assets in a structure predominantly comprised of related party investments, eliminates the requirement to identify and assess the investment transaction as a related party arrangement.

b. For asset-backed securities resulting from transfers of an entire financial asset or group of entire financial assets that qualify as a sale, assets obtained, including beneficial interests, shall be initially recognized at fair value.

c. For asset-backed securities resulting from the transfer of assets that do not qualify as sales, the reporting entity transferor shall continue to report the transferred financial assets with no change in measurement.

~~13.~~8. Costs related to origination when paid in the form of brokerage and other related fees shall be capitalized as part of the cost of the asset-backed security. All other costs, including internal costs or costs paid to an affiliated entity related to origination, purchase, or commitment to purchase asset-backed securities, shall be charged to expense when incurred. (P44)

~~14.~~9. Origination fees represent fees charged to the borrower (paid to the reporting entity) in connection with the process of originating or restructuring a transaction. The fees include, but are not limited to, points, management, arrangement, placement, application, underwriting, and other fees pursuant to such a transaction. Origination fees shall not be recorded until received in cash. Origination fees intended to compensate the reporting entity for interest rate risks (e.g., points), shall be amortized into income over the term of the ~~loan-backed or structured~~asset-backed security consistent with paragraph ~~17~~ 12 of this statement. Other origination fees shall be recorded as income upon receipt. (P43)

~~15.~~10. Commitment fees are fees paid to the reporting entity that obligate the reporting entity to make available funds for future borrowing under a specified condition:

a. A fee paid to the reporting entity to obtain a commitment to make funds available at some time in the futureis generally refundable only if the ~~loan-backed or structured~~asset-backed security is issued. If the security is not issued, then the fees shall be recorded as investment income by the reporting entity when the commitment expires. (P45)

b. A fee paid to the reporting entity to obtain a commitment to borrow funds at a specified rate and with specified terms quoted in the commitment agreement is generally not refundable unless the commitment is refused by the reporting entity. This type of fee shall be deferred, and amortization shall depend on whether or not the commitment is exercised. If the commitment is exercised, then the fee shall be amortized in accordance with paragraph ~~17~~ 12 of this statement over the life of the asset-backed security as an adjustment to the investment income on the security. If the commitment expires unexercised, the commitment fee shall be recognized in income on the commitment expiration date. (P46)

Subsequent Carrying Value Method, Amortization, Accruals and Prepayment Penalties

~~16.~~11. After initial recognition, the carryng value shall be determined in accordance with the reported NAIC designation. The determination of NAIC designations shall be in accordance with the requirements detailed in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual)[8]: (P26)

a. For reporting entities that maintain an Asset Valuation Reserve (AVR), ~~loan-backed and structured~~asset-backed securities, excluding residual tranches or interests, shall be reported at amortized cost, except for those with an NAIC designation of 6, which shall be reported at the lower of amortized cost or fair value.

[8] Paragraphs 39-40 provide guidance on the NAIC financial modeling approach applicable to certain securities in determining NAIC designations.

b. For reporting entities that do not maintain an AVR, ~~loan-backed and structured~~asset-backed securities designated highest-quality and high-quality (NAIC designations 1 and 2, respectively), excluding residual tranches or interests, shall be reported at amortized cost; loan-backed and structured securities that are designated medium quality, low quality, lowest quality and in or near default (NAIC designations 3 to 6, respectively) shall be reported at the lower of amortized cost or fair value.

c. For residual tranches or interests[9] captured in scope of this statement, all reporting entities shall report the item on Schedule BA: Other Long-Term Invested Assets at the lower of amortized cost or fair value. Changes in the reported value from the prior period shall be recorded as unrealized gains or losses. For reporting entities that maintain an AVR, the accounting for unrealized gains and losses shall be in accordance with *SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve*.

~~17.~~12. Amortization of premium or discount shall be calculated using the scientific (constant yield) interest method and shall be recorded as an adjustment to investment income.(INT 07-01) The interest method results in a constant effective yield equal to the prevailing rate at the time of purchase or at the time of subsequent adjustments to book value. The amortization period shall reflect estimates of the period over which repayment of principal of the asset-backed securities is expected to occur, not the stated maturity period. (P9)

~~18.~~13. Interest shall be accrued using the effective-yield method using the redemption prices and redemption dates used for amortizing premiums and discounts. Interest income consists of interest collected during the period, the change in the due and accrued interest between the beginning and end of the period as well as reductions for premium amortization and interest paid on acquisition of ~~loan-backed and structured~~ asset-backed securities, and the addition of discount accrual. Contingent interest may be accrued if the applicable provisions of the underlying contract and the prerequisite conditions have been met. (P10)

~~19.~~14. An asset-backed security may provide for a prepayment penalty or acceleration fee in the event the investment is liquidated prior to its scheduled termination date. These fees shall be reported as investment income when received. (P12)

~~20.~~15. The amount of prepayment penalty and/or acceleration fees to be reported as investment income shall be calculated as follows: (P13)

a. The amount of investment income reported is equal to the total proceeds (consideration) received less the par value of the investment; and

b. Any difference between the book adjusted carrying value (BACV) and the par value at the time of disposal shall be reported as realized capital gains and losses subject to the authoritative literature in SSAP No. 7.

Assessment of Cash Flows and Impact of Prepayments

~~21.~~16. Prepayments can be a significant variable element in the cash flows received fromasset-backed securities because they may affect the yield and determine the expected maturity against which the yield is evaluated. For example, with a mortgage-backed security, falling interest rates generate faster prepayment

[9] Reference to "residual tranches or interests" intends to capture securitization tranches and beneficial interests as well as other structures captured in scope of this statement that reflect loss layers without any contractual payments, whether principal or interest, or both. Payments to holders of these investments occur after contractual interest and principal payments have been made to other tranches or interests and are based on the remaining available funds. Although payments to holders can occur throughout an investment's duration (and not just at maturity), such instances still reflect the residual amount permitted to be distributed after other holders have received contractual interest and principal payments.

of the mortgages underlying the security, shortening its duration. This causes the reporting entity to reinvest assets sooner than expected at potentially less advantageous rates. This is called prepayment risk. Extension risk is created when rising interest rates slow repayment and can significantly lengthen the duration of the security. In addition to interest rate risk, other factors can influence the cash flows generated from an asset-backed securities. These factors include, but are not limited to, defaults of the underlying payors as well as performance requirements that must occur before cash flows can be generated from the underlying assets (such as with leases or royalty rights). If the underlying assets are delinquent or otherwise not generating expected cash flows, such items should be reflected in the cash flow analysis through diminishing security cash flows. Updated cash flow assessments shall continue to occur even if the underlying assets have not been liquidated and regardless of whether an other-than-temporary loss has been recognized. (P14)

~~22.~~17. Changes in currently estimated cash flows, including the effect of prepayment assumptions, on all asset-backed securities shall be reviewed periodically, at least quarterly. The prepayment rates of the underlying assets ~~(as applicable)~~ shall be used to determine prepayment assumptions. Prepayment assumptions shall be applied consistently across portfolios to all asset-backed securities backed by similar collateral (similar with respect to coupon, issuer, and age of collateral). Reporting entities shall use consistent assumptions across portfolios for similar collateral within controlled affiliated groups. Since each reporting entity may have a unique method for determining the prepayment assumptions, it is impractical to set standard assumptions for the industry. Relevant sources and rationale used to determine each prepayment assumption shall be documented by the reporting entity. (P15)

~~23.~~18. Asset-backed securities shall be revalued using the currently estimated cash flows, including new prepayment assumptions. Reporting entities may utilize the prospective adjustment method for all asset-backed securities, or they may elect to utilize the retrospective adjustment methodology to specific asset-backed securities that are reported with NAIC ~~1~~ designations that are of high credit quality[10] at the time of acquisition by the reporting entity. That is, the reporting entity shall determine if it will apply the retrospective or prospective method at the time of acquisition depending on the NAIC designation at that time and can only apply retrospective (as a policy election) to securities that of high credit. Subsequently, if an investment is downgraded below high credit qualify, the reporting entity may continue to apply the retrospective method unless the security is other-then-temporarily impaired. (P16)

~~24.~~19. The prospective approach recognizes, through the recalculation of the effective yield to be applied to future periods, the effects of all cash flows whose amounts differ from those estimated earlier and the effects and changes in projected cash flows. Under the prospective method, the recalculated effective yield will equate the ~~carrying amount~~amortized cost of the investment to the present value of the anticipated future cash flows. The recalculated yield is then used to accrue income on the investment balance for subsequent accounting periods. There are no accounting changes in the current period unless the security is determined to be other than temporarily impaired. (P17)

~~25.~~20. The retrospective methodology changes both the yield and the ~~asset balance~~amortized cost so that expected future cash flows produce a return on the investment equal to the return now expected over the life of the investment as measured from the date of acquisition. Under the retrospective method, the

[10] Under U.S. GAAP, application of the retrospective method for beneficial interests in securitized financial assets, which would generally encompass most asset backed securities defined within SSAP 43R, is limited to "high quality" investments. This has been interpreted to be investments with AA or better ratings. ~~Under U.S. GAAP, application of the retrospective method for beneficial interests in securitized financial assets, which would generally encompass most asset backed securities defined within SSAP 43R, is limited to "high quality" investments. This has been interpreted to be investments with AA or better ratings. Under the NAIC designation mapping, this equates to an NAIC 1 designation. For purposes of SAP, reporting entities may elect to apply the prospective method to all securities, however, the retrospective method is limited to the NAIC 1 designated investments. Reporting entities are not required to apply the retrospective method in all allowable situations and are permitted to only apply the retrospective method to selected NAIC 1 securities. The NAIC 1 designation also include single A ratings, therefore mandating the retrospective approach to all NAIC 1 securities would force companies to utilize different methods for the same security between U.S. GAAP and SAP.~~

recalculated effective yield will equate the present value of the actual and anticipated cash flows with the original cost of the investment. The current amortized cost basis for the asset-backed security is then increased or decreased to the amount that would have resulted had the revised yield been applied since inception, and investment income is correspondingly decreased or increased. (P18)

Accretable Yield and Changes to Effective Yield for Application of Prospective Method

~~26.~~21. At initial acquisition of an asset-backed security, the reporting entity shall determine the accretable yield. The accretable yield is the excess of cash flows expected to be collected over the reporting entity's initial investment in the asset-backed security. The accretable yield shall be recognized as interest income on an effective-yield basis over the life of the asset-backed security[11]. The nonaccretable difference is the contractually required payments in excess of the cash flows expected to be collected. The nonaccretable difference shall not be recognized as an adjustment to yield, a loss accrual or a valuation allowance for credit risk. For transactions initially captured in SSAP No. 103R resulting from a reporting entity's transfer of assets, all cash flows estimated at the transaction date are defined as the holder's estimate of the amount and timing of estimated future principal and interest cash flows used in determining the purchase price or the holder's fair value for purposes of determining a gain or loss under SSAP No. 103R. (P20 – In Part) (FASB Glossary / ASC 325-40-35-1 & 3) *(Note – Modified to be applicable to all ABS and not just those with known credit deterioration.)*

~~27.~~22. After the transaction date, cash flows expected to be collected are defined as the holder's estimate of the amount and timing of the estimated principal and interest cash flows based on the holder's best estimate of current considerations and reasonable and supportable forecasts. Expected cash flows are re-evaluated each quarter to determine if there has been a favorable (or an adverse) change in cash flows versus the previous estimate. ~~For transactions initially captured in SSAP No. 103R resulting from a reporting entity's transfer of assets, all cash flows estimated at the transaction date are defined as the holder's estimate of the amount and timing of estimated future principal and interest cash flows used in determining the purchase price or the holder's fair value determination for purposes of determining a gain or loss under SSAP No. 103R. (ASC 325-40-35-3/ P25)~~

~~28.~~23. If upon evaluation there is a favorable (or an adverse) change in cash flows expected to be collected from the cash flows previously projected, the reporting entity shall recalculate the amount of accretable yield for the asset-backed security on the date of evaluation as the excess of cash flows expected to be collected over the assert-backed security's current amortized cost~~reference amount~~. The amortized cost~~reference amount~~ is equal to the initial investment minus cash received to date, minus write-offs of the amortized cost basis (e.g., recognized other than temporary impairments) plus the yield accreted to date. If the security is in an impaired state (meaning, fair value is less than amortized cost, regardless if an unrealized loss has been recognized because the security is reported at amortized cost) and there is an adverse change in cash flows expected to be collected, an other-than-temporary impairment shall be considered to have occurred as described in paragraph 30 and requires recognition of a realized loss pursuant to paragraph 35. However, an adverse change in cash flows due solely to changes in the interest rate of a "plain-vanilla", variable-rate asset-backed security generally shall not result in the recognition of an other-than-temporary impairment (a plan-vanilla, variable-rate asset-backed investment does not include those variable-rate investments with interest rate reset formulas that involve either leverage or an inverse floater). (ASC 325-40-35-4, 4A and 4B)

~~29.~~24. A favorable (or an adverse) change in cash flows expected to be collected is considered in the context of both timing and amount of the cash flows expected to be collected. Based on cash flows expected

[11] An asset-backed security may be acquired at a discount because of a change in credit quality or rate or both. When a security is acquired at a discount that relates, at least in part, to the security's credit quality, the effective interest rate is the discount rate that equates the present value of the investor's estimate of the security's future cash flows with the purchase price of the security.

to be collected, interest income may be recognized on an asset-backed security even if the net investment in the asset-backed security is accreted to an amount greater than the amount at which the asset-backed security could be settled if prepaid immediately in its entirety. The adjustment shall be accounted for prospectively as a change in estimate in conformity ~~under~~ with SSAP No. 3, with the amount of periodic accretion adjusted over the remaining life of the asset-backed security.

25. Determining whether there has been a favorable (or an adverse) change in cash flows expected to be collected from the cash flows previously projected (taking into consideration both the timing and amount of the cash flows expected to be collected) involves comparing the present value of the remaining cash flows expected to be collected at the initial transaction date (or at the last date previously revised) against the present value of the cash flows expected to be collected at the current financial reporting date. Both the current and previous sets of cash flows ~~The cash flows~~ shall be discounted at a rate equal to the current yield used to accrete the asset-backed security. (ASC 325-40-35-5 & 6.)

Recognition of Realized and Unrealized Gains and Losses and Impairment Guidance

~~30.~~26. Asset-backed securities required to be reported at the lower of amortized cost or fair value shall report changes from the prior reporting period as unrealized gains or losses unless an other-than-temporary impairment has occurred. For reporting entities required to maintain an AVR, the accounting for unrealized gains and losses shall be reported through the AVR. For reporting entities not required to maintain an AVR, unrealized gains and losses shall be recorded as a direct credit or charge to unassigned funds (surplus). (P29)

~~31.~~27. Assessment of an other-than-temporary impairment is required for all asset-backed securities when fair value is less than the amortized cost basis. The amortized cost basis includes adjustments made to the cost of an investment for accretion, amortization, collection of cash, and previous other-than-temporary impairments recognized as a realized loss. Reporting a security at the lower of amortized cost or fair value is not a substitute for other-than-temporary impairment recognition . For securities reported at fair value where an other-than-temporary impairment has been determined , the loss recognized reflects the realization of unrealized losses previously recorded from fluctuations in fair value. (The extent to which unrealized losses are realized depends on whether the other-than-temporary impairment is considered a full impairment or a bifurcated impairment pursuant to paragraphs ~~40~~ 34 and 35~~41~~.) After the recognition of an other-than-temporary impairment, securities reported at the lower of amortized cost or fair value shall continue to report unrealized gains and losses from fluctuations in fair value. (P31 & 30)

~~32.~~28. If an entity intends to sell the asset-backed security (that is, it has decided to sell the security), an other-than-temporary impairment shall be considered to have occurred. (P32)

~~33.~~29. If an entity does not intend to sell the ~~loan-backed or structured~~asset-backed security, the entity shall assess whether it has the intent and ability[12] to retain the investment in the security for a period of time sufficient to recover the amortized cost basis. If the entity does not have the intent and ability to retain the investment for the time sufficient to recover the amortized cost basis, an other-than-temporary impairment shall be considered to have occurred. (P33)

~~34.~~30. If the entity does not expect to recover the entire amortized cost basis of the security, the entity would be unable to assert that it will recover its amortized cost basis even if it does not intend to sell the security and the entity has the intent and ability to hold. (This includes situations in which an entity has an adverse change in cash flows expected to be collected for a security that is an impaired position (meaning, fair value is less than amortized cost, regardless of if an unrealized loss has been recognized.) ~~Therefore, in~~

[12] This assessment shall be considered a high standard due to the accounting measurement method established for the securities within the scope of this statement (amortized cost).

~~those~~In such situations, an other-than temporary impairment shall be considered to have occurred. (For mortgage-referenced securities, an OTTI is considered to have occurred when there has been a delinquency or other credit event in the referenced pool of mortgages such that the entity does not expect to recover the entire amortized cost basis of the security.) In assessing whether the entire amortized cost basis of the security will be recovered, an entity shall compare the present value of cash flows expected to be collected from the security with the amortized cost basis of the security. If present value of cash flows expected to be collected is less than the amortized cost basis of the security, the entire amortized cost basis of the security will not be recovered, and an other-than-temporary impairment shall be considered to have occurred. A decrease in the present value of cashflows expected to be collected on an asset-backed security that results from an increase or decrease in expected prepayments on the underlying assets shall be considered in the estimate of the present value of cashflows expected to be collected. (P34)

~~35.~~31. In determining whether an other than-temporary impairment has occurred, an entity shall calculate the present value of cash flows expected to be collected based on an estimate of the expected future cash flows of the impaired ~~loan-backed or structured~~asset-backed security, discounted at the security's effective interest rate. For securities in which there was no nonaccretable yield and for which there has been no changes to estimated cash flows since acquisition, the effective interest rate is the rate of return implicit in the security (that is, the contractual interest rate adjusted for any net deferred fees or costs, premium, or discount existing at the origination or acquisition of the security).[13] For all other securities, the effective interest rate is the rate implicit immediately prior to the recognition of the other-than-temporary impairment. (Meaning, the effective interest rate as adjusted to reflect the last revised assessment of expected cash flows.) (P35)

~~36.~~32. It is inappropriate to automatically conclude that a security is not other-than-temporarily impaired because all of the scheduled payments to date have been received. However, it also is inappropriate to automatically conclude that every decline in fair value represents an other-than-temporary impairment. Further analysis and judgment are required to assess whether a decline in fair value indicates that it is probable that the holder will not collect all of the contractual or estimated cash flows from the security. In addition, the length of time and extent to which the fair value has been less than cost can indicate a decline is other than temporary. The longer and/or the more severe the decline in fair value, the more persuasive the evidence that is needed to overcome the premise that it is probable that the holder will not collect all of the contractual or estimated cash flows from the issuer of the security. (P41, ASC 325-40-35-10A)

~~37.~~33. In making its other-than-temporary impairment assessment, the holder shall consider all available information relevant to the collectibility of the security, including information about past events, current conditions, and reasonable and supportable forecasts, when developing the estimate of future cash flows. Such information generally shall include the remaining payment terms of the security, prepayment speeds, the financial condition of the issuer(s), expected defaults, and the value of any underlying collateral. To achieve that objective, the holder shall consider, for example, industry analyst reports and forecasts, sector credit ratings, and other market data that are relevant to the collectibility of the security. The holder also shall consider how other credit enhancements affect the expected performance of the security, including consideration of the current financial condition of the guarantor of a security (if the guarantee is not a separate contract) and/or whether any subordinated interests are capable of absorbing estimated losses on the loans underlying the security. The remaining payment terms of the security could be significantly different from the payment terms in prior periods (such as for some securities backed by "nontraditional

[13] See Footnote 1.

loans"[14]). Thus, the holder shall consider whether a security backed by currently performing loans will continue to perform when required payments increase in the future (including "balloon" payments). The holder also shall consider how the value of any collateral would affect the expected performance of the security. If the fair value of the collateral has declined, the holder needs to assess the effect of that decline on the ability of the holder to collect the balloon payment. (P42)

~~38.~~34. When an other-than-temporary impairment has occurred because the entity intends to sell the security or has assessed that that they do not have the intent and ability to retain the investments in the security for a period of time sufficient to recover the amortized cost basis, the amount of the other-than-temporary impairment recognized in earnings as a realized loss shall equal the entire difference between the investment's amortized cost basis and its fair value at the balance sheet date (full impairment). For asset-backed securities held at lower of amortized cost or fair value, upon recognition of an other-than-temporary impairment, all unrealized losses would be considered realized and the current fair value becomes the new cost basis.) (P36)

~~39.~~35. When an other-than-temporary impairment has occurred because the entity does not expect to recover the entire amortized cost basis of the security even if the entity has no intent to sell and the entity has the intent and ability to hold, the amount of the other-than-temporary impairment recognized as a realized loss shall equal the difference between the investment's amortized cost basis and the present value of cash flows expected to be collected, discounted at the security's effective interest rate in accordance with paragraph ~~36~~ 31 (bifurcated impairment). For asset-backed securities held at lower of cost or fair value, unrealized losses would be realized for the non-interest related decline. Hence, unrealized losses could continue to be reflected for these securities based on the difference between the current fair value and the present value of cash flows expected to be collected. (After recognizing an OTTI in these situations, the present value of cash flows expected to be collected becomes the new cost basis of the security.) (P37)

~~40.~~36. For reporting entities required to maintain an AVR or IMR, all unrealized gains and losses shall be reported through the AVR. For realized gains and losses, an analysis is required on whether the realized loss reflects an interest or non-interest related decline[15]. The analysis required is the same regardless whether a realized loss results from an impairment write-down or whether there was a gain or loss upon sale. Guidance on specific scenarios resulting in realized gains and losses are as follows (P38):

a. Unrealized Gains and Losses – Record all unrealized gains and losses through AVR. At the time an unrealized gain or loss is realized, allocation between AVR or IMR will depend on the analysis and bifurcation between interest or non-interest related declines Unrealized gains or losses that are realized shall be reversed from AVR before the recognition of the realized gain or loss within AVR and IMR.

b. Other-Than-Temporary Impairment – Non-interest related other-than-temporary impairment losses shall be recorded through the AVR and interest-related OTTI losses shall be recorded through the IMR. If the reporting entity wrote the security down to fair value due to the intent to sell or because the entity does not have the intent and ability to

[14] A nontraditional loan may have features such as (a) terms that permit principal payment deferral or payments smaller than interest accruals (negative amortization), (b) a high loan-to-value ratio, (c) multiple loans on the same collateral that when combined result in a high loan-to value ratio, (d) option adjustable-rate mortgages (option ARMs) or similar products that may expose the borrower to future increases in repayments in excess of increases that result solely from increases in the market interest rate (for example, once negative amortization results in the loan reaching a maximum principal accrual limit), (e) an initial interest rate that is below the market interest rate for the initial period of the loan term and that may increase significantly when that period ends, and (f) interest-only loans that should be considered in developing an estimate of future cash flows.

[15] Pursuant to INT 06-07, the term interest-related includes a declining value due to both increases in the risk free interest rate and general credit spread widening. Credit spreads can widen or contract for a variety of reasons, including supply/demand imbalances in the marketplace or the perceived higher/lower risk of an entire sector. If the declining value is caused, in whole or in part, due to credit spreads widening, but not due to fundamental credit problems of the issuer, the change in credit spreads is deemed to be interest-related.

retain the investment for a period of time sufficient to recover the amortized cost basis, the entity shall bifurcate the realized loss between non-interest related (AVR) and interest related (IMR). The analysis for bifurcating impairment losses between AVR and IMR shall be completed as of the date when the other-than-temporary impairment is determined. Entities that recognized an OTTI based on the difference between amortized cost and the present value of expected cash flows shall recognize the full realized loss through AVR.

c. Security Sold at a Loss Without Prior OTTI – An entity shall bifurcate the loss into AVR and IMR portions depending on interest and non-interest related declines in accordance with the analysis performed as of the date of sale.

d. Security Sold at a Loss With Prior OTTI – An entity shall bifurcate the current realized loss into AVR and IMR portions depending on interest and non-interest related declines in accordance with the analysis performed as of the date of sale. An entity shall not adjust previous allocations to AVR and IMR that resulted from previous recognition of other-than-temporary impairments.

e. Security Sold at a Gain With Prior OTTI – An entity shall bifurcate the gain into AVR and IMR portions depending on interest and non-interest factors in accordance with the analysis performed as of the date of sale. The bifurcation between AVR and IMR that occurs as of the date of sale may be different from the AVR and IMR allocation that occurred at the time of previous other-than-temporary impairments. An entity shall not adjust previous allocations to AVR and IMR that resulted from previous recognition of other-than-temporary impairments.

f. Security Sold at a Gain Without Prior OTTI – An entity shall bifurcate the gain into AVR and IMR portions depending on interest and non-interest factors in accordance with the analysis performed as of the date of sale.

~~41.~~37. This statement does not permit reversals of recognized other-than-temporary impairments based on subsequent recoveries of fair value. If there are subsequent changes to the cash flows expected to be collected, the prospective adjustment method shall be used toadjust the effective yield in future periods to reflect those changes. (P39)

~~42.~~38. In periods subsequent to the recognition of an other than temporary impairment loss for an asset-backed security, the reporting entity shall account for the other-than-temporarily impaired security as if the security had been purchased on the measurement date of the other-than-temporary impairment at an amortized cost basis equal to the previous amortized cost basis less the other-than-temporary impairment recognized as a realized loss. The difference between the new amortized cost basis and the cash flows expected to be collected shall be accreted as interest income. A reporting entity shall continue to estimate the present value of cash flows expected to be collected over the life of the ~~loan-backed or structured~~asset-backed security. (P40)

Designation Guidance

~~43.~~39. For RMBS/CMBS securities within the scope of this statement, the initial NAIC designation used to determine the carrying value method and the final NAIC designation for reporting purposes is determined using a multi-step process or the NAIC designation assigned by the NAIC Securities Valuation Office. The P&P Manual provides detailed guidance. A general description of the processes is as follows:

a. Financial Modeling: Pursuant to the P&P Manual, the NAIC identifies select securities where financial modeling must be used to determine the NAIC designation. For a modeled legacy security, meaning one which closed prior to January 1, 2013, the NAIC designation

is based on financial modeling incorporating the insurers' carrying value. For a modeled non-legacy security, meaning one which closed after December 31, 2012, the NAIC designation and NAIC designation category assigned by the NAIC Securities Valuation Office must be used. For those legacy securities that are financially modeled, the insurer must use NAIC CUSIP specific modeled breakpoints provided by the modelers in determining initial and final designation for these identified securities. As specified in the P&P Manual, a modeled legacy security RMBS or CMBS tranche that has no expected loss, as compiled and published by the NAIC Securities Valuation Office, under any of the selected modeling scenarios would be assigned an NAIC 1 designation and NAIC 1.A designation category regardless of the insurer's book/adjusted carrying value. The three-step process for modeled legacy securities is as follows:

i. Step 1: Determine Initial Designation – The current amortized cost (divided by remaining par amount) of an ~~loan-backed or structured~~asset-backed security is compared to the modeled breakpoint values assigned to each NAIC designation and NAIC designation category for each CUSIP to establish the **initial** NAIC designation.

ii. Step 2: Determine Carrying Value Method – The carrying value method, either the amortized cost method or the lower of amortized cost or fair value method, is then determined as described in paragraph 11~~16~~ based upon the initial NAIC designation from Step 1.

iii. Step 3: Determine Final Designation – The final NAIC designation is determined by comparing the carrying value (divided by remaining par amount) of a security (based on paragraph 39~~44~~.a.ii.) to the NAIC CUSIP specific modeled breakpoint values assigned to the NAIC designation and NAIC designation category for each CUSIP or is mapped to an NAIC designation category, according to the instructions in the P&P Manual. This final NAIC designation 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 39~~44~~.a.ii.).

b. All Other ~~Loan-Backed and Structured~~Asset-Backed Securities: For securities not subject to paragraph 39~~44~~.a. (financial modeling) follow the established designation procedures according to the appropriate section of the P&P Manual. The NAIC designation shall be applicable for statutory accounting and reporting purposes (including determining the carrying value method and establishing the AVR charges). The carrying value method is established as described in paragraph 11~~16~~.

~~44.~~40. For securities that will be financially modeled under paragraph 39~~46~~, the guidance in this paragraph shall be applied in determining the reporting method for such securities acquired in the current year for quarterly financial statements. Securities reported as of the prior-year end shall continue to be reported under the prior-year end methodology for the current-year quarterly financial statements. For year-end reporting, securities shall be reported in accordance with paragraph 39~~46~~, regardless of the quarterly methodology used. (P28)

a. Reporting entities that acquired the entire financial modeling database for the prior-year end are required to follow the financial modeling methodology (paragraph 39~~46~~.a.) for all securities acquired in the subsequent year that were included in the financial modeling data acquired for the prior year-end.

b. Reporting entities that acquired identical securities (identical CUSIP) to those held and financially modeled for the prior year-end are required to follow the prior year-end financial modeling methodology (paragraph 39~~46~~.a.) for these securities acquired subsequent to year-end.

c. Reporting entities that do not acquire the prior-year financial modeling information for current-year acquired individual CUSIPS, and are not captured within paragraphs 39~~46~~.a. or 39~~46~~.b., are required to follow the analytical procedures for non-financially modeled securities (paragraph 39~~46~~.b. as appropriate). Reporting entities that do acquire the individual CUSIP information from the prior-year financial modeling database shall use that information for interim reporting.

d. Reporting entities that acquire securities not previously modeled at the prior year-end are required to follow the analytical procedures for non-financially modeled securities (paragraph 39~~46~~.b. as appropriate).

Giantization/Megatization of FHLMC or FNMA Mortgage-Backed Securities

~~45.~~41. Giantization/megatization of mortgage-backed securities is defined as existing pools of FHLMC or FNMA mortgage-backed securities (MBS) with like coupon and prefix which are repooled together by the issuing agency creating a new larger security. The new Fannie Mae "Mega" or Freddie Mac "Giant" is a guaranteed MBS pass-through representing an undivided interest in the underlying pools of loans. (P47)

~~46.~~42. Repooled FHLMC and FNMA securities meet the definition of substantially the same as defined in *SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. The transaction shall not be considered a sale/purchase and no gain or loss shall be recognized. To properly document the repooling, the transaction shall be reported through Schedule D of the annual statement as a disposition and an acquisition. (P48)

~~47.~~43. Transaction fees charged by the issuing agencies shall be capitalized and amortized over the life of the repooled security. (P49)

Disclosures

~~48.~~44. In addition to the disclosures required for invested assets in general, the following disclosures regarding asset-backed securities shall be made in the financial statements. Regardless of the allowances within paragraph 63 of the Preamble, the disclosures in paragraph 44~~49~~.f., 44~~49~~.g. and 44~~49~~.h. of this statement are required in separate, distinct notes to the financial statements:

a. Fair values in accordance with *SSAP No. 100R—Fair Value*.

b. Concentrations of credit risk in accordance with SSAP No. 27;

c. Basis at which the asset-backed securities are stated;

d. The adjustment methodology used for each type of security (prospective or retrospective);

e. Descriptions of sources used to determine prepayment assumptions.

f. All securities within the scope of this statement with a recognized other-than-temporary impairment, disclosed in the aggregate, classified on the basis for the other-than-temporary impairment: (1) intent to sell, (2) inability or lack of intent to retain the investment in the security for a period of time sufficient to recover the amortized cost basis, or (3) present

value of cash flows expected to be collected is less than the amortized cost basis of the security.

g. For each security with an other-than-temporary impairment, recognized in the current reporting period by the reporting entity, as the present value of cash flows expected to be collected is less than the amortized cost basis of the securities:

i. The amortized cost basis, prior to any current-period other-than-temporary impairment.

ii. The other-than-temporary impairment recognized in earnings as a realized loss.

iii. The fair value of the security.

iv. The amortized cost basis after the current-period other-than-temporary impairment.

h. All impaired securities (fair value is less than cost or amortized cost) for which an other-than-temporary impairment has not been recognized in earnings as a realized loss (including securities with a recognized other-than-temporary impairment for non-interest related declines when a non-recognized interest related impairment remains):

i. The aggregate amount of unrealized losses (that is, the amount by which cost or amortized cost exceeds fair value) and

ii. The aggregate related fair value of securities with unrealized losses.

i. The disclosures in (i) and (ii) above should be segregated by those securities that have been in a continuous unrealized loss position for less than 12 months and those that have been in a continuous unrealized loss position for 12 months or longer using fair values determined in accordance with SSAP No. 100R.

j. Additional information should be included describing the general categories of information that the investor considered in reaching the conclusion that the impairments are not other-than-temporary.

k. When it is not practicable to estimate fair value, the investor should disclose the following additional information, if applicable:

i. The aggregate carrying value of the investments not evaluated for impairment, and

ii. The circumstances that may have a significant adverse effect on the fair value.

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

m. The items in the scope of this statement are also subject to the annual audited disclosures in *SSAP No. 26R—Bonds*, paragraphs ~~30.e.~~, 39~~30~~.f. and 39~~30~~.g.

~~49.~~45. Refer to the Preamble for further discussion regarding disclosure requirements. All disclosures within this statement, except disclosures included in paragraphs 44~~49~~.b., 44~~49~~.k. and 44~~49~~.m., shall be included within the interim and annual statutory financial statements. Disclosure requirements in

paragraphs 44~~49~~.b., 44~~49~~.k. and 44~~49~~.m. are required in the annual audited statutory financial statements only.

Relevant Literature

~~50.~~46. This statement reflects specific statutory accounting guidance for assets that qualify as asset-backed securities under the statutory accounting principles-based bond definition. The classification of investments as 'bonds' for statutory accounting and reporting purposes differs from the U.S. GAAP determination of a "debt instrument" and this statement reflects statutory specific measurement and impairment guidance for investments captured in scope. This statement does incorporate limited U.S. GAAP concepts, particularly with the determination of accretable yield and consideration of changes in expected cash flows using the retrospective or prospective method. However, due to the statutory accounting specifications on scope, measurement method and impairment, no U.S. GAAP standards are considered adopted within this statement. Concepts that converge with U.S. GAAP are limited to the extent they are detailed in this statement.

Note – With adoption, U.S. GAAP standards previously adopted in SSAP No. 43R will be identified as rejected for statutory accounting. With the issuance of this standard, all relevant literature guidance will be removed. This information can be detailed in the issue paper for historical tracking purposes. GAAP guidance previously adopted that will no longer be identified as adopted within this guidance are shown as deleted text below:

Effective Date and Transition

47. This statement is effective for years beginning January 1, 2025~~XXXX. 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 revisions to this statement, and *SSAP No. 26R—Bonds*, incorporate principal concepts on what should be reported as a long-term bond. Securities that qualify as issuer credit obligations within the principal concepts are captured within scope of SSAP No. 26R. Securities that qualify as asset-backed securities within the principal concepts are captured within scope of SSAP No. 43R. Securities that do not qualify as issuer credit obligations or ABS, unless specifically permitted in scope of these statements, are not permitted to be reported as a bond.

48. At the time of transition, reporting entities shall make their best efforts to assess investments to determine whether they qualify within the bond definition for reporting as issuer credit obligations on Schedule D-1-1 or asset-backed securities on Schedule D-1-2. The bond definition requires assessments at the time of acquisition, and it is recognized that reporting entities may not have the means to complete historical assessments for securities held at the time of transition. For these instances, if information is not readily available for reporting entities to assess a security as of the date at acquisition, reporting entities may utilize current information in concluding that a security qualifies for reporting as a bond as either an issuer obligation or asset-backed security.

49. Investments that were reported as a bond on Schedule D-1: Long-Term Bonds as of December 31, 2024 that do not qualify under the principle-based bond concepts shall be reported as a disposal from that schedule, with a reacquisition on the appropriate reporting schedule as of January 1, 2025. These investments shall be accounted for in accordance with the resulting SSAP that addresses the specific investment structure. For securities that are reported at the lower of amortized cost or fair value under the new applicable guidance, this could result with an unrealized loss in the measurement of the investment at the time of the reclassification. Although the adoption of this guidance is considered a change in accounting principle under SSAP No. 3, the following transition guidance shall be applied on January 1, 2025, to ensure consistency in reporting and to allow investment schedules to roll appropriately:

a. Securities reclassified from Schedule D-1 as they no longer qualify under the bond definition shall be reported as a disposal from Schedule D-1 at amortized cost. Although no proceeds are received, amortized cost at the time of disposal shall be reported as consideration on Schedule D-4.

i. For securities held at amortized cost at the time of disposal, book adjusted carrying value and amortized cost shall agree, preventing gain or loss recognition at the time of reclassification.

ii. For securities held at fair value under the lower of amortized cost or fair value measurement method, previously reported unrealized losses shall be reversed on Jan. 1, 2025, prior to disposal, resulting with a reported value that mirrors amortized cost at the time of disposal. This action prevents realized loss recognition at time of reclassification.

b. Securities reclassified from Schedule D-1 shall be recognized on the subsequent schedule (e.g., Schedule BA) with an actual cost that agrees to the disposal value (amortized cost). Immediately subsequent to recognition on the resulting schedule, the securities shall be reported in accordance with the measurement method prescribed by the applicable SSAP:

i. For securities previously reported at fair value on Schedule D-1 (under a lower of amortized cost or fair value measurement method), the reporting entity will recognize an unrealized loss to match the previously reported book adjusted carrying value. Subsequently, the security will continue to reflect a lower of amortized cost or fair value measurement method.

ii. For securities previously reported at amortized cost on Schedule D-1, if the subsequent statement requires a lower of amortized cost or fair value measurement method, then the reporting entity shall recognize an unrealized loss to the extent fair value is less than amortized cost.

iii. After application of paragraph 49b.i and 49b.ii all securities shall reflect either the same reported value as of December 31, 2024 (amortized cost or fair value) or a lower reported value (if the security is subject to the lower of amortized cost or fair value measurement method). There should be no instances that result with a security having a greater reported value than what was presented on December 31, 2024. Subsequent to transition, securities reported at fair value may incur unrealized gains or losses due to fair value fluctuations, but should never have unrealized gains that result with a book adjusted carrying value that exceeds amortized cost.

50. With this transition guidance, changes in measurement for securities reclassified under the bond definition will be reported as a change in unrealized capital gains (losses) in the first quarter 2025 financial statements (unless sold in the interim with a realized gain or loss) and not as a change in accounting principle. To enable regulators the ability to identify the impact of securities reclassified under the bond definition, the following disclosure for the 2025 first quarter financial statement is required:

a. Aggregate book adjusted carrying value for all securities reclassified off Schedule D-1.

b. Aggregate book adjusted carrying value after transition for all securities reclassified off Schedule D-1 that resulted with a change in measurement basis. (This shall be a subset of paragraph 50a and captures the securities that moved from an amortized cost to a fair value measurement method under the lower of amortized cost or fair value approach.)

c. Aggregate surplus impact for securities reclassified off Schedule D-1. This shall include the difference between book adjusted carrying value as of December 31, 2024 and book adjusted carrying value after transition for those securities that moved from an amortized cost to a fair value measurement method under the lower of amortized cost or fair value approach.

51. Asset-backed securities that were previously reported as short-term (Schedule DA) or as a cash equivalent (Schedule E2) shall be reclassified to be reported on Schedule D-1-2 on Jan. 1, 2025. Similar to the process detailed in paragraph 49, the securities shall be removed from DA and E2 at amortized cost, with reversal of any unrealized loss prior to the reclassification. The amortized cost shall be reported as "consideration received on disposals' on Schedule DA – Verification Between Years or Schedule E-2 – Verification Between Years, as applicable based on the prior reporting location. The security shall be recognized as an ABS acquired on Schedule D-3 at amortized cost. Immediate after initial recognition, if the security was required to be held at fair value, under the lower of amortized cost or fair value measurement method, the reporting entity shall recognize an unrealized loss.

REFERENCES

Other

- *Purposes and Procedures Manual of the NAIC Investment Analysis Office*
- NAIC Valuation of Securities product prepared by the Securities Valuation Office

Relevant Issue Papers

- *Issue Paper No. XX—Principles Based Bond Definition*

~~Appendix - Examples of Analysis for Asset Backed Securities~~

1. ~~As detailed in paragraphs 4-5, the holder of an asset-backed securities is 1) required to be in a different economic position than if the holder owned the ABS Issuer's assets directly, and 2) if the assets owned by the ABS Issuer are cash-generating non-financial assets, then the assets are expected to generate a meaningful level of cash flows towards repayment of the bond through use, licensing, leasing servicing or management fees, or other similar cash flow generation. (This guidance requires a meaningful level of cash flows to service the debt other than through the sale or refinancing of the assets.) This appendix details example analysis for these meaningful cash flow and substantive credit enhancements.~~

2. ~~**Example 1**: A reporting entity invests in debt instruments issued from a SPV sponsored by the Government National Mortgage Association (GNMA), the Federal National Mortgage Association (FNMA) and the Federal Home Loan Mortgage Corporation (Freddie Mac) (collectively, "Agency or Agencies"). These debt instruments pass through principal and interest payments received from underlying mortgage loans held by the SPV to the debtholders proportionally, with principal and interest guaranteed by the Agencies. While there is prepayment and extension risk associated with the repayment of the underlying mortgage loans, the credit risk associated with the mortgage loans is assumed by the Agencies.~~

3. ~~**Example 1 Rationale**: Although the reporting entity participates on a proportional basis in the cash flows from the underlying mortgage loans held by the SPV, the reporting entity is in a different economic position than if it owned the underlying mortgage loans directly because the credit risk has been redistributed and assumed by the Agencies. This is a substantive credit enhancement because a market participant (i.e., a knowledgeable investor transacting at arm's length) would conclude the Agency guarantee is expected to absorb all losses before the debt instrument being evaluated. Therefore, the holder of the debt instrument is in a substantively different economic position than if the holder owned the ABS Issuer's unguaranteed assets directly, in accordance with the requirements in paragraph 3b. When guarantees do not cover 100% of principal and interest as the Agency guarantees do in this example, it is still appropriate to determine if the guarantee is substantive in accordance with the requirements in paragraph 3.b., to determine if the holder is in a substantively different economic position that if the holder held the ABS Issuer's assets directly.~~

4. ~~**Example 2**: A reporting entity invested in a debt instrument issued by a SPV that owns equipment which is leased to an equipment operator. The equipment operator makes lease payments to the SPV, which are passed through to service the SPV's debt obligation. While the debt is outstanding, the equipment and lease are held in trust and pledged as collateral for the debtholders. Should a default occur, the debtholders can foreclose on and liquidate the equipment as well as submit an unsecured lease claim in the lessee's bankruptcy for any defaulted lease payments. The loan-to-value at origination is 70%.~~

5. ~~The existing lease payments are sufficient to cover all interest payments and all scheduled debt amortization payments over the life of the debt instrument. However, at debt maturity, there is a balloon payment due, totaling 50% of the original outstanding debt principal amount. The corresponding lease has no balloon payment due at lease maturity, so the SPV will either need to refinance the debt or sell the underlying equipment to service the final debt balloon payment. The loan-to-value at maturity is expected to decline to 40% considering the scheduled principal amortization payments net of the expected economic depreciation in the equipment value over the term of the debt. The equipment is expected to be subject to some market value volatility and periods of lower liquidity at certain points in time but has a predictable value range and ready market over a longer period of time, such that the equipment could be liquidated over a reasonable period of time, if necessary.~~

6. ~~**Example 2 Rationale**: The equipment is a cash-generating non-financial asset which is expected to generate a meaningful level of cash flows for the repayment of the bonds via the existing lease that~~

~~covers all interest payments and 50% of the principal payments. In reaching this determination, the reporting entity considered the predictable nature of the cash flows, which are contractually fixed for the life of the debt instrument, as well as the ability of the collateral value to provide for the balloon payment through sale or refinancing in light of its characteristics. While the equipment may have some market value volatility and periods of lower liquidity at points in time, the cash flows produced by the lease were concluded to reduce the loan balance to a level (40% loan-to-value) that would be able to be recovered by sale or refinancing even if it were to mature at such point in time.~~

7. ~~The reporting entity also determined that the structure provides substantive credit enhancement in the form of overcollateralization to conclude that investors are in a different economic position than holding the equipment directly, in accordance with the requirements in paragraph 3.b. In reaching this conclusion, the reporting entity noted that the debt instrument starts with a 70% loan-to-value, which continues to improve over the life of the debt as the loan balance amortizes more quickly than the expected economic depreciation on the underlying equipment. In the context of the predictable nature of the cash flows and collateral value range over time, the reporting entity concluded that a market participant (i.e., knowledgeable investor transacting at arm's length) would consider this level of overcollateralization to put the investor in a substantively different economic position than owning the underlying equipment directly.~~

8. ~~For the purposes of determining whether there is substantive overcollateralization, it is appropriate to consider any expected economic depreciation, if it is reasonably expected, but it is not appropriate to consider any expected economic appreciation. Note that a debt instrument with a loan-to- value that is expected to decrease over time is not necessarily deemed to have substantive overcollateralization.~~

9. ~~**Example 3**: A reporting entity invested in a debt instrument with the same characteristics as described in Example 2, except that the existing equipment lease at the time of origination has a contractual term that is shorter than that of the debt instrument. It is expected with a high degree of probability that the lease will be renewed, and a substantial leasing market exists to replace the lessee should they not renew. However, in the unlikely circumstance that the equipment cannot be re-leased, there would not be enough cash flows to service the scheduled principal and interest payments, and the equipment would have to be liquidated to pay off the debt upon default.~~

10. ~~**Example 3 Rationale**: All details of Example 3, including the expected collateral cash flows, are consistent with those in Example 2, except that the cash flows in Example 2 are contractually fixed for the duration of the debt while the cash flows in Example 3 are subject to re-leasing risk. Notwithstanding the involvement of re-leasing risk, the reporting entity concluded that the ability to re-lease the equipment was highly predictable and supported the conclusion that the equipment was expected to produce meaningful cash flows to service the debt.~~

11. ~~This distinction is to highlight that the expected cash flows of a cash-generating non-financial asset may or may not be contractually fixed for the term of the bond. Certain securitized cash flow streams may not by their nature lend themselves to long-term contracts (e.g., single-family home rentals), but may nevertheless lend themselves to the production of predictable cash flows. While the non-contractual nature of the cash flows is an important consideration in determining whether a non-financial asset is expected to produce meaningful cash flows to service the debt, it does not, in and of itself, preclude a reporting entity from concluding that the assets are expected to produce meaningful cash flows.~~

12. ~~**Example 4**: A reporting entity invested in a debt instrument issued by a SPV that owns equipment which is leased to an equipment operator. The equipment operator makes lease payments to the SPV, which are passed through to service the SPV's debt obligation. While the debt is outstanding, the equipment and lease are held in trust and pledged as collateral for the debtholders. Should a default occur, the debtholders can foreclose on and liquidate the equipment as well as submit an unsecured~~

~~lease claim in the lessee's bankruptcy for any defaulted lease payments. The loan-to-value at origination is 70%.~~

13. ~~The existing lease payments are sufficient to cover all interest payments and all scheduled debt amortization payments over the life of the debt instrument. However, at maturity, there is a balloon payment due, totaling 80% of the original outstanding principal amount. The corresponding lease has no balloon payment due at lease maturity, so the SPV will either need to refinance the debt or sell the underlying equipment to service the final debt balloon payment. The loan-to-value at maturity is expected to increase to 95% considering the scheduled principal amortization payments net of the expected economic depreciation in the equipment value over the term of the debt. The equipment is expected to be subject to some market value volatility and periods of lower liquidity at certain points in time, but has a predictable value range and ready market over a longer period of time, such that the equipment could be liquidated over a reasonable period of time, if necessary.~~

14. ~~**Example 4 Rationale**: The equipment is a cash generating non-financial asset which is not expected to generate a meaningful level of cash flows for the repayment of the bonds via the existing lease that covers all interest payments and 20% of principal payments. In reaching this determination, the reporting entity considered that, while the cash flows being produced are predictable, the ability to recover the principal of the debt investment is almost entirely reliant on the equipment retaining sufficient value to sell or refinance to satisfy the debt.~~

15. ~~The reporting entity also determined that the structure lacks substantive credit enhancement to conclude that investors are in a different economic position than holding the equipment directly, in accordance with the requirements are in paragraph 3.b. In reaching this conclusion, the reporting entity noted that the debt starts with a 70% loan-to-value, but the overcollateralization is expected to deteriorate over the term of the debt as the equipment economically depreciates more quickly than the debt amortizes. This results in a high loan-to-value (i.e., 95%) at maturity, relative to the market value volatility of the underlying collateral. Despite the predictable nature of the cash flows, the reporting entity concluded that the debt instrument lacked a substantive level of overcollateralization to conclude that the investor is in a different economic position than owning the underlying equipment directly. It was determined that the level of overcollateralization , as determined by a market participant (i.e., a knowledgeable investor transacting at arm's length), is nominal. Therefore, the reporting entity concluded that it was in a substantively similar position as if it owned the equipment directly.~~

16. ~~For the purposes of determining whether there is substantive overcollateralization, it is appropriate to consider any expected economic depreciation, if it is reasonably expected, but it is not appropriate to factor in any expected economic appreciation. Note that a debt instrument with a loan-to- value that is expected to increase over time is not necessarily deemed to have nominal overcollateralization.~~

EXHIBIT A – QUESTION AND ANSWER IMPLEMENTATION GUIDE

This exhibit addresses common questions regarding the valuation and impairment guidance detailed in SSAP No. 43R.

Index to Questions

No.	Question
1	Are reporting entities permitted to establish an accounting policy to write down a SSAP No. 43R other-than-temporarily impaired security, for which a "non-interest" related decline exists, to fair-value regardless of whether the reporting entity intends to sell, or has the intent and ability to hold?
2	Can a reporting entity avoid completing a cash-flow assessment or testing for a specific other-than-temporarily impaired security when the entity believes there is a clear cash-flow shortage (i.e., non-interest related impairment) and elect to recognize a full impairment for the SSAP No. 43R security (no impairment bifurcation), with fair value becoming the new amortized cost basis, and recognition of the full other-than-temporary impairment as a realized loss?
3	Can reporting entities change their "intend to sell" or "unable to hold" assertions and recover previously recognized other-than-temporary impairments?
4	How do the regulators intend the phrase "intent and ability to hold" as used within SSAP No. 43R to be interpreted?
5	How do contractual prepayments affect the determination of credit losses?
6	Are the disclosure requirements within paragraphs ~~51~~44.f. and ~~51~~44.g. of SSAP No. 43R required to be completed for the current reporting quarter only, or as a year-to-date cumulative disclosure?
7	If an impairment loss is recognized based on the "present value of projected cash flows" in one period is the entity required to get new cash flows every reporting period subsequent or just in the periods where there has been a significant change in the actual cash flows from projected cash flows?
Questions 8-10 are specific to securities subject to the financial modeling process. (This process is limited to qualifying RMBS/CMBS securities reviewed by the NAIC Structured Securities Group.) The guidance in questions 8-10 shall not be inferred to other securities in scope of SSAP No. 43R.	
8	Do ABS~~LBSS~~ purchased in different lots result in a different NAIC designation for the same CUSIP? Can reporting entities use a weighted average method determined on a legal entity basis?
9	The NAIC Designation process for ~~LBSS~~ ABS may incorporate loss expectations that differ from the reporting entity's expectations related to OTTI conclusions. Should the reporting entities be required to incorporate recovery values obtained from data provided by the service provider used for the NAIC Designation process for impairment analysis as required by SSAP No. 43R?

No.	Question
10	For companies that have separate accounts, can the NAIC designation be assigned based upon the total legal entity or whether it needs to be calculated separately for the general account and the total separate account?

Questions 8-10 are specific to securities subject to the financial modeling process. (This process is limited to qualifying RMBS/CMBS securities reviewed by the NAIC Structured Securities Group.) The guidance in questions 8-10 shall not be inferred to other securities in scope of SSAP No. 43R.

1. Question - Are reporting entities permitted to establish an accounting policy to write down a SSAP No. 43R other-than-temporarily impaired security, for which a "non-interest" related decline exists, to fair-value regardless of whether the reporting entity intends to sell, or has the intent and ability to hold?

1.1 Pursuant to the guidance in SSAP No. 43R, optionality is not permitted. As such, an accounting policy that differs from SSAP No. 43R would be considered a departure from statutory accounting principles as prescribed by the NAIC *Accounting Practices and Procedures Manual.*

2. Question – Can a reporting entity avoid completing a cash-flow assessment or testing for a specific other-than-temporarily impaired security when the entity believes there is a clear cash-flow shortage (i.e., non-interest related impairment) and elect to recognize a full impairment for the SSAP No. 43R security (no impairment bifurcation), with fair value becoming the new amortized cost basis, and recognition of the full other-than-temporary impairment as a realized loss?

2.1 Under the basis of SSAP No. 43R, an entity is not permitted to elect a write-down to fair value in lieu of assessing cash flows and bifurcating "interest" and "non-interest" impairment components. As noted in paragraph 30~~34~~, if the entity does not have the intent to sell, and has the intent and ability to hold, but does not expect to recover the entire amortized cost basis of the security, the entity shall compare the present value of cash flows expected to be collected with the amortized cost basis of the security. If present value of cash flows expected to be collected is less than the amortized cost basis of the security, the entire amortized cost basis of the security will not be recovered (a non-interest decline exists) and an other-than-temporary impairment shall be considered to have occurred. Pursuant to paragraph 34~~37~~, when an other-than-temporary impairment has occurred because the entity does not expect to recover the entire amortized cost basis of the security even if the entity has no intent to sell and the entity has the intent and ability to hold, the amount of the other-than-temporary impairment recognized as a realized loss shall equal the difference between the investment's amortized cost basis and the present value of cash flows expected to be collected, discounted at the ~~loan-backed or structured~~asset-backed security's effective interest rate.

2.2 If the entity does not want to assess cash flows of an impaired security (fair value is less than amortized cost), the entity can designate the security as one the entity intends to sell, or one that the entity does not have the intent and ability to hold, providing it is reflective of the true intent and assessment of the ability of the entity. Once an impaired security has this designation, pursuant to paragraphs 28~~32~~ or 29~~33~~, an other-than-temporary impairment shall be considered to have occurred. As detailed in paragraph 34~~36~~, the amount of the other-than-temporary impairment recognized in earnings as a realized loss shall equal the entire difference between the investment's amortized cost basis and its fair value at the balance sheet date.

2.3 As addressed in question 3 of this Question and Answer Guide, reporting entities are not permitted to change assertions regarding their intent to sell or their lack of intent and ability

to hold. Once the security has been identified as one the entity intends to sell, or as a security that the entity does not have the intent and ability to hold, that assertion shall not change as long as the entity continues to hold the security.

3. Question - Can reporting entities change their "intend to sell" or "unable to hold" assertions and recover previously recognized other-than-temporary impairments?

3.1 No, a reporting entity is not permitted to change assertions and reverse previously recognized SSAP No. 43R other-than-temporary impairments. Although an entity may elect to hold a security due to a favorable change in the security's fair value, once the security has been identified as one the entity intends to sell, or as a security that the entity does not have the intent and ability to hold for purposes of initially recognizing an other-than-temporary impairment, that assertion shall not change as long as the entity continues to hold the security.

3.2 Reporting entities that have recognized an other-than-temporary impairment on a SSAP No. 43R security in a manner corresponding with an assertion on the intent to sell or the lack of the intent and ability to hold, for which a subsequent other-than-temporary impairment has been identified, shall recognize a realized loss for the difference between the current amortized cost (reflecting the previously recognized SSAP No. 43R other-than-temporary impairment) and the fair value at the balance sheet date of the subsequent impairment. Thus, bifurcation of impairment between interest and non-interest related declines is not permitted for securities in which an other-than-temporary impairment was previously recognized on the basis that the reporting entity had the intent to sell, or lacked the intent and ability to hold, regardless if the entity has subsequently decided to hold the security.

3.3 Reporting entities shall reclassify a security as one for which there is an intent to sell, or for which there is not an intent or ability to hold, regardless if a bifurcated other-than-temporary impairment had previously been recognized, as soon as the entity realizes that they can no longer support a previous assertion to hold the security. In making such reclassifications, if the security is impaired, the difference between the amortized cost (reflecting the initial non-interest other-than-temporary impairment recognized) and fair value at the balance sheet date of the reclassification shall be recognized as a realized loss, with fair value reflecting the new amortized cost basis. Once such a reclassification occurs, and the security is classified as one for which there is an intent to sell, or for which there is not an intent and ability to hold, the security must continue to carry that assertion until it is no longer held by the reporting entity.

4. Question – How do the regulators intend the phrase "intent and ability to hold" as used within SSAP No. 43R to be interpreted?

4.1 SSAP No. 43R paragraph 29~~33~~ states in part "…the entity shall assess whether it has the intent and ability to retain the investment in the security for a period of time sufficient to recover the amortized cost basis. If the entity does not have the intent and ability to retain the investment for the time sufficient to recover the amortized cost basis, an other-than-temporary impairment shall be considered to have occurred."

4.2 The intent of this language within SSAP No. 43R is focused on ensuring that, as of the balance sheet date, after considering the entity's own cash or working capital requirements and contractual or regulatory obligations and all known facts and circumstances related to the impaired security, the entity does not have the intention of selling the impaired security and has the current intent and ability to hold the security to recovery. Due to impairment

bifurcation provisions provided within SSAP No. 43R, and the amortized cost measurement method generally permitted for ~~loan-backed and structured~~asset-backed securities, the assessment of "intent and ability" is intended to be a high standard. Despite the intent of paragraph 29~~33~~, it is identified that information not known to the entity may become known in subsequent periods and/or facts and circumstances related to an individual holding or group of holdings may change thereby influencing the entity's subsequent determination of intent and ability with respect to a security or securities.

4.3 If a reporting entity asserts that it has the intent and ability to hold a security, or group of securities, until recovery of the amortized cost, but sells or otherwise disposes the security or securities prior to such recovery, the reporting entity shall be prepared to justify this departure from their original assertion to examiners and auditors. SSAP No. 43R purposely does not identify specific circumstances in which a change in assertion would be justifiable, but requires judgment from management, examiners and auditors on whether future assertions warrant closer review.

4.4 Delaying recognition of other-than-temporary impairments is a cause of serious concern by the regulators, and entities that habitually delay such recognition through false assertions on the "intent and ability to hold" may face increased scrutiny and regulatory action by their domiciliary state. It is imperative that a reporting entity recognize the full other-than-temporary impairment as soon as the entity realizes that they will no longer be able to hold the security until recovery of the amortized cost basis. Greater scrutiny shall be placed on securities sold or otherwise disposed shortly after a financial statement reporting date if such securities had been excluded from the full other-than-temporary impairment recognition on the basis of the reporting entity's intent and ability to hold.

4.5 As noted in paragraph 3.3 of this question and answer guide, once a security is classified as one for which there is an intent to sell, or for which there is not an intent and ability to hold, the security must continue to carry that assertion until the security is no longer held by the reporting entity.

5. Question – How do contractual prepayments affect the determination of credit losses?

5.1 Paragraph 30~~34~~ of SSAP No. 43R states that "A decrease in cash flows expected to be collected on ~~a loan-backed or structured~~asset-backed security that results from an increase in prepayments on the underlying assets shall be considered in the estimate of present value of cash flows expected to be collected." Paragraph ~~16~~ 18 states that "~~Loan-backed and structured~~Asset-backed securities shall be revalued using the currently estimated cash flows, including new prepayment assumptions. Reporting entities may utilize the prospective adjustment method for all asset-backed securities that are reported with NAIC designations that are of high credit at the of acquisition by the reporting entity." ~~, using either the prospective or retrospective adjustment methodologies consistently applied by type of securities."~~

~~5.2 The language in paragraph 34 is consistent with GAAP, and the GAAP guidance related to the treatment of prepayments in the consideration of credit losses was intended to provide clarification for determining the "cash flows expected to be collected" on interest-only securities and other similar securities that can be contractually prepaid or otherwise settled in such a way that the holder would not recover substantially all of the investment. These securities are generally accounted for in accordance with paragraphs 19-25 of SSAP No. 43R, which requires that an entity estimate cash flows expected to be collected including both amount and timing. Therefore, for securities under SSAP No. 43R, excluding those~~

~~accounted for under paragraphs 19-25, decreases in cash flows resulting in contractual prepayments should be considered yield adjustments rather than potential credit losses.~~

6. Question – Are the disclosure requirements within paragraphs ~~51~~44.f. and ~~51~~44.g. of SSAP No. 43R required to be completed for the current reporting quarter only, or as a year-to-date cumulative disclosure?

6.1 The disclosures should reflect the year-to-date other-than-temporary impairments. The "fair value" reported within the disclosure is intended to reflect the fair value at the date of the other-than-temporary impairment and shall not be updated due to the fluctuations identified at subsequent reporting dates. If a security has more than one other-than-temporary impairment identified during a fiscal reporting year, the security shall be included on the disclosure listing separately for each identified other-than-temporary impairment. Notation shall be included on the disclosure identifying the other-than-temporary impairments that were recognized for each respective reporting period.

7. Question – If an impairment loss is recognized based on the "present value of projected cash flows" in one period is the entity required to get new cash flows every reporting period subsequent or just in the periods where there has been a significant change in the actual cash flows from projected cash flows?

7.1 The guidance in paragraph 38~~40~~ of SSAP No. 43R indicates that a reporting entity shall continue to estimate the present value of cash flows expected to be collected over the life of the ~~loan-backed or structured~~asset-backed security. This guidance is explicit that the reporting entity shall continue to estimate the present value of cash flows expected to be collected over the life of the loan-backed or structured security.

7.2 As provided in paragraph 2.2 of this Q&A, if the entity does not want to assess cash flows of an impaired security (fair value is less than amortized cost), the entity can designate the security as one the entity intends to sell, or one that the entity does not have the intent and ability to hold, providing it is reflective of the true intent and assessment of the ability of the entity. Reporting entities subject to the requirements of AVR and IMR should allocate the impairment loss between AVR and IMR accordingly.

8. Question – Do ~~LBSS~~ ABS purchased in different lots result in a different NAIC designation for the same CUSIP? Can reporting entities use a weighted average method determined on a legal entity basis?

8.1 Under the financial modeling process (applicable to qualifying RMBS/CMBS reviewed by the NAIC Structured Securities Group), the amortized cost of the security impacts the "final" NAIC designation used for reporting and RBC purposes. As such, securities subject to the financial modeling process acquired in different lots can result in a different NAIC designation for the same CUSIP. In accordance with the current instructions for calculating AVR and IMR, reporting entities are required to keep track of the different lots separately, which means reporting the different designations. For reporting purposes, if a SSAP No. 43R security (by CUSIP) has different NAIC designations by lot, the reporting entity shall either 1) report the aggregate investment with the lowest applicable NAIC designation or 2) report the investment separately by purchase lot on the investment schedule. If reporting separately, the investment may be aggregated by NAIC designation. (For example, all acquisitions of the identical CUSIP resulting with an NAIC 1 designation may be aggregated, and all acquisitions of the identical CUSIP resulting with an NAIC 3 designation may be aggregated.)

9. Question – The NAIC Designation process for ~~LBSS~~ ABS subject to the financial modeling process may incorporate loss expectations that differ from the reporting entity's expectations related to

OTTI conclusions. Should the reporting entities be required to incorporate recovery values obtained from data provided by the service provider used for the NAIC Designation process for impairment analysis as required by SSAP No. 43R?

9.1 In accordance with *INT 06-07: Definition of Phrase "Other Than Temporary*," reporting entities are expected to "consider all available evidence" at their disposal, including the information that can be derived from the NAIC designation.

10. Question - For companies that have separate accounts, can the NAIC designation be assigned based upon the total legal entity or whether it needs to be calculated separately for the general account and the total separate account?

10.1 The financial modeling process for qualifying RMBS/CMBS securities is required for applicable securities held in either the general or separate account.

Bond Definition - Proposed Revisions to other SSAPs

SSAP Reference Revisions

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

   SSAP No. 26R: Update reference in paragraph 18. No revisions needed to paragraph 7 or 15.

   SSSAP No. 43R: Adjusted title references in paragraphs 7 and 15.

2. ***SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve***

   SSAP No. 43R: Adjusted reference in paragraph 3.

3. ***SSAP No. 15—Debt and Holding Company Obligations***

   SSAP No. 26R: No revisions needed to paragraph 13.

4. ***SSAP No. 21—Other Admitted Assets***

   SSAP No. 26R: Update footnote 1 and clarified guidance for GICs in paragraphs 14-17.

   SSAP No. 43R: Adjusted reference in paragraph 6 to asset backed securities that qualify.

5. ***SSAP No. 36—Troubled Debt Restructuring***

   SSAP No. 26R: No revisions needed to paragraph 29.

6. ***SSAP No. 43R—Asset-Backed Securities***

   SSAP No. 26R: Update disclosure reference that link to SSAP No. 26R, paragraph 51m

7. ***SSAP No. 86—Derivatives***

   SSAP No. 26R and SSAP No. 43R: Updated the guidance for structured notes in paragraph 5.g.

8. ***SSAP No. 95—Nonmonetary Transactions***

   SSAP No. 26R: No revisions needed to paragraph 6.

   SSAP No. 43R: Adjusted the citation to SSAP No. 43R in paragraph 6.

9. ***SSAP No. 100R—Fair Value***

   SSAP No. 26R: No revisions needed to Footnote 3.

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

    SSAP No. 43R: Revisions remove the direct pointer of beneficial interests as in scope of SSAP No. 43R and incorporate guidance for reporting under the applicable SSAP in paragraphs 2, 11 and 18.

11. ***INT 01-25:Accounting for U.S. Treasury Inflation-Indexed Securities***

    SSAP No. 26: No revisions needed.

12. ***06-02: Accounting and Reporting for Investments in a Certified Capital Company (CAPCO)***

    SSAP No. 26: Update paragraph reference in paragraph 5.a.

13. ***06-07: Definition of Phrase "Other Than Temporary"***

    SSAP No. 26: No revisions needed.

    SSAP No. 43R: Updated reference in list of applicable SSAPs.

14. ***INT 07-01: Application of the Scientific (Constant Yield) Method in Situations of Reverse Amortization***

    SSAP No. 26R: Remove quoted guidance.

    SSAP No. 43R: Updated reference in list of applicable SSAPs and remove quoted guidance.

15. ***INT 19-02: Freddie Mac Single Security Initiative***

    SSAP No. 26R: No revisions needed.

    SSAP No. 43R: Updated reference in list of applicable SSAPs and in paragraph 1.

16. ***INT 22-01: Freddie Mac When Issued K-Deal (WI Trust) Certificates***

    SSAP No. 43R: Updated reference in list of applicable SSAPs and in paragraph 1.

Summary of SAP Guidance Revisions

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

    Revisions preclude asset backed securities that are in scope of SSAP No. 43R from being reported as cash equivalents or short-term investments. The revisions also identify items captured on Schedule BA as non-bond securities. (These revisions also add reference to working capital finance investments, but that is not new guidance, but was not explicitly stated in SSAP No. 2R.)

18. ***SSAP No. 21—Other Admitted Assets***

    Revisions introduce new guidance for the accounting and reporting of securities that do not qualify for bonds within scope of SSAP No. 26R (as issuer credit obligations) or SSAP No. 43R (as asset backed securities).

Summary of SAP Reference Revisions:

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

7. Regardless of maturity date, related party or affiliated investments that would be in scope of *SSAP No. 26R—Bonds, SSAP No. 43R—~~Loan-Backed and Structured~~Asset-Backed Securities,* or that would be reported as "Other Invested Assets" shall be reported as long-term investments if any of the following conditions apply,[1] unless the reporting entity has re-underwritten the investment, maintained appropriate re-underwriting documentation, and each participating party had the ability to independently review the terms and can terminate the transaction prior to renewal.

a. The reporting entity does not reasonably expect the investment to terminate on the maturity date. This provision includes investments that are expected to be renewed (or rolled) with a maturity date that ends subsequent to the initial 90-day timeframe.

b. The investment was previously reported as a cash equivalent investment and the initial maturity timeframe has passed. If an investment is reported as a cash equivalent and it is unexpectedly renewed/rolled, the reporting entity is not permitted to continue to report the held security as a cash equivalent, regardless of the updated maturity date, and shall report the security as a long-term investment. An investment is only permitted to be reported as a cash equivalent for one quarter reporting period. Meaning, if an investment was reported as a cash equivalent in the first quarter, it is not permitted to be reported as a cash equivalent in the second quarter.

c. The reporting entity reacquired the investment (or a substantially similar investment) within one year after the original security matured or was terminated. These reacquired securities shall be reported as long-term investments. (These securities are also not permitted to be reported as short-term investments, regardless of the maturity date of the reacquired investment.)

Footnote 1: Cash equivalents subject to the provisions of paragraph 7 are not permitted to be subsequently reported as short-term investments, even if the updated/reacquired maturity date is within one year. These investments shall be reported as long-term investments. To avoid changes in reporting schedules, reporting entities are permitted to report securities as long-term investments at initial acquisition, regardless of the initial maturity date.

15. Regardless of maturity date, related party or affiliated investments in scope of *SSAP No. 26R—Bonds, SSAP No. 43R—~~Loan-Backed and Structured~~Asset-Backed Securities,* or that would be reported as "Other Invested Assets" shall be reported as long-term investments if any of the following conditions apply,[2, 3] unless the reporting entity has re-underwritten the investment, maintained appropriate re-underwriting documentation, and each participating party had the ability to independently review the terms and can terminate the transaction prior to renewal.

a. The reporting entity does not reasonably expect the investment to terminate on the maturity date. This provision includes investments that are expected to be renewed (or rolled) with a maturity date that ends subsequent to the initial "less than one year" timeframe.

b. The investment was previously reported as a short-term investment and the initial maturity timeframe has passed. If an investment is reported as a short-term investment and it is unexpectedly renewed/rolled, the reporting entity is not permitted to continue to report the held security as a short-term investment (or as a cash equivalent) regardless of the updated maturity date and shall report the security as a long-term investment. An investment is only permitted to be reported as a short-term investment for one annual reporting period. Meaning, if an investment was reported as a short-term investment as of December 31, 2018, it is not permitted to be reported as short-term investment as of December 31, 2019.

c. The reporting entity reacquired the investment (or a substantially similar investment) within one year after the original security matured or was terminated. These reacquired securities shall be reported as long-term investments. (These securities are also not permitted to be reported as cash equivalent investments regardless of the maturity date of the reacquired investment.)

Footnote 2: Reverse repurchase transactions are excluded from these provisions if admitted in accordance with collateral requirements pursuant *to SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities.*

Footnote 3: Short-term investments subject to the provisions of paragraph 15 are not permitted to be subsequently reported as cash equivalents, even if the updated/reacquired maturity date is within 90 days. These investments shall be reported as long-term investments. To avoid changes in reporting schedules, reporting entities are permitted to report securities as long-term investments at initial acquisition, regardless of the initial maturity date.

Disclosures

18. The following disclosures shall be made for short-term investments in the financial statements:

a. Fair values in accordance with *SSAP No. 100R—Fair Value*;

b. Concentrations of credit risk in accordance with *SSAP No. 27—Off-Balance-Sheet and Credit Risk Disclosures*;

c. Basis at which the short-term investments are stated.

d. The items in the scope of this statement are also subject to the annual audited disclosures in *SSAP No. 26R—Bonds*, paragraph 39.f~~30.f~~.

e. Identification of cash equivalents (excluding money market mutual funds as detailed in paragraph 8) and short-term investments (or substantially similar investments), which remain on the same reporting schedule for more than one consecutive reporting period. This disclosure is satisfied by use of a designated code in the investment schedules of the statutory financial statements.

SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve

3. The IMR and AVR shall be calculated and reported as determined per guidance in the SSAP for the specific type of investment (e.g., SSAP No. 43R for ~~loan-backed and structured~~asset-backed securities), or if not specifically stated in the respective SSAP, in accordance with the NAIC *Annual Statement Instructions* for Life and Accident and Health Insurance Companies.

SSAP No. 15—Debt and Holding Company Obligations - (No Changes)

13. Convertible debt securities and convertible preferred stock with beneficial conversion features are to be valued according to the appropriate statutory accounting statement; *SSAP No. 26R—Bonds* or *SSAP No. 32R—Preferred Stock.*

SSAP No. 21R—Other Admitted Assets

Collateral Loans

4. Collateral loans are unconditional obligations[1] for the payment of money secured by the pledge of an investment[2] and meet the definition of assets as defined in SSAP No. 4, and are admitted assets to the extent they conform to the requirements of this statement. The outstanding principal balance on the loan and any related accrued interest shall be recorded as an admitted asset subject to the following limitations:

Footnote 1: For purposes of determining a collateral loan in scope of this statement, a collateral loan does not include investments captured in scope of other statements. For example, *SSAP No. 26R—Bonds* includes securities that qualify as issuer creditor obligations and *SSAP No. 43—Asset-Backed Securities* includes securities that qualify as asset backed securities under the bond definition. ~~(as defined in that statement) representing a creditor relationship whereby there is a fixed schedule for one or more future payments.~~ Investments captured in SSAP No. 26R or SSAP No. 43R that are also secured with collateral shall continue to be captured within scope of ~~SSAP No. 26R~~those statements.

Footnote 2: Investment defined as those assets listed in Section 3 of *Appendix A-001—Investments of Reporting Entities*.

6. A reporting entity that acquires (directly or indirectly) structured settlement payment rights[3] through a factoring company, excluding securitizations that qualify as asset-backed securities ~~captured~~ in scope of SSAP No. 43R, shall report the acquisition as follows:

a. Period-certain (non-life contingent) structured settlement income streams shall be reported as other long-term invested assets[4], and are admitted assets if the rights to the future payments from a structured settlement have been legally acquired in accordance with all state and federal requirements. If the structured settlement has not met all legal requirements, including the court-approved transfer from the original recipient, then the reporting entity shall recognize the appropriate excise tax obligation and the structured settlement shall be nonadmitted.

b. Life-contingent structured settlement income streams shall be reported as other long-term invested assets on Schedule BA and shall be nonadmitted. (Nonadmittance is required regardless if the right to future payments has been legally transferred.)

Footnote 3: This guidance is specific to acquired structured settlement income streams (legal right to receive future payments from a structured settlement) and does not capture accounting and reporting guidance for the acquisition of any insurance product (e.g., life settlement, annuities, etc.).

Footnote 4: Reporting entities that hold qualifying structured settlement payment rights shall report the security on Schedule BA either as an "any other class of asset" or as a "fixed or variable interest rate investment with underlying characteristics of other fixed income instruments" if the structured settlement payment right qualifies for reporting within that reporting line (e.g., NAIC designation).

Guaranteed Investment Contracts

14. Guaranteed Investment Contracts (GICs) purchased for investment purposes meet the definition of assets as defined in SSAP No. 4~~,~~ and are admitted assets to the extent they conform to the requirements of this statement. This includes an investment in a GIC payment stream which can be created when an intermediary purchases individual GICs, pools them, and sells the rights to the payment stream.

15. GICs acquired in a security structure that qualify under the bond definition as an issuer obligation or asset backed security shall follow the accounting guidance within SSAP No. 26R or SSAP No. 43R as applicable.

~~15.~~16. Purchases of GIC investments that do not meet the definition of a security, but for which all contractual rights and ownership of the GIC result in an investment similar to a corporate bond, shall be reported at amortized cost and ~~accounted for in accordance with the guidance in *SSAP No. 26R—Bonds*~~ included on Schedule BA: Other Long-Term Invested Assets. If, in accordance with SSAP No. 5R, it is probable that the carrying value of a GIC is not fully recoverable the investment shall be considered impaired. Accordingly, the cost basis of the investment shall be written down to the undiscounted estimated cash flows and the amount of the write down shall be accounted for as a realized loss. The new cost basis shall not be changed for subsequent recoveries in fair value.

~~16. An investment in a GIC payment stream is created when an intermediary purchases individual GICs, pools them, and sells the rights to the payment stream. These investments shall be reported as other long-term invested assets and shall be carried at amortized cost.~~

~~17. If, in accordance with SSAP No. 5R, it is probable that the carrying value of a GIC is not fully recoverable the investment shall be considered impaired. Accordingly, the cost basis of the investment shall be written down to the undiscounted estimated cash flows and the amount of the write down shall be accounted for as a capital loss. The new cost basis shall not be changed for subsequent recoveries in fair value.~~

SSAP No. 36—Troubled Debt Restructuring (No Changes)

29. Although *FASB Statement No. 91, Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases* (FAS 91) was rejected in *SSAP No. 26R—Bonds*, this statement is consistent with paragraph 14 of *FAS No. 91.*

SSAP No. 43R—Asset-Backed Securities

Disclosures

51. In addition to the disclosures required for invested assets in general, the following disclosures regarding loan-backed and structured securities shall be made in the financial statements. Regardless of the allowances within paragraph 63 of the Preamble, the disclosures in paragraph 51.f., 51.g. and 51.h. of this statement are required in separate, distinct notes to the financial statements:

m. The items in the scope of this statement are also subject to the annual audited disclosures in *SSAP No. 26R—Bonds*, paragraphs 39.e.,~~30.e.~~, 39.f.,~~30.f.~~ and 39.g.~~30.g~~.

SSAP No. 86—Derivatives

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

g. "Structured Notes" ~~in scope of this statement are instruments defined in *SSAP No. 26R—Bonds* (often in the form of debt instruments),~~ in scope of this statement are instruments in which the amount of principal repayment or return of original investment is contingent on an underlying variable/interest[5]~~.~~where the terms of the agreement make it possible that the reporting entity could lose all or a portion of its original investment amount (for other than failure of the issuer to pay the contractual amounts due). ~~Structured notes that are "m~~Mortgage-referenced securities~~"~~ issued by a government sponsored enterprise in the

form of credit-risk transfers where an issue security is tied to a referenced pool are mortgages are captured in *SSAP No. 43R—Loan-Backed and Structured Securities*.

Footnote 5 - ~~The "structured notes" captured within scope of this statement is specific to instruments in which the terms of the agreement make it possible that the reporting entity could lose all or a portion of its original investment amount (for other than failure of the issuer to pay the contractual amounts due).~~ These instruments incorporate both the credit risk of the issuer, as well as the risk of an underlying variable/interest (such as the performance of an equity index or the performance of an unrelated security). Securities that are labeled "principal-protected notes" are captured within scope of this statement if the "principal protection" involves only a portion of the principal and/or if the principal protection requires the reporting entity to meet qualifying conditions in order to be safeguarded from the risk of loss from the underlying linked variable. Securities that may have changing positive interest rates in response to a linked underlying variable or the passage of time, or that have the potential for increased principal repayments in response to a linked variable (such as U.S. Treasury Inflation-Indexed Securities) that do not incorporate risk of original investment/principal loss (outside of default risk) are not captured as structured notes in scope of this statement.

SSAP No. 95—Nonmonetary Transactions

6. Fair value of assets received or transferred in a nonreciprocal transfer shall be measured based on statutory accounting principles for the type of asset transferred. Accordingly, the value shall be determined in accordance with *SSAP No. 26R—Bonds*, *SSAP No. 30R—Unaffiliated Common Stock*, *SSAP No. 32R—Preferred Stock*, SSAP No. 37*—Mortgage Loans*, *SSAP No. 39—Reverse Mortgages*, *SSAP No. 40R—Real Estate Investments*, *SSAP No. 43R—~~Loan-Backed and Structured~~Asset-Backed Securities*, *SSAP No. 90—Impairment or Disposal of Real Estate Investments* or other applicable statements. The guidance provided in SSAP No. 25 shall be followed in accounting for nonreciprocal transactions with affiliates and other related parties as defined in that statement.

SSAP No. 100—Fair Value (No Changes)

48. For each class of assets and liabilities measured and reported[3] at fair value or NAV in the statement of financial position after initial recognition. The reporting entity shall determine appropriate classes of assets and liabilities in accordance with the annual statement instructions.

Footnote 3: The term "reported" is intended to reflect the measurement basis for which the asset or liability is classified within its underlying SSAP. For example, a bond with an NAIC designation of 2 is considered an amortized cost measurement and is not included within this disclosure even if the amortized cost and fair value measurement are the same. An example of when such a situation may occur includes a bond that is written down as other-then-temporarily impaired as of the date of financial position. The amortized cost of the bond after the recognition of the other-than-temporary impairment may agree to fair value, but under SSAP No. 26R this security is considered to still be reported at amortized cost.

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

2. This statement focuses on the issues of accounting for transfers and servicing of financial assets and extinguishments of liabilities. This statement establishes statutory accounting principles for transfers and servicing of financial assets, including asset securitizations and securitizations of policy acquisition costs, extinguishments of liabilities, repurchase agreements, repurchase financing and reverse repurchase agreements, including dollar repurchase and dollar reverse repurchase agreements that are consistent with the Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy (Statement of Concepts). This statement discusses generalized situations. Facts and circumstances and specific contracts need to be considered carefully in applying this statement. Securitizations of nonfinancial assets are outside the scope of this statement. Transfers of financial assets that are in substance real estate shall be accounted for in accordance with *SSAP No. 40R—Real Estate Investments*. Additionally, retained beneficial interests from the sale of ~~loan-backed or structured~~ asset-backed securities are to be accounted for in accordance with the statutory accounting statement that is applicable to the investment retained~~with~~. ~~SSAP No. 43R—Loan-Backed and Structured Securities, Revised.~~ If the retained security does not qualify for reporting as a

bond under the bond definition detailed in SSAP No. 26R, it shall be reported as a debt security that does not qualify as a bond in scope of *SSAP No. 21R—Other Admitted Assets*.

11. Upon completion of a transfer of an entire financial asset or a group of entire financial assets that satisfies the conditions to be accounted for as a sale (see paragraph 8), the transferor (seller) shall:

a. Derecognize the transferred financial assets;

b. Recognize and initially measure at fair value servicing assets, servicing liabilities, and any other assets obtained (including a transferor's beneficial interest in the transferred financial assets) and liabilities incurred[1] in the sale (paragraphs 60 and 62-66).

c. For reporting entities required to maintain an Interest Maintenance Reserve (IMR), the accounting for realized and unrealized capital gains and losses shall be determined per the guidance in the SSAP for the specific type of investment ~~(e.g., SSAP No. 43R for loan-backed and structured securities)~~, or if not specifically stated in the related SSAP, in accordance with *SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve*. For reporting entities not required to maintain an IMR, realized capital gains and losses shall be reported as net realized capital gains or losses in the statement of income, and unrealized capital gains and losses shall be reported as net unrealized gains and losses in unassigned funds (surplus).

The transferee shall recognize all assets obtained and any liabilities incurred, and initially measure them at fair value.

Footnote 1: Some assets that might be obtained and liabilities that might be incurred include cash, put or call options that are held or written (for example, guarantee or recourse obligations), forward commitments (for example, commitments to deliver additional receivables during the revolving periods of some securitizations) and swaps (for example, provisions that convert interest rates from fixed to variable).

Financial Assets Subject to Prepayment

18. Financial assets, except for instruments that are within the scope of *SSAP No. 86—Derivatives*, that can contractually be prepaid or otherwise settled in such a way that the holder would not recover substantially all of its recorded investment shall be assessed in accordance with the bond definition captured in *SSAP No. 26R—Bonds* to determine appropriate accounting and reporting. Securities that do not qualify for bond reporting shall be captured as debt securities that do not qualify as bonds in scope of *SSAP No. 21R—Other Admitted Assets*. ~~subsequently measured in accordance with the statutory accounting statement that is applicable to the financial asset. subsequently measured like investments in debt securities and loan-backed and structured securities in accordance with SSAP No. 43R. Examples of such financial assets include, but are not limited to, interest-only strips, other beneficial interests, loans, or other receivables.~~

INT 01-25: Accounting for U.S. Treasury Inflation-Indexed Securities

- No Change – Applies to SSAP No. 26R.

INT 06-02: Accounting and Reporting for Investments in a Certified Capital Company (CAPCO)

5. For Issue 1, the Working Group came to a consensus that reporting entities should account and report for investments in CAPCO's consistent with the agreement structure within the guidance provided below:

h. Investment in a debt instrument of a CAPCO shall be reported as a bond in accordance with the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* and the designation assigned in the *NAIC Valuations of Securities* product prepared by the NAIC Securities Valuation Office (Valuations of Securities manual) as stated in SSAP No. 26R, paragraph 20~~11~~.

i. Investment in an equity interest of a CAPCO shall be reported as common stock and reported at fair value as stated in SSAP No. 30R, paragraph 8.

j. Investment in preferred stock interest of a CAPCO shall be reported as preferred stock in accordance with the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* and the designation assigned in the *NAIC Valuations of Securities* product prepared by the NAIC Securities Valuation Office (Valuations of Securities manual) as stated in SSAP No. 32R, paragraphs 19-22.

k. Investment in a Joint Venture, Partnership and Limited Liability Company (LLC) shall be reported in accordance with SSAP No. 48, paragraphs 5-6. The reported value of the investment shall be decreased in proportion to the premium tax credits utilized.

l. The tax credits shall be recognized as a reduction of the tax liabilities as they are utilized. Tax credits received are not to be included in investment income.

INT 06-07: Definition of Phrase "Other Than Temporary"

- Update interpreted SSAP list to reference to *SSAP No. 43R—Asset Backed Securities*

INT 07-01: Application of the Scientific (Constant) Yield Method in Situations of Reverse Amortizations

1. SSAP No. 26R and SSAP No. 43R both reference the use of the scientific or constant yield method of amortization of a premium or a discount. ~~*SSAP No. 26R—Bonds* provides the following (bolding added for emphasis):~~

> ~~**Amortized Cost**~~
>
> ~~9. **Amortization of bond premium or discount shall be calculated using the scientific (constant yield) interest method taking into consideration specified interest and principal provisions over the life of the bond.** Bonds containing call provisions (where the issue can be called away from the reporting entity at the issuer's discretion) shall be amortized to the call or maturity value/date which produces the lowest asset value (yield to worst).~~

~~*SSAP No. 43R—Loan-Backed and Structured Securities* provides the following (bolding added for emphasis):~~

> ~~**Amortization**~~
>
> ~~8. **Amortization of premium or discount shall be calculated using the scientific (constant yield) interest method** and shall be recorded as an adjustment to investment income. The interest method results in a constant effective yield equal to the prevailing rate at the time of purchase or at the time of subsequent adjustments to book value. The amortization period shall reflect estimates of the period over which repayment of principal of the loan-backed securities is expected to occur, not the stated maturity period.~~
>
> ~~**Collection of All Contractual Cashflows is Probable**~~

~~12. The following guidance applies to loan-backed and structured securities for which it is probable that the investor will be able to collect all contractually required payments receivable. (Paragraphs 17-19 provide guidance for securities in which collection of all contractual cash flows is not probable and paragraphs 20-24 provide guidance for beneficial interests.) Prepayments are a significant variable element in the cash flow of loan-backed securities because they affect the yield and determine the expected maturity against which the yield is evaluated. Falling interest rates generate faster prepayment of the mortgages underlying the security, shortening its duration. This causes the reporting entity to reinvest assets sooner than expected at potentially less advantageous rates. This is called prepayment risk. Extension risk is created by rising interest rates which slow repayment and can significantly lengthen the duration of the security. Differences in cash flows can also result from other changes in the cash flows from the underlying assets. If assets are delinquent or otherwise not generating cash flow, which should be reflected in the cash flow analysis through diminishing security cash flows, even if assets have not been liquidated and gain/losses have not been booked.~~

~~13. Changes in currently estimated cash flows, including the effect of prepayment assumptions, on loan-backed securities shall be reviewed periodically, at least quarterly. The prepayment rates of the underlying loans shall be used to determine prepayment assumptions. Prepayment assumptions shall be applied consistently across portfolios to all securities backed by similar collateral (similar with respect to coupon, issuer, and age of collateral). Reporting entities shall use consistent assumptions across portfolios for similar collateral within controlled affiliated groups. Since each reporting entity may have a unique method for determining the prepayment assumptions, it is impractical to set standard assumptions for the industry. Relevant sources and rationale used to determine each prepayment assumption shall be documented by the reporting entity.~~

~~14. Loan-backed securities shall be revalued using the currently estimated cash flows, including new prepayment assumptions, using either the prospective or retrospective adjustment methodologies, consistently applied by type of securities. However, if at any time during the holding period, the reporting entity determines it is no longer probable that they will collect all contractual cashflows, the reporting entity shall apply the accounting requirements in paragraphs 17-19.~~

~~15. The prospective approach recognizes, through the recalculation of the **effective yield** to be applied to future periods, the effects of all cash flows whose amounts differ from those estimated earlier and the effects and changes in projected cash flows. Under the prospective method, the recalculated effective yield will equate the carrying amount of the investment to the present value of the anticipated future cash flows. The recalculated yield is then used to accrue income on the investment balance for subsequent accounting periods. There are no accounting changes in the current period unless the security is determined to be other than temporarily impaired.~~

~~16. The retrospective methodology changes both the yield and the asset balance so that expected future cash flows produce a return on the investment equal to the return now expected over the life of the investment as measured from the date of acquisition. Under the retrospective method, the recalculated **effective yield** will equate the present value of the actual and anticipated cash flows with the original cost of the investment. The current balance is then increased or decreased to the amount that would have resulted had the revised yield been applied since inception, and investment income is correspondingly decreased or increased.~~

2. This interpretation~~The following~~ identifies three situations where, using a constant yield methodology for determining amortization or accretion, changes in amortized value move in the opposite direction of what is expected. That is, if a security is purchased at a premium, the constant yield methodology will, in certain cases, cause the amortized value to move to a discount during the life of the security. Conversely, if the security were purchased at a discount, the constant yield methodology will, in certain cases, cause the amortized value to move to a premium during the life of the security.

INT 19-02: Freddie Mac Single Security Initiative

- Update interpreted SSAP list to reference to *SSAP No. 43R—Asset Backed Securities*

  1. This interpretation has been issued to provide a limited-scope exception to the exchange and conversion guidance in *SSAP No. 26R—Bonds* as well as prescribe guidance in *SSAP No. 43R—Asset-Backed ~~Loan-Backed and Structured~~ Securities* (SSAP No. 43R) for instruments converted in accordance with the Freddie Mac Single Security Initiative. Under this initiative, reporting entities will be permitted to exchange "45-day securities" for "55-day securities" without any material change to the securities, or to the loans that back the securities. (With the exchange, there would be a 10-day delay in payment cycle.)

INT 22-01: Freddie Mac When Issued K-Deal (WI Trust) Certificates

- Update interpreted SSAP list to reference to *SSAP No. 43R—Asset Backed Securities*

  1. This interpretation is to address questions on the accounting and reporting for Freddie Mac "When-Issued K-Deal (WI Trust) Certificates" (WI Program). Ultimately, the question is whether the structure should be initially captured in scope of *SSAP No. 43R—~~Loan-Backed and Structured~~Asset-Backed Securities* or as a forward contract in scope of *SSAP No. 86—Derivatives*.

Summary of SAP Guidance Revisions:

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

Cash Equivalents

6. Cash equivalents are short-term, highly liquid investments that are both (a) readily convertible to known amounts of cash, and (b) so near their maturity that they present insignificant risk of changes in value because of changes in interest rates. Only investments with original maturities[1] of three months or less can qualify under this definition, with the exception of money market mutual funds, as detailed in paragraph 8, and cash pooling, as detailed in paragraph 9. Regardless of maturity date, the following investments are not permitted to be reported as cash equivalents and shall be reported on the investment schedule that corresponds to the SSAP for which the investment is applicable:

a. Asset-backed securities captured in scope of SSAP No. 43R.

b. All debt securities that do not qualify as bonds which are in scope of SSAP No. 21R.

~~a.~~c. ~~, d~~Derivative instruments in scope of SSAP No. 86 or SSAP No. 108~~shall not be reported as cash equivalents and shall be reported as derivatives on Schedule DB~~.

d. Working capital finance investments in scope of SSAP No. 105R.

~~b.~~e. ~~-~~Securities with terms that are reset at predefined dates (e.g., an auction-rate security that has a long-term maturity and an interest rate that is regularly reset through a Dutch auction) or have other features an investor may believe results in a different term than the related contractual maturity shall be accounted for based on the contractual maturity at the date of acquisition, except where other specific rules within the statutory accounting framework currently exist.

Short-Term Investments

14. Short-term investments are investments that do not qualify as cash equivalents with remaining maturities (or repurchase dates under reverse repurchase agreements) of one year or less at the time of acquisition. Short-term investments can include, but are not limited to bonds, commercial paper, reverse repurchase agreements, and collateral and mortgage loans which meet the noted criteria. Short-term investments shall not include investments specifically classified as cash equivalents as defined in this statement, certificates of deposit, or derivatives. Regardless of maturity date, , the following investments are not permitted to be reported as cash equivalents and shall be reported on the investment schedule that corresponds to the SSAP for which the investment is applicable:

a. Asset-backed securities captured in scope of SSAP No. 43R.

b. All debt securities that do not qualify as bonds which are in scope of SSAP No. 21R.

c. ~~d~~Derivative instruments in scope of SSAP No. 86 or SSAP No. 108~~shall not be reported as short-term investments and shall be reported as derivatives on Schedule DB~~.

d. Working capital finance investments in scope of SSAP No. 105R.

[1] Original maturity means original maturity to the entity holding the investment. For example, both a three-month U.S. Treasury bill and a three-year Treasury note purchased three months from maturity qualify as cash equivalents. However, a Treasury note purchased three years ago does not become a cash equivalent when its remaining maturity is three months.

SSAP No. 21R—Other Admitted Assets

Debt Securities That Do Not Qualify as Bonds

20. The guidance within paragraphs 20-28 of this statement shall apply for any security, as defined in SSAP No. 26R, whereby there is a fixed schedule for one or more future payments (referred to herein as debt securities), but for which the security does not qualify for bond reporting under SSAP No. 26R as an issuer credit obligation or an asset backed security. Investments in scope of this guidance are limited to:

a. Debt securities for which the investment does not reflect a creditor relationship in substance.

b. Debt securities that do not qualify for bond reporting due to a lack of substantive credit enhancement.

c. Debt securities that do not qualify for bond reporting due solely to a lack of meaningful cash flows.

21. Debt securities as described in this statement meet the definition of assets as defined in SSAP 4, and are admitted assets to the extent they conform to the requirements of this statement. The guidance in these paragraphs shall not be inferred to other securities or investment structures that are not otherwise addressed in statutory accounting, nor shall it be applied to any investments that are captured within other statutory accounting guidance.

22. Debt securities in scope for which the source of repayment is derived through rights to underlying collateral, qualify as admitted assets only to the extent they are secured by admitted invested assets. Any amounts in excess of the fair value of the underlying admitted invested assets shall be nonadmitted.

23. Debt securities that do not qualify for bond reporting due solely to a lack of meaningful cash flows shall be reported on *Schedule BA: Other Long-Term Invested Assets* using the same accounting and measurement basis described in *SSAP 43R—Asset-Backed Securities*, including using a carrying value method determined by NAIC designation. Reporting entities that are reporting an amortized cost measurement shall obtain an NAIC designation in accordance with the parameters of the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* and report the designation on Schedule BA.

24. All other debt securities in scope of this statement shall be reported at acquisition at cost, including brokerage and other related fees on *Schedule BA: Other Long-Term Invested Assets*. These securities are permitted as admitted assets, with subsequent measurement at the lower of amortized cost or fair value. Changes in measurement to reflect the lower value or to reflect changes in fair value shall be recorded as unrealized gains or losses.

25. Debt securities that do not qualify as bonds captured in scope of this statement shall follow the guidance in *SSAP No. 43R—Asset-Backed Securities* for calculating amortized cost, for determining and recognizing other-than-temporary impairments and for allocating unrealized and realized gains and losses between the asset valuation reserve (AVR) and interest maintenance reserve (IMR).

26. Investment income shall be recorded, with assessments for collectability and nonadmittance completed and recognized, pursuant to *SSAP No. 34—Investment Income Due and Accrued*.

27. Securities captured within this section shall be included in all invested asset disclosures, along with the following disclosures:

a. Fair values in accordance with *SSAP No. 100R—Fair Value*.

b. Concentrations of credit risk in accordance with SSAP No. 27;

c. Basis at which the securities are stated;

d. The adjustment methodology used for each type of security (prospective or retrospective);

e. Descriptions of sources used to determine prepayment assumptions.

f. All securities within the scope of this statement with a recognized other-than-temporary impairment, disclosed in the aggregate, classified on the basis for the other-than-temporary impairment: (1) intent to sell, (2) inability or lack of intent to retain the investment in the security for a period of time sufficient to recover the amortized cost basis, or (3) present value of cash flows expected to be collected is less than the amortized cost basis of the security.

g. For each security with an other-than-temporary impairment, recognized in the current reporting period by the reporting entity, as the present value of cash flows expected to be collected is less than the amortized cost basis of the securities:

    i. The amortized cost basis, prior to any current-period other-than-temporary impairment.

    ii. The other-than-temporary impairment recognized in earnings as a realized loss.

    iii. The fair value of the security.

    iv. The amortized cost basis after the current-period other-than-temporary impairment.

h. All impaired securities (fair value is less than cost or amortized cost) for which an other-than-temporary impairment has not been recognized in earnings as a realized loss (including securities with a recognized other-than-temporary impairment for non-interest related declines when a non-recognized interest related impairment remains):

    v. The aggregate amount of unrealized losses (that is, the amount by which cost or amortized cost exceeds fair value) and

    vi. The aggregate related fair value of securities with unrealized losses.

i. The disclosures in (i) and (ii) above should be segregated by those securities that have been in a continuous unrealized loss position for less than 12 months and those that have been in a continuous unrealized loss position for 12 months or longer using fair values determined in accordance with SSAP No. 100R.

j. Additional information should be included describing the general categories of information that the investor considered in reaching the conclusion that the impairments are not other-than-temporary.

k. When it is not practicable to estimate fair value, the investor should disclose the following additional information, if applicable:

    i. The aggregate carrying value of the investments not evaluated for impairment, and

ii. The circumstances that may have a significant adverse effect on the fair value.

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