NAIC NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS

# Adoptions by the Statutory Accounting Principles (E) Working Group

*This list of adopted items will be updated following each interim and national meeting of the Statutory Accounting Principles (E) Working Group.*

**Revisions to the**
***As of March 2023 Accounting Practices and Procedures Manual***

On **January 10, 2024**, the Statutory Accounting Principles (E) Working Group adopted the following revisions to the *As of March 2023 Accounting Practices and Procedures Manual*. Documents associated with these revisions are linked to the reference items in bold text.

| Ref # | SSAP/ Appendix | Title | Summary |
|---|---|---|---|
| **INT 23-04** | SSAP No. 61R | Scottish Re Life Reinsurance Liquidation Questions<br><br>*SAP Clarification*<br><br>Effective<br>(December 31, 2023) | *INT 23-04: Scottish Re Life Reinsurance Liquidation Questions* provides accounting and reporting guidance for ceding entities with reinsurance balances to or from Scottish Re, a U.S.-based life reinsurer in liquidation. The guidance focuses primarily on reinsurance recoverables. |
| **2023-24** | INT 06-07<br><br>SSAP No. 2R<br>SSAP No. 5R<br>SSAP No. 22R<br>SSAP No. 26R<br>SSAP No. 32R<br>SSAP No. 34<br>SSAP No. 37<br>SSAP No. 39<br>SSAP No. 41R<br>SSAP No. 43R<br>SSAP No. 61R<br>SSAP No. 62R<br>SSAP No. 86<br>SSAP No. 103R<br>SSAP No. 105R | ASU 2016-13 Measurement of Credit Losses on Financial Instruments (CECL)<br><br>*SAP Clarification*<br><br>Effective<br>(December 31, 2023) | Revisions reject ASU 2016-13 and related subsequent ASUs in various SSAPs and *INT 06-07: Definition of Phrase "Other Than Temporary."* These revisions reject CECL for statutory accounting. |

https://naiconline.sharepoint.com/teams/frsstatutoryaccounting/national meetings/a. national meeting materials/2024/01 1-10-24/adoptions/00 - adoptions toc.docx

# Interpretation of the Statutory Accounting Principles (E) Working Group

## INT 23-04: Scottish Re Life Reinsurance Liquidation Questions

**INT 23-04 Dates Discussed**
October 23, 2023; October 24, 2023; December 1, 2023; January 10, 2024

**INT 23-04 References**

**Current:**
*SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance*

**INT 23-04 Issue**

**Background:**

1. Liquidations of U.S. licensed reinsurers are uncommon. Due to a 2023 liquidation order of a U.S.-based life reinsurer, life industry cedents have requested an interpretation to address the accounting and reporting for reinsurance receivables from the reinsurer's estate. This interpretation is intended to be applied generically; however, the following circumstances are relevant to the accounting issues identified.

   a. The recent liquidation order was for Scottish Re, a U.S. life reinsurance entity, which was in regulatory supervision for several years.

   b. The life reinsurer was not assuming new business but was receiving ongoing premium on yearly renewable contracts.

   c. The 2023 liquidation order cancelled reinsurance contracts on a cut-off basis, effective September 30, 2023.

   d. Settlement from the reinsurer's estate is expected to exceed one year.

   e. Settlement from the reinsurer's estate to the ceding entities is expected to be less than 100%. That is, cedents are expected to receive a portion of what they are owed.

   f. Some ceding insurers established trusts to hold assets backing the reserves under the reinsurance agreements.

**Interpretation Discussion**

2. This interpretation is applicable only to the accounting and reporting of reinsurance recoverables from Scottish Re, a U.S.-based life reinsurer in liquidation. The Statutory Accounting Principles (E) Working Group consensuses to the noted issues are included below.

**Issue 1 – Commutation or Recapture of a Life Reinsurance Contract**

3. If a liquidation order cancels a life reinsurance contract on a cut-off basis, should the life reinsurance commutation guidance in S*tatement of Statutory Accounting Principle*s (*SSAP) No. 61R—Life, Deposit-Type and Accident and Health Reinsurance* be used as the primary accounting guidance for the commutation?

 

4. Yes. SSAP No. 61R, paragraph 58, provides the primary guidance for a life reinsurance commutation. The guidance provides that:

> **Recaptures and Commutations**
>
> 58. A recapture or a commutation of a reinsurance agreement is a transaction which results in the complete and final settlement and discharge of all present and future obligations between the parties arising out of the agreement or a portion of the agreement. Commuted and recaptured balances shall be accounted for by writing them off through the accounts, exhibits and schedules in which they were originally recorded. The assumed reserves and reserve credits taken are eliminated by the reinsurer and ceding entity, respectively. The reinsurer and ceding entity must also make any required IMR liability adjustment changes. Any net gain or loss is reported in the summary of operations.

**Issue 2 – Impairment of Reinsurance Recoverables**

5. The reinsurer that was previously in regulatory supervision and is now in liquidation was known to have financial difficulties and many ceding entities have either established valuation allowances and/or written off reinsurance recoverables as impairment losses. Questions have been received in response to the diversity in practice on whether the ceding entities were reporting impairment losses or were reporting a valuation allowance on all categories of their expected reinsurance recoverables from the reinsurer which is now in liquidation.

6. Do reporting entities have the choice of setting up a valuation allowance or applying the impairment guidance in SSAP No. 61R to the reinsurance recoverables from the life reinsurer in liquidation?

7. No. Reporting entities do not have a choice of a valuation allowance or applying impairment analysis. SSAP No. 61R, paragraph 42, requires impairment analysis of uncollectible reinsurance amounts in accordance with *SSAP No. 5R—Liabilities, Contingencies and Impairments of Asset.* The guidance requires that impaired amounts shall be written off through a charge to the Statement of Operations utilizing the same accounts which established the reinsurance recoverables. SSAP No. 5R and SSAP No. 61R do not permit a valuation allowance.

8. The liquidation order of a reinsurer should prompt an impairment analysis of all amounts recoverable from the reinsurer with a write-off of amounts not expected to be recovered.

9. The impairment analysis shall be updated at every reporting date.

**Issue 3 – Reporting of Reinsurance Recoverables**

10. The liquidation order results in a commutation and recapture of business for the ceding entity. A liquidation will determine the reinsurer's estate assets, then determine payments based on liquidation priority. This will result in a delay in settlement from the estate of the reinsurer. As previously detailed, the amounts paid by the estate shall be impaired to the amount expected to be received by the ceding entities.

11. Where shall the ceding entity report the remaining receivables for the reinsurer's estate?

12. In accordance with the recapture and commutation guidance in SSAP No. 61R, paragraph 58 (quoted above), the ceding entity shall remove balances through the schedules and exhibits originally reported. No reserve credit or contra-liabilities shall be reported. The reinsurance reserve credits shall be removed. Gains or losses are reported in the summary of operations.

13. Based on preliminary information received, it is expected that there will be an amount receivable for paid claims incurred before the reinsurance contract cancellation. This amount shall be reported on the asset page line 16.1 - Amounts Recoverable from Reinsurers.

14. Amounts recoverable from the reinsurer's estate for claims incurred before the reinsurance contract cancellation and unpaid as of the reporting date shall be reported on the asset page line 16.3 - Other Amounts Receivable Under Reinsurance Contracts.

15. If the ceding entity owes amounts to the reinsurer's estate, the amounts shall be reported as a liability on line 9.3 - Other Amounts Payable on Reinsurance.

16. After impairing the recoverables, any other amount expected to be recovered from the reinsurer's estate shall be reported on line 25 Aggregate Write-ins for Other Than Invested Assets.

**Issue 4 – Admissibility of Reinsurance Recoverables**

17. As noted above, quarterly impairment analysis of collectability is required. After evaluating for impairment, if there are remaining receivables from the reinsurer's estate, do those assets qualify as admitted reinsurance recoverable assets?

18. Reinsurance recoverables from Scottish Re in liquidation are admitted as follows:

a. The reinsurance recoverable amount from Scottish Re from paid claims incurred prior to the reinsurance contract cancellation which are reported on the asset page line 16.1 - Amounts Recoverable from Reinsurers which are not in dispute are admitted after impairment review.

b. To the extent reinsurance amounts recoverable are secured by assets in an Appendix A-785 - Credit for Reinsurance compliant trust, such recoverable amounts may be admitted to the extent the that the amounts are not in dispute and that the collateral in an Appendix A-785 compliant trust is sufficient.

19. Other reinsurance recoverables, which are not identified as admitted assets in paragraph 18 are nonadmitted until received. This includes amounts either in dispute or not secured by collateral in a trust that is compliant with Appendix A-785.

**Issue 5 – Disclosures**

20. Do the relevant disclosures in SSAP No. 61R and other relevant SSAPs apply to a commuted life reinsurance contract which has not been fully settled due to a liquidation?

21. Yes. The relevant disclosures in SSAP No. 61R and other relevant SSAPs continue to apply to a life reinsurance contract which is commuted and recaptured due to a liquidation. These disclosures include but are not limited to the disclosures regarding commutation, uncollectible reinsurance and anything else that is required.

22. Disclosure in the reinsurance notes to the financial statements shall include additional information necessary to obtain an understanding of the impact of Scottish Re reinsurance counterparties in liquidation, including but not limited to, reinsurance payable liabilities, reinsurance recoverables by paid claims and other amounts, information regarding the status of any collateral and its fair value. Where applicable, reporting entities should disclose any individual components (e.g., unreimbursed claims or provisions for future losses) of recoverable amounts that are presented in the aggregate on the financial statements. The

 

disclosure shall include measurement, impairment and collectability of any reinsurance recoverables including timing of expected payments and nonadmitted amounts.

**INT 23-04 Summary**

23. Although readers should refer to the detailed guidance above, a summary of the key provisions is as follows:

a. Issue 1 – Commutation or Recapture of a Life Reinsurance Contract: Follow SSAP No. 61R, paragraph 58, as it provides primary recapture and commutation guidance.

b. Issue 2 – Impairment of Reinsurance Recoverables: SSAP No. 61R paragraph 42, requires impairment of uncollectible reinsurance in accordance with SSAP No. 5R.

c. Issue 3 – Reporting of Reinsurance Recoverables: Follow the recapture and commutation guidance in SSAP No. 61R, then analyze for impairment. Report reinsurance payables separate from reinsurance recoverables. Amounts related to paid and unpaid claims incurred prior to reinsurance contract cancellation are reported on asset page line 16.1 - Amounts Recoverable from Reinsurers and asset page line 16.3 - Other Amounts Receivable Under Reinsurance Contracts, respectively. Any remaining reinsurance recoverables from the reinsurance counterparty after impairment assessment shall be reported on the asset page line 25 Aggregate Write-ins for Other than Invested Assets.

d. Issue 4 – Admissibility of Reinsurance Recoverables: Admit amounts related to claims incurred prior to contract cancellation which have been paid by the reporting entity as of the reporting date (reported on asset page line 16.1 - Amounts Recoverable from Reinsurers) which are not in dispute after impairment review. Admit reinsurance recoverables which are not in dispute, and which are secured by collateral in an A-785 compliant trust. Nonadmit all amounts recoverable from a life reinsurer in liquidation which are either in dispute or which are not secured by collateral in a trust compliant with Appendix A-785.

e. Issue 5 – Disclosures: Follow existing applicable disclosures and provide additional information sufficient to understand the nature and impact of a reinsurance counterparty in liquidation as described in paragraph 22.

**INT 23-04 Status**

**24.** The consensuses in this interpretation were adopted on January 10, 2024, with an effective date of reporting periods on or after December 31, 2023.

**25.** No further discussion is planned.

 

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

**Issue: ASU 2016-13 Measurement of Credit Losses on Financial Instruments**

**Check (applicable entity):**

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

**Description of Issue:** In June 2016, the Financial Accounting Standards Board (FASB) issued *ASU 2016-13 Financial Instruments–Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments* (CECL*)* to change impairment and credit loss United States generally accepted accounting principles (GAAP) guidance from an "incurred loss" methodology to an "expected loss" methodology. These changes were made primarily in response to the 2008 Great Recession in which companies were anticipating significant credit losses but were unable to record these losses as the probable threshold had not yet been met. In response to this issue, FASB established the Financial Crisis Advisory Group (FCAG) to advise FASB on improvements to financial reporting in response to the Great Recession. The main recommendation from the FCAG to FASB was to investigate improvements to impairment and credit loss guidance through the development of an alternative to the "incurred loss" methodology. Based on this recommendation FASB developed CECL which replaces the "incurred loss" methodology and provides financial statement users with more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date. CECL affects all entities holding financial assets that are not accounted for at fair value through net income, including loans, debt securities, trade receivables, net investments in leases, off-balance sheet credit exposures, reinsurance recoverables and any other financial assets not specifically excluded that have the contractual right to receive cash. The impact from applying CECL is anticipated to vary by reporting entity in accordance with the credit quality of assets held and how they apply current GAAP.

One significant difference between previous GAAP and CECL is that the impairment guidance for in-scope assets were superseded and replaced with credit loss guidance under *Topic 326–Financial Instruments—Credit Losses*. Beyond consolidating new credit loss guidance into a single topic, CECL fundamentally changed the methodology for calculating and recording credit losses by replacing the incurred credit loss model with the expected credit loss model, which requires expected losses to be assessed and recorded at the onset of the acquisition of in-scope assets. This requirement is applicable for all in-scope assets unless management assesses that the asset represents a zero-risk transaction, U.S. Treasuries for example. As a result, the calculation of a credit loss allowance is now required for many assets which previously would have only recorded a credit loss allowance once it has occurred, or the probable threshold had been met. The asset categories scoped into the new CECL credit loss guidance are as follows:

- Financing Receivables
- Receivables from Sales-Type or Direct Finance Leases
- Related Party Accounts and Loans Receivable, excluding related parties under common control.
- All financial instruments held at Amortized Cost (categorized as Held to Maturity under GAAP), excluding purchased financial assets with credit deterioration (PCDs).
    - Includes but is not limited to debt securities, trade and time-share receivables, contract assets, and reinsurance recoverables.
- Off-balance-sheet credit exposures not accounted for as insurance.
    - Includes but is not limited to loan commitments, forward commitments to purchase loans, letters of credit, and financial guarantees.
- Cash Equivalents

While CECL does require the accrual of an allowance on expected credit losses, it does not require a specific evaluation method but rather adopts a principles-based approach which allows for any kind of credit loss evaluation if the end product of the evaluation meets certain defined criteria. Additionally, assets with similar risk profiles may be evaluated for expected credit losses collectively but these risk profiles must be assessed annually to determine if they remain similar. Note that Available for Sale securities are excluded from the expected credit loss methodology but are instead required to utilize a modified other-than-temporary impairment (OTTI) model detailed in Topic 326-30. The following information summarizes the key information on the accounting and reporting of credit losses under Topic 326:

**Overview of CECL Concepts:**
Accounting guidance is divided into securities reported at amortized cost (includes investment held at Held-to-Maturity, or HTM), and debt securities reported as available for sale (AFS), which reports fair value through OCI. The following reflects high-level concepts from CECL:

Amortized Cost Securities:

1. Allowance for credit losses is a valuation accounting that is deducted from the amortized cost basis of the financial assets to present the net amount expected to be collected on the financial assets. Net income is adjusted to reflect the allowance for credit losses based on the current expected estimate. The allowance shall be reported at each reporting date. Changes from current estimates shall be compared to estimates previously reported, with adjustments reflected in net income.

2. The entity shall measure credit losses on a collective basis when similar risk characteristics exist. If a financial asset does not share risk characteristics with other assets, the entity shall evaluate the asset on an individual basis. (Should not include individual and collective assessments on the same asset.)

3. The entity shall estimate expected credit losses over the contractual terms of the financial assets, considering prepayments. However, it shall not extend the contractual term for expected extensions, renewals, and modifications unless there is a reasonable expectation of executing a troubled debt restructuring.

4. When developing an estimate, the entity shall consider available information relevant to assessing collectability of cash flows. This may include internal information, external information, or a combination of past events, current conditions and reasonable and supportable forecasts. (Internal information may be determined sufficient.)

5. Historical credit loss information for assets with similar characteristics generally provides a basis for expected losses, but entities shall not rely solely on past events to estimate expected credit losses. When using historical information, the entity shall consider the need to adjust for management expectations about current conditions and reasonable and supported forecasts that differ from the historical period.

6. Estimate of expected credit losses shall include a measure of the expected risk of credit loss even if that risk is remote. However, entities are not required to measure expected credit losses when the expectation of nonpayment of the amortized cost basis is zero.

7. Estimate of expected credit losses shall reflect how credit enhancements (other than freestanding contracts) mitigate expected credit losses. However, freestanding contracts shall not be used to offset expected losses.

8. Assets purchased with existing credit deterioration are initially reported at the purchase price plus the allowance for credit losses to determine the initial amortized cost basis. Any noncredit discount or premium shall be allocated to each individual asset. At the acquisition date, the initial allowance for credits losses determined on a collective basis shall be allocated to individual assets to appropriately allocate any noncredit discount or premium.

9. For collateral-dependent financial assets, entities shall measure expected credit losses based on the fair value of the collateral when the entity determines that foreclosure is probable. The entity may expect credit losses of zero when the fair value (less costs to sell) of the collateral at the reporting date is equal to or exceeds the amortized cost basis of the financial asset. If the collateral is less than the amortized cost basis, an entity shall recognize an allowance for credit losses as the difference between the collateral fair value and the amortized cost of the asset.

10. In the period when financial assets are deemed uncollectible, they shall be written off with a deduction from the allowance.

11. Detailed disclosures are included to enable users to understand: 1) credit risk inherent in a portfolio and how management monitors credit quality of a portfolio; 2) management's estimate of expected credit losses; and 3) changes in the estimate of expected credit losses that have occurred during the period. These disclosures include a rollforward of the allowance for credit losses and a reconciliation of the purchase price for assets purchased with credit deterioration.

12. Noted examples are included for collateral-dependent financial assets (real estate loans), assets with collateral maintenance provisions (reverse-repurchase agreements), and HTM debt securities when potential default is greater than zero, but expected nonpayment is zero (Treasury Securities).

<u>Available-for-Sale Debt Securities</u>

13. Investment is impaired if the fair value of the investment is less than amortized cost basis.

14. For individual AFS debt securities, the entity shall determine whether a decline in fair value below the amortized cost basis has resulted from a credit loss or other factors. Impairments related to credit losses shall be recorded through an allowance for credit losses. However, the allowance shall be limited by the amount that the fair value is less than the amortized cost basis.

15. At each reporting date, the entity shall record an allowance for credit losses that reflects the amount of impairment related to credit losses, limited by the fair value floor. Changes in the allowance shall be recorded in the period of the change as a credit loss expense (or reversal of credit loss expense).

16. <u>Impairment shall be assessed at the individual security level</u>. For example, debt securities bearing the same CUSIP – even if purchased in separate lots – may be aggregated by a reporting entity on an average cost basis if that corresponds to the basis used to measure realized or unrealized gains and losses for the debt securities. <u>Providing a general allowance for an unidentified investment in a portfolio of debt securities is not appropriate.</u>

17. In assessing whether a credit loss exists, 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 the present value of cash flows expected to be collected is less than the amortized cost basis of the security, a credit loss exists and an allowance for credit losses shall be recorded for the credit loss, limited by the amount that the fair value is less than amortized cost basis. Credit losses on an impaired security shall continue to be measured using the present value of expected future cash flows. (Entity would discount the expected cash flows at the effective interest risk implicit in the security at the date of acquisition.)

18. Estimates of expected future cash flows shall be on the entity's best estimate based on past events, current conditions and on reasonable and supportable forecasts.

19. If the entity intends to sell, or if more-likely-than-not will be required to sell before recovery of the amortized cost basis, any allowance for credit losses shall be written off and the amortized cost basis shall

be written down to the debt security's fair value at the reporting date with any incremental impairment reflected in earnings.

20. Entities shall reassess the credit losses each reporting period when there is an allowance for credit losses. Subsequent changes shall be recorded in the allowance for credit losses, with a corresponding adjustment in the credit loss expense. Entities are not permitted to reverse a previously recorded allowance for credit losses to an amount below zero.

21. Once an AFS debt security has been written down, the previous amortized cost basis less write-offs, including noncredit related impairment reported in earnings, shall become the new amortized cost basis, and shall not be adjusted for subsequent recoveries in fair value.

22. For AFS debt securities for which impairments were reported in earnings as a write-off because of an intent to sell or a more-likely-than-not requirement to sell, the difference between the new amortized cost basis and the cash flows expected to be collected shall be accreted as interest income. Over the life of the security, continue to estimate the present value of cash flows expected to be collected. For all other AFS debt securities, if there is a significant increase in the cash flows expected to be collected or if actual cash flows are significantly greater than cash flows previously expected, those changes shall be accounted for as a prospective adjustment to the yield. Subsequent increases in fair value after the write-down shall be included in other comprehensive income.

23. These AFS debt securities shall be presented on the balance sheet at fair value, with parenthetical presentation of the amortized cost and the allowance for credit losses. The allowance for credit losses shall be separately presented as a component of accumulated other comprehensive income.

24. Detailed disclosures are included to allow users to understand: 1) credit risk inherent in AFS debt securities; 2) management's estimate of credit losses; and 3) changes in the estimate of credit losses that have taken place during the period. These disclosures include detailed information for situations in which AFS securities are in an unrealized loss position, but the entity has reached a conclusion that an allowance for credit losses is unnecessary. Other key disclosures include the methodology and significant inputs used to measure credit loss, a rollforward of the allowance for credit losses, and a reconciliation of purchased financial assets with credit deterioration.

25. Noted examples are included for AFS debt securities in an unrealized loss position for which no credit losses are reported (situations include Treasury Securities, Federal Agency MBS, and Corporate Bonds).

Additionally, CECL would make changes to how companies account for off-balance sheet credit exposures. Traditionally, most credit exposures have had no financial impact outside of disclosures until the probable threshold has been met. However, as credit exposures are within the scope of CECL entities will likely be required to assess and accrue a credit loss allowance at the inception of the credit exposure.

CECL also includes revisions to various other elements of the FASB Codification – Contingencies, Guarantees, Troubled Debt Restructuring, Revenue, Business Combinations, Consolidation, Derivatives, Fair Value Measurement, Foreign Currency Transactions, Leases, Transfer and Servicing, Insurance, Financial Guarantee Contracts, & Health Care Entities. Staff will evaluate these changes in detail, and if these revisions are applicable to SAP, as CECL is considered.

**Subsequent Revisions:**

Several ASUs have been issued after CECL to provide clarification and improvements to the guidance in ASC Topic 326. Note that references to CECL are inclusive of these subsequent revisions. For the discussion at the 2023 Fall National Meeting, NAIC staff will include the following ASUs:

- *ASU 2018-19, Codification Improvements to Topic 326, Financial Instruments—Credit Losses*, amends CECL guidance by providing clarification on two specific issues.
    - Issue 1 amended the transition date effective for nonpublic entities from 2020 to 2021 year-end.
    - Issue 2 clarifies that receivables from operating leases are not within the scope of CECL and should be accounted for in accordance with Topic 820.
- *ASU 2019-04, Codification Improvements to Topics 326, 815, 825*, addresses several topics, which are further disaggregated by issue, intended to clarify or correct the original CECL guidance. The Topics are numbered from 1-5 with several individual issues addressed within each Topic.
    - Topic 1 provides clarifications on accrued interest, transfers between categories/classifications of loans and debt securities, and recoveries on previously written off financial assets.
    - Topic 2 corrects cross-references, clarifies that reinsurance recoverables are within the scope of CECL, and provides methodological clarifications in several areas involving the calculation of credit loss reserves (see Issues 2D through 2F).
    - Topic 3 provides clarifications and corrections on several issues involving Fair Value Hedges and Hedge Accounting and clarifies that non-profit organizations that do not separately report earnings may not adopt the amortization approach as detailed for fair value hedging.
    - Topic 4 clarifies that Health and Welfare Benefit plans are not within the scope of CECL, that the scope of certain disclosures is limited to only public entities and clarifies guidance on alternative to fair value valuations.
    - Topic 5 clarifies the presentation of line of credit converted to debt items and whether entities should consider extension or renewals when calculating contract terms.
- *ASU 2019-10 Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842)*, amends the effective date for various ASUs. The transition date for CECL was moved to December 15, 2022, for all entities other than public SEC filers.
- *ASU 2019-11 Codification Improvements to Topic 326, Financial Instruments—Credit Losses*, addresses five issues identified with CECL.
    - Issues 1 and 2 involve clarifications and additional guidance on assets purchased with credit deterioration.
    - Issue 3 extends the disclosure relief detailed in ASU 2019-04 to additional disclosures on accrued interest receivables.
    - Issue 4 provides clarifications on CECL assessments which involve financial assets secured by collateral maintenance provisions.
    - Issue 5 corrects a cross-reference error.
- *ASU 2020-03 Codification Improvements to Financial Instruments* addresses several issues identified with CECL.
    - Issue 1 clarifies that all entities are required to provide the fair value option disclosures.
    - Issue 2 corrects certain paragraphs in Topic 820 to include the phrase nonfinancial items accounted for as derivatives under Topic 815 to be consistent with the previous amendments.
    - Issue 3 clarifies that the disclosure requirements in Topic 320 apply to the disclosure requirements in Topic 942 for depository and lending institutions.
    - Issues 4 and 5 correct and enhance various cross-references.
    - Issue 6 clarifies the correct contractual term used to measure the net investment in a lease.
    - Issue 7 clarifies that when an entity regains control of financial assets sold, an allowance for credit losses should be recorded in accordance with Topic 326.

**<u>Staff Analysis:</u>**

The main purpose of statutory accounting principles (SAP) is to address the concerns of regulators, primarily as it relates to assessing solvency, who are the primary users of statutory financial statements. To do so, SAP stresses measurement of a company’s ability to pay claims in the future and adopts reasonably conservative principles of accounting to ensure that insurance companies’ capital and surplus is reflective of funds in excess of policyholder liabilities which are available to pay claims should the assets backing reserves become insufficient. Risk-based capital then provides a basis for evaluating the sufficiency of this capital and surplus amount in the context of a particular company's risk-taking activities, including its exposure to credit risk. Capital requirements are calibrated to ensure sufficiency of capital even during periods of economic uncertainty and distress, within the intended level of statistical safety.

The statutory framework has long incorporated concepts that incorporate a prospective view of future credit risk that historical GAAP has not. The first is the Asset Valuation Reserve (AVR). AVR requires life insurance companies to establish a reserve to account for future impairment losses on all assets (with some minor exceptions). While this is much more formulaic than the allowance required under CECL, it is intended to accomplish the same objective. The second is that *SSAP No. 26R—Bonds* requires insurance companies that do not maintain AVR to report bonds at fair value if the bond is not considered high-quality (NAIC designations 3 to 6). While this requirement does not result in credit loss reserves, it does have a similar effect by requiring non-life companies to report lower quality bonds at fair value or convert previously highest or high-quality bonds to fair value in the event of credit quality degradation. Further, the RBC formula factors in the credit risk of each individual asset in calculating the amount of capital required to be held. These mechanisms incorporate an expectation of future credit losses. Therefore, while GAAP has just begun recognizing an expectation of future credit losses with the advent of CECL, the statutory framework has recognized and incorporated future credit loss potential for decades.

Although the statutory framework has long considered future credit losses, it is worth assessing CECL to determine whether it could introduce any improvements to the existing statutory framework if adopted. Based on the review performed, Staff does not recommend adoption of CECL for the following reasons:

- CECL is a framework that incorporates significant judgement and forecasting by the company to establish credit reserves. The assumptions and data that go into these estimates are required to be company-specific, reflecting the company's reasonable and supportable forecasts of future economic conditions. It also is required to consider current economic conditions, which results in sensitivity in the reserve to changing economic conditions. The statutory framework has historically limited insurer judgment in estimating reserves. Where judgment has been allowed, there are typically mechanisms in place to closely regulate and assess those assumptions for reasonableness. Further, loss reserves and RBC are generally set to already incorporate downside risk within a desire level of statistical safety. As the framework already incorporates an expectation of adverse experience, it is not particularly volatile with changes in economic conditions. It is intended to reflect risk through the economic cycle, not at a point in time. As a result of both the volatility and judgment involved, the CECL standard does not fit the overall design of the statutory accounting and solvency monitoring framework.
- CECL does not provide a specific method that companies must use to make expected loss estimates but is instead defined by several results-oriented principles. While this does allow companies the flexibility to adopt the forecasting process that best fits their investments and company, it also means that there will be a significant diversity in the methods used to calculate expected credit losses under CECL. Such optionality is generally not considered compatible with SAP and would also place a significant burden on regulators and examiners to assess the variety of forecasting methods utilized by insurance companies.
- The majority of insurance company investments are debt securities which are generally classified as Available for Sale (AFS) for GAAP reporting. Investments classified as AFS are held at fair value with changes in fair value recorded through other comprehensive income. The portion of the CECL standard that applies to AFS securities is markedly different than what applies to debt securities held at amortized cost. Unlike GAAP, statutory accounting requires the majority of debt securities to be held at amortized cost. As a result, using a CECL standard for statutory accounting would be significantly more expansive and impactful to a statutory balance sheet than under GAAP and would result in a significantly different application of CECL between statutory accounting and GAAP, even if the identical standard were adopted.
- CECL is a complex standard that requires companies to either develop internal models or to contract an external solution to support calculating a reserve. GAAP does allow companies to elect to hold their investments under the fair value option, in which case CECL is not required. This may be an appealing option for some insurers, particularly smaller ones that wish to avoid the operational cost of CECL. The

 

fair value option does not exist for statutory accounting. As such, adopting CECL would likely force insurers to incur the cost of CECL that would not otherwise be necessary for their GAAP financial statements.

- Similarly, many insurance companies do not prepare GAAP financial statements. This means that they would need to learn about and adopt CECL for the first time for their statutory financial statements if CECL were to be adopted.
- As RBC has its own methodology for incorporating credit risk, any CECL allowance would need to be reversed in the RBC formula in order to avoid double counting expected losses. This would largely eliminate any benefit of CECL to regulators' solvency monitoring efforts.

<u>As a result of these factors, NAIC Staff does not recommend adopting CECL for statutory accounting.</u>

**Existing Authoritative Literature:**

Existing SAP guidance has predominantly adopted (or adopted with modification) GAAP guidance pertaining to other-than-temporary impairment. <u>However, the adopted guidance, although coming from GAAP, does not reflect GAAP concepts for similar securities.</u> For example, the guidance in SSAP No. 26R reflects concepts from GAAP applicable for receivables and loans (e.g., it is probable that the entity will be unable to collect all amounts due accordingly to the contractual terms.) The guidance in *SSAP No. 43R—Loan-Backed and Structured Securities* is more comparable to current GAAP concepts applicable for both HTM and AFS debt securities (e.g., assessment of whether an entity will recover the amortized cost basis based on a review of the present value of cash flows.)

The GAAP categories for debt securities have previously been rejected for statutory accounting. As such, SAP does not include the classifications of "Held-to-Maturity," "Available-for-Sale" or "Trading" for debt securities. All debt securities are captured within SSAP No. 26R or SSAP No. 43R and reported at either amortized cost, or the lower of amortized cost or fair value, based on NAIC designation.

**Existing Authoritative Literature:**

*INT 06-07: Definition of the Phrase "Other Than Temporary"* – This INT reflects the adoption with modification of *FSP FAS 115-1/124-1: The Meaning of Other Them Temporary Impairment and Its Application to Certain Investments*. **This FSP was subsequently included in the FASB Codification in ASC 320-10 and ASC 326-30 and this ASC guidance has been deleted (or significantly revised) with the issuance of ASU 2016-13**. (This INT has not been duplicated in this agenda item.)

Preamble – This guidance reflects some of the core principles of statutory accounting as it pertains to the Staff Analysis detailed above:

> 19. SAP is conservative in some respects but not unreasonably conservative over the span of economic cycles, or in recognition of the primary statutory responsibility to regulate for financial solvency. SAP attempts to determine at the financial statement date an insurer's ability to satisfy its obligations to its policyholders and creditors.
>
> 33. Conservative valuation procedures provide protection to policyholders against adverse fluctuations in financial condition or operating results. Statutory accounting should be reasonably conservative over the span of economic cycles and in recognition of the primary responsibility to regulate for financial solvency. Valuation procedures should, to the extent possible, prevent sharp fluctuations in surplus.

SSAP No. 26R, Paragraphs 12-13 – This guidance reflects adoption of *FSP FAS 115-1/124-1: The Meaning of Other Them Temporary Impairment and Its Application to Certain Investments.* **This FSP was subsequently included in the FASB Codification in ASC 320-10 and ASC 326-30 and this ASC guidance has been deleted (or significantly revised) with the issuance of ASU 2016-13**.

13. 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.[1] 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.

14. 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.

SSAP No. 43R, Paragraphs 12-13 – This guidance reflects concepts included within *FSP FAS 115-1/124-1: The Meaning of Other Them Temporary Impairment and Its Application to Certain Investments,* as well the adoption of *EITF 99-20, Exchange of Interest-Only and Principal-Only Securities for a Mortgage-Backed Security,* and *FSP ETIF 99-20-1, Amendments to the Impairment Guidance of ETIF Issue 99-20.* **The guidance reflected from this FSP was included in ASC 310-20, 325-40, and 326-30 and has been deleted or significantly revised with the issuance of ASU 2016-13:**

**Collection of All Contractual Cashflows is Not Probable**

19. The following guidance applies to loan-backed and structured securities with evidence of deterioration of credit quality since origination for which it is probable, either known at acquisition or identified during the holding period, that the investor will be unable to collect all contractually required payments receivable, except for those beneficial interests that are not of high credit quality or can contractually be prepaid or otherwise settled in such a way that the reporting entity would not recover substantially all of its recorded amount determined at acquisition (see paragraphs 22-25).

20. The reporting entity shall recognize the excess of all cash flows expected at acquisition over the investor's initial investment in the loan-backed or structured security as interest income on an effective-yield basis over the life of the loan-backed or structured security (accretable yield). Any excess of contractually required cash flows over the cash flows expected to be collected is the nonaccretable difference. Expected prepayments shall be treated consistently for determining cash flows expected to be collected and projections of contractual cash flows such that the nonaccretable difference is not affected. Similarly, the difference between actual prepayments and expected prepayments shall not affect the nonaccretable difference.

21. An investor shall continue to estimate cash flows expected to be collected over the life of the loan-backed or structured security. If, upon subsequent evaluation:

[1] 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.

a. The fair value of the loan-backed or structured security has declined below its amortized cost basis, <u>an entity shall determine whether the decline is other than temporary</u> (INT 06-07). For example, if, based on current information and events, there is a decrease in cash flows expected to be collected (that is, the investor is unable to collect all cash flows expected at acquisition plus any additional cash flows expected to be collected arising from changes in estimate after acquisition (in accordance with paragraph 19.b.), an other-than-temporary impairment shall be considered to have occurred. The investor shall consider both the timing and amount of cash flows expected to be collected in making a determination about whether there has been a decrease in cash flows expected to be collected.

b. Based on current information and events, if there is a significant increase in cash flows previously expected to be collected or if actual cash flows are significantly greater than cash flows previously expected, the investor shall recalculate the amount of accretable yield for the loan-backed or structured security as the excess of the revised cash flows expected to be collected over the sum of (1) the initial investment less (2) cash collected less (3) other-than-temporary impairments plus (4) amount of yield accreted to date. The investor shall adjust the amount of accretable yield by reclassification from nonaccretable difference. The adjustment shall be accounted for as a change in estimate in conformity with *SSAP No. 3—Accounting Changes and Corrections of Errors* (SSAP No. 3), with the amount of periodic accretion adjusted over the remaining life of the loan-backed or structured security (prospective method).

**Unrealized Gains and Losses and Impairment Guidance**

29. For reporting entities required to maintain an AVR, the accounting for unrealized gains and losses shall be in accordance with paragraph 36 of this statement. 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).

30. The application of this reporting requirement resulting from NAIC designation (i.e., lower of cost or fair value) is not a substitute for other-than-temporary impairment recognition (paragraphs 33-37). For securities reported at fair value where an other-than-temporary impairment has been determined to have occurred, the realized loss recognized from the other-than-temporary impairment shall first be applied towards the realization of any unrealized losses previously recorded as a result of fluctuations in the security's fair value due to the reporting requirements. After the recognition of the other-than-temporary impairment, the security shall continue to report unrealized gains and losses as a result of fluctuations in fair value.

31. If the fair value of a loan-backed or structured security is less than its amortized cost basis at the balance sheet date, an entity shall assess whether the impairment is other than temporary. Amortized cost basis includes adjustments made to the cost of an investment for accretion, amortization, collection of cash, previous other-than-temporary impairments recognized as a realized loss.

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

33. If an entity does not intend to sell the loan-backed or structured security, the entity shall assess whether it has the intent and ability[2] 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.

34. 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

[2] 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).

security and the entity has the intent and ability to hold. Therefore, in those 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 (that is, a non-interest related decline[3] exists), and an other-than-temporary impairment shall be considered to have occurred. A decrease in cashflows expected to be collected on a loaned-backed or structured security that results from an increase in prepayments on the underlying assets shall be considered in the estimate of the present value of cashflows expected to be collected.

35. In determining whether a non-interest related decline exists, 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 security, discounted at the security's effective interest rate.

a. For securities accounted for under paragraphs 14-18 – the effective interest rate of the loan-backed or structured security 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).

b. For securities accounted for under paragraphs 19-21 – the effective interest rate is the rate implicit immediately prior to the recognition of the other-than-temporary impairment.

c. For securities accounted for under paragraphs 22-25 – the reporting entity shall apply the guidance in paragraph 24.b.

36. 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. (This guidance includes loan-backed and structured securities previously held at lower of cost or market. For these securities, upon recognition of an other-than-temporary impairment, unrealized losses would be considered realized.)

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 security's effective interest rate in accordance with paragraph 35. (This guidance includes loan-backed and structured securities previously held at lower of cost or market. For these securities, upon recognition of an other-than-temporary impairment, unrealized losses would be considered realized for the non-interest related decline. Hence, unrealized losses could continue to be reflected for these securities due to the reporting requirements.)

Reinsurance recoverables are explicitly included in the scope of the new CECL guidance, but only for "*expected losses related to the credit risk of the reinsurer/assuming company"* (326-20-55-82). The current existing statutory accounting guidance does not include the concept of reserving for expected credit losses. It should be noted that while not related to creditworthiness, *SSAP No. 62R—Property and Casualty Reinsurance* does include the concept

[3] A non-interest related decline is a decline in value due to fundamental credit problems of the issuer. Fundamental credit problems exist with the issuer when there is evidence of financial difficulty that may result in the issuer being unable to pay principal or interest when due. An interest related decline in value may be due to both increases in the risk-free interest rate and general credit spread widening.

of the provision for reinsurance, which is more focused on known overdue/uncollectible reinsurance and does not take the creditworthiness of the reinsurer into the calculation. However, impairment analysis is required for reinsurance balances in both *SSAP No. 61R—Life, Deposit -Type and Accident and Health Reinsurance* and SSAP No. 62R.

Multiple other SSAPs are impacted by the updated guidance, and NAIC Staff has prepared tables in Exhibit 1 which provide detailed summarizations of the updates made by CECL.

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

The following ASUs were issued after CECL as clarifications and improvements to the guidance in ASC Topic 326 but have already been addressed for statutory accounting purposes by the Working Group:

- *ASU 2019-05 Financial Instruments—Credit Losses (Topic 326)—Targeted Transition Relief* was assessed and rejected for statutory accounting purposes by the Working Group. For further details see Agenda Item 2019-28.
- *ASU 2022-02 Financial Instruments—Credit Losses (Topic 326) Troubled Debt Restructurings and Vintage Disclosures* was assessed and rejected for statutory accounting purposes by the Working Group. For further details see Agenda Item 2022-10.
- *ASU 2022-01 Derivatives and Hedging (Topic 815) Fair Value Hedging—Portfolio Layer Method* was assessed and adopted with modification for statutory accounting purposes by the Working Group. For further details see Agenda Item 2022-09.

Agenda item 2016-20 was started on CECL and last exposed for comment on August 4, 2018.

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

**Convergence with International Financial Reporting Standards (IFRS):**
The credit losses project began as a joint project with the IASB, but the Boards determined that convergence was not possible in 2012 due to the differing needs of their respective stakeholder groups. The IASB issued *IFRS 9, Financial Instruments* in July 2014. The FASB and IASB both sought to respond to concerns identified pertaining to the delayed recognition of credit losses; however, the IASB's stakeholders strongly preferred an impairment model that uses a dual measurement approach, while U.S. stakeholders strongly preferred the current expected credit loss model.

The main difference between ASU 2016-13 and IFRS 9 relates to the timing of recognition of expected losses. The ASU requires that the full amount of expected credit losses be recorded for all financial assets measured at amortized cost, whereas IFRS 9 requires an allowance for credit losses equal to 12 months of expected credit losses until there is a significant increase in credit risk, at which point lifetime expected losses are recognized. Consequently, the allowance for credit losses as measured and recorded under the ASU will be accounted for differently under GAAP than under IFRS and will have a different effect on the financial statements.

**Staff Recommendation:**
**Based on the Staff Analysis detailed on Pages 6-7, Staff recommends that the Working Group move this item to the active listing, categorized as a SAP clarification, and expose revisions to reject *ASU 2016-13 Measurement of Credit Losses on Financial Instruments* and other related ASUs (see "Subsequent Revisions" on page 5) within the following SSAPs:**

- *SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments*
- *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets*
- *SSAP No. 22R—Leases*

- *SSAP No. 26R—Bonds*
- *SSAP No. 32R—Preferred Stock*
- *SSAP No. 34—Investment Income Due and Accrued*
- *SSAP No. 37—Mortgage Loans*
- *SSAP No. 39—Reverse Mortgages*
- *SSAP No. 41R—Surplus Notes*
- *SSAP No. 43R—Loan and Asset Backed Securities*
- *SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance*
- *SSAP No. 62R—Property and Casualty Reinsurance*
- *SSAP No. 86—Derivatives*
- *SSAP No. 103R—Transfer/Service of Financial Assets*
- *SSAP No. 105R—Working Capital Finance Investments*
- *INT 06-07: Definition of the Phrase "Other Than Temporary*

**Staff also recommends modifying *INT 06-07: Definition of Phrase "Other Than Temporary"* to clarify that companies should adhere to the impairment guidance detailed within the SSAPs, which may reflect U.S. GAAP guidance prior to the FASB's issuance of ASU 2016-13.**

**Agenda item 2016-20 was started on CECL and last exposed for comment on August 4, 2018. Agenda item 2016-20 was reviewed by NAIC Staff, and we recommend it be formally disposed and replaced by this new agenda item.**

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

**Relevant Literature**

21. This statement rejects *ASU 2016-13 Financial Instruments–Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments, ASU 2018-19 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, ASU 2019-04 Codification Improvements to Topics 326, 815, 825, ASU 2019-10 Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842), ASU 2019-11 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, and ASU 2020-03 Codification Improvements to Financial Instruments*. Companies should continue to apply the relevant statutory accounting impairment guidance, which may reflect U.S. GAAP guidance prior to FASB's issuance of ASU 2016-13 and other related ASUs.

***Proposed Revisions to SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets***

43. This statement rejects ASU 2016-13 Financial Instruments–Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments, ASU 2018-19 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, ASU 2019-04 Codification Improvements to Topics 326, 815, 825, ASU 2019-10 Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842), ASU 2019-11 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, and ASU 2020-03 Codification Improvements to Financial Instruments. Companies should continue to apply the relevant statutory accounting impairment guidance, which may reflect U.S. GAAP guidance prior to FASB's issuance of ASU 2016-13 and other related ASUs.

***Proposed Revisions to SSAP No. 22R—Leases***

53. This statement rejects ASU 2016-13 Financial Instruments–Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments, ASU 2018-19 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, ASU 2019-04 Codification Improvements to Topics 326, 815, 825, ASU 2019-10 Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842),

ASU 2019-11 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, and ASU 2020-03 Codification Improvements to Financial Instruments. Companies should continue to apply the relevant statutory accounting impairment guidance, which may reflect U.S. GAAP guidance prior to FASB's issuance of ASU 2016-13 and other related ASUs.

***Proposed Revisions to SSAP No. 26R—Bonds***

33. This statement rejects the GAAP guidance for debt securities, which is contained in *ASU 2020-08, Codification Improvements to Subtopic 310-20, Receivables – Nonrefundable Fees and Other Costs*, *ASU 2018-03, Recognition and Measurement of Financial Assets and Financial Liabilities, ASU 2017-08, Premium Amortization on Purchased Callable Debt* Securities, ASU *2016-01, Financial Instruments – Overall*, *FASB Statement No. 115, Accounting for Certain Investments in Debt and Equity Securities, FASB Statement No. 91, Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases, FASB Emerging Issues Task Force No. 89-18, Divestitures of Certain Investment Securities to an Unregulated Commonly Controlled Entity under FIRREA,* and *FASB Emerging Issues Task Force No. 96-10, Impact of Certain Transactions on Held-to-Maturity Classifications Under FASB Statement No. 115.* This statement rejects ASU 2016-13 Financial Instruments–Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments, ASU 2018-19 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, ASU 2019-04 Codification Improvements to Topics 326, 815, 825, ASU 2019-10 Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842), ASU 2019-11 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, and ASU 2020-03 Codification Improvements to Financial Instruments.

***Proposed Revisions to SSAP No. 32R—Preferred Stock***

21. This statement rejects *ASU 2018-03, Recognition and Measurement of Financial Assets and Financial* Liabilities*, ASU 2016-01, Financial Instruments – Overall, FASB Statement No. 115, Accounting for Certain Investments in Debt and Equity Securities* and *FASB Emerging Issues Task Force No. 86-32, Early Extinguishment of a Subsidiary's Mandatorily Redeemable Preferred Stock*. This statement 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 rejects ASU 2016-13 Financial Instruments–Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments, ASU 2018-19 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, ASU 2019-04 Codification Improvements to Topics 326, 815, 825, ASU 2019-10 Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842), ASU 2019-11 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, and ASU 2020-03 Codification Improvements to Financial Instruments.

***Proposed Revisions to SSAP No. 34—Investment Income Due and Accrued***

9. This statement 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 rejects ASU 2016-13 Financial Instruments–Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments, ASU 2018-19 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, ASU 2019-04 Codification Improvements to Topics 326, 815, 825, ASU 2019-10 Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842), ASU 2019-11 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, and ASU 2020-03 Codification Improvements to Financial Instruments. Companies should continue to apply the relevant statutory accounting impairment guidance, which may reflect U.S. GAAP guidance prior to FASB's issuance of ASU 2016-13 and other related ASUs.

***Proposed Revisions to SSAP No. 37—Mortgage Loans***

31. This statement rejects *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. 88-17, Accounting for Fees and Costs Associated with Loan Syndications and Loan Participations,* and *AICPA Practice Bulletin 6, Amortization of Discounts on Certain Acquired Loans*. This statement rejects ASU 2016-13 Financial Instruments–Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments, ASU 2018-19 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, ASU 2019-04 Codification Improvements to Topics 326, 815, 825, ASU 2019-10 Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842), ASU 2019-11 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, and ASU 2020-03 Codification Improvements to Financial Instruments.

***Proposed Revisions to SSAP No. 39—Reverse Mortgages***

**Relevant Literature**

17. This statement rejects *ASU 2016-13 Financial Instruments–Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments, ASU 2018-19 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, ASU 2019-04 Codification Improvements to Topics 326, 815, 825, ASU 2019-10 Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842), ASU 2019-11 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, and ASU 2020-03 Codification Improvements to Financial Instruments.*

***Proposed Revisions to SSAP No. 41R—Surplus Notes***

22. This statement rejects AICPA Practice Bulletin No. 15, Accounting by the Issuer of Surplus Notes, which requires surplus notes to be accounted for as debt and that interest be accrued over the life of the surplus note, irrespective of the approval of interest and principal payments by the insurance commissioner. This statement rejects *ASU 2016-13 Financial Instruments–Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments, ASU 2018-19 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, ASU 2019-04 Codification Improvements to Topics 326, 815, 825, ASU 2019-10 Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842), ASU 2019-11 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, and ASU 2020-03 Codification Improvements to Financial Instruments***.**

***Proposed Revisions to SSAP No. 43R—Loan-Backed and Structured Securities***

58. This statement rejects *ASU 2016-13 Financial Instruments–Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments, ASU 2018-19 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, ASU 2019-04 Codification Improvements to Topics 326, 815, 825, ASU 2019-10 Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842), ASU 2019-11 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, and ASU 2020-03 Codification Improvements to Financial Instruments.*

***Proposed Revisions to SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance***

88. This statement rejects *ASU 2016-13 Financial Instruments–Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments, ASU 2018-19 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, ASU 2019-04 Codification Improvements to Topics 326, 815, 825, ASU 2019-10 Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842),*

*ASU 2019-11 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, and ASU 2020-03 Codification Improvements to Financial Instruments*. Companies should continue to apply the relevant statutory accounting impairment guidance, which may reflect U.S. GAAP guidance prior to FASB's issuance of ASU 2016-13 and other related ASUs.

***Proposed Revisions to SSAP No. 62R—Property and Casualty Reinsurance***

129. This statement rejects *ASU 2016-13 Financial Instruments–Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments, ASU 2018-19 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, ASU 2019-04 Codification Improvements to Topics 326, 815, 825, ASU 2019-10 Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842), ASU 2019-11 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, and ASU 2020-03 Codification Improvements to Financial Instruments*. Companies should continue to apply the relevant statutory accounting impairment guidance, which may reflect U.S. GAAP guidance prior to FASB's issuance of ASU 2016-13 and other related ASUs.

***Proposed Revisions to SSAP No. 86—Derivatives***

73. This statement rejects 2020-06, Debt—Debt with Conversion and Other Options (Subtopic 470-20) and Derivatives and Hedging—Contracts in Entity's Own Equity (Subtopic 815-40), Accounting for Convertible Instruments and Contracts in an Entity's Own Equity, ASU 2020-01, Investments—Equity Securities (Topic 321), Investments—Equity Method and Joint Ventures (Topic 323), and Derivatives and Hedging (Topic 815), Clarifying the Interactions between Topic 321, Topic 323 and Topic 815, ASU 2018-03, Recognition and Measurement of Financial Assets and Financial Liabilities, and ASU 2016-03, Intangibles—Goodwill and Other, Business Combinations, Consolidation, Derivatives and Hedging. This statement rejects *ASU 2016-13 Financial Instruments–Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments, ASU 2018-19 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, ASU 2019-04 Codification Improvements to Topics 326, 815, 825, ASU 2019-10 Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842), ASU 2019-11 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, and ASU 2020-03 Codification Improvements to Financial Instruments*. Companies should continue to apply the relevant statutory accounting impairment guidance, which may reflect U.S. GAAP guidance prior to FASB's issuance of ASU 2016-13 and other related ASUs.

***Proposed Revisions to SSAP No. 103R—Transfer/Service of Financial Assets***

134. This statement rejects *ASU 2016-13 Financial Instruments–Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments, ASU 2018-19 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, ASU 2019-04 Codification Improvements to Topics 326, 815, 825, ASU 2019-10 Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842), ASU 2019-11 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, and ASU 2020-03 Codification Improvements to Financial Instruments*. Companies should continue to apply the relevant statutory accounting impairment guidance, which may reflect U.S. GAAP guidance prior to FASB's issuance of ASU 2016-13 and other related ASUs.

***Proposed Revisions to SSAP No. 105R—Working Capital Finance Investments***

**Relevant Literature**

32. This statement rejects *ASU 2016-13 Financial Instruments–Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments, ASU 2018-19 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, ASU 2019-04 Codification Improvements to Topics 326, 815, 825, ASU 2019-10 Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842), ASU 2019-11 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, and ASU 2020-03 Codification Improvements to Financial Instruments.*

***Proposed Revisions to INT 06-07: Definition of Phrase "Other Than Temporary"***

**INT 06-07 Discussion**

13. On xx/xx/2024, the Working Group rejected *ASU 2016-13 Measurement of Credit Losses on Financial Instruments* and other related ASUs. As a result, companies should continue to apply the relevant statutory accounting impairment guidance, which may reflect prior U.S. GAAP guidance.

**Staff Review Completed by:**
NAIC Staff – William Oden, September 2023

**Status:**
On December 1, 2023, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a SAP clarification and exposed this agenda item to reject ASU 2016-13, *ASU 2018-19, Codification Improvements to Topic 326, Financial Instruments—Credit Losses*, *ASU 2019-04, Codification Improvements to Topics 326, 815, 825*, *ASU 2019-10 Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842)*, *ASU 2019-11 Codification Improvements to Topic 326, Financial Instruments—Credit Losses*, and *ASU 2020-03 Codification Improvements to Financial Instruments*, within INT 06-07: Definition of Phrase "Other Than Temporary" and fifteen applicable SSAPs which are detailed above. The Working Group also moved agenda item 2026-20, which was started to address CECL, to the disposed listing. The Working Group directed NAIC staff to research how best to maintain pre-CECL GAAP impairment guidance for posterity.

On December 11, 2023, the Working Group chair approved an accelerated comment deadline that was requested by industry after the December 1, 2023 meeting. As a result, the comment deadline for the Fall National Meeting exposure of agenda item 2023-24 was shortened from February 4, 2024 to December 29, 2023, to allow the Working Group the ability to formally reject CECL and other related ASUs in January 2024.

On January 10, 2024, the Working adopted, as final, the exposed revisions, as detailed below, to INT 06-07 and SSAP Nos. 2R, 5R, 22R, 26R, 32R, 34, 37, 39, 41R, 61R, 62R, 86, 103R, and 105R to reject ASUs 2016-13, 2018-19, 2019-04, 2019-10, 2019-11, and 2020-03 as not applicable to statutory accounting. The Working Group also reiterated its direction to NAIC staff to research and prepare a document to maintain pre-CECL GAAP impairment guidance for posterity.

**Note on January 10, 2024, Exposed Revisions:** Subsequent to the Fall National Meeting Exposure, additional consistency revisions were made to the proposed revisions and are shown highlighted grey below for January 10, 2024, discussion. The sentence directing companies to continue applying the relevant statutory accounting impairment guidance was originally excluded from any revised SSAPs which was within scope of INT 06-07 as the INT already had this sentence. Staff later determined that it would be clearer and cleaner to have this sentence within all revised SSAPs. Additionally, Staff adjusted each of the revised SSAPs to specifically denote the effective date of the rejection.

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

**Relevant Literature**

21. Effective December 31, 2023, ~~T~~this statement rejects *ASU 2016-13 Financial Instruments–Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments, ASU 2018-19 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, ASU 2019-04 Codification Improvements to Topics 326, 815, 825, ASU 2019-10 Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842), ASU 2019-11 Codification Improvements to Topic 326, Financial Instruments—Credit Losses*, and *ASU 2020-03 Codification Improvements to Financial Instruments*. Companies should continue to apply the relevant statutory accounting impairment guidance, which may reflect U.S. GAAP guidance prior to FASB's issuance of ASU 2016-13 and other related ASUs.

***Proposed Revisions to SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets***

43. Effective December 31, 2023, ~~T~~this statement rejects *ASU 2016-13 Financial Instruments–Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments, ASU 2018-19 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, ASU 2019-04 Codification Improvements to Topics 326, 815, 825, ASU 2019-10 Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842), ASU 2019-11 Codification Improvements to Topic 326, Financial Instruments—Credit Losses*, and *ASU 2020-03 Codification Improvements to Financial Instruments*. Companies should continue to apply the relevant statutory accounting impairment guidance, which may reflect U.S. GAAP guidance prior to FASB's issuance of ASU 2016-13 and other related ASUs.

***Proposed Revisions to SSAP No. 22R—Leases***

53. Effective December 31, 2023, ~~T~~this statement rejects *ASU 2016-13 Financial Instruments–Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments, ASU 2018-19 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, ASU 2019-04 Codification Improvements to Topics 326, 815, 825, ASU 2019-10 Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842), ASU 2019-11 Codification Improvements to Topic 326, Financial Instruments—Credit Losses*, and *ASU 2020-03 Codification Improvements to Financial Instruments*. Companies should continue to apply the relevant statutory accounting impairment guidance, which may reflect U.S. GAAP guidance prior to FASB's issuance of ASU 2016-13 and other related ASUs.

***Proposed Revisions to SSAP No. 26R—Bonds***

33. This statement rejects the GAAP guidance for debt securities, which is contained in *ASU 2020-08, Codification Improvements to Subtopic 310-20, Receivables – Nonrefundable Fees and Other Costs*, *ASU 2018-03, Recognition and Measurement of Financial Assets and Financial Liabilities, ASU 2017-08, Premium Amortization on Purchased Callable Debt* Securities, ASU *2016-01, Financial Instruments – Overall*, *FASB Statement No. 115, Accounting for Certain Investments in Debt and Equity Securities, FASB Statement No. 91, Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases, FASB Emerging Issues Task Force No. 89-18, Divestitures of Certain Investment Securities to an Unregulated Commonly Controlled Entity under FIRREA,* and *FASB Emerging Issues Task Force No. 96-10, Impact of Certain Transactions on Held-to-Maturity Classifications Under FASB Statement No. 115.* Effective December 31, 2023, ~~T~~this statement rejects *ASU 2016-13 Financial Instruments–Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments, ASU 2018-19 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, ASU 2019-04 Codification Improvements to Topics 326, 815, 825, ASU 2019-10 Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842), ASU 2019-11 Codification Improvements to Topic 326, Financial Instruments—Credit Losses*, and *ASU 2020-03 Codification*

*Improvements to Financial Instruments*. Companies should continue to apply the relevant statutory accounting impairment guidance, which may reflect U.S. GAAP guidance prior to FASB's issuance of ASU 2016-13 and other related ASUs.

***Proposed Revisions to SSAP No. 32R—Preferred Stock***

21. This statement rejects *ASU 2018-03, Recognition and Measurement of Financial Assets and Financial* Liabilities*, ASU 2016-01, Financial Instruments – Overall, FASB Statement No. 115, Accounting for Certain Investments in Debt and Equity Securities* and *FASB Emerging Issues Task Force No. 86-32, Early Extinguishment of a Subsidiary's Mandatorily Redeemable Preferred Stock*. This statement 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. Effective December 31, 2023, ~~T~~this statement rejects ASU 2016-13 Financial Instruments–Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments, *ASU 2018-19 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, ASU 2019-04 Codification Improvements to Topics 326, 815, 825, ASU 2019-10 Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842), ASU 2019-11 Codification Improvements to Topic 326, Financial Instruments—Credit Losses*, and *ASU 2020-03 Codification Improvements to Financial Instruments*. Companies should continue to apply the relevant statutory accounting impairment guidance, which may reflect U.S. GAAP guidance prior to FASB's issuance of ASU 2016-13 and other related ASUs.

***Proposed Revisions to SSAP No. 34—Investment Income Due and Accrued***

9. This statement 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. Effective December 31, 2023, ~~T~~this statement rejects *ASU 2016-13 Financial Instruments–Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments, ASU 2018-19 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, ASU 2019-04 Codification Improvements to Topics 326, 815, 825, ASU 2019-10 Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842), ASU 2019-11 Codification Improvements to Topic 326, Financial Instruments—Credit Losses*, and *ASU 2020-03 Codification Improvements to Financial Instruments*. Companies should continue to apply the relevant statutory accounting impairment guidance, which may reflect U.S. GAAP guidance prior to FASB's issuance of ASU 2016-13 and other related ASUs.

***Proposed Revisions to SSAP No. 37—Mortgage Loans***

31. This statement rejects *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. 88-17, Accounting for Fees and Costs Associated with Loan Syndications and Loan Participations,* and *AICPA Practice Bulletin 6, Amortization of Discounts on Certain Acquired Loans*. Effective December 31, 2023, ~~T~~this statement rejects *ASU 2016-13 Financial Instruments–Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments*, *ASU 2018-19 Codification Improvements to Topic 326, Financial Instruments—Credit Losses*, *ASU 2019-04 Codification Improvements to Topics 326, 815, 825, ASU 2019-10 Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842*), *ASU 2019-11 Codification Improvements to Topic 326, Financial Instruments—Credit Losses*, and *ASU 2020-03 Codification Improvements to Financial Instruments*. Companies should continue to apply the relevant statutory accounting impairment guidance, which may reflect U.S. GAAP guidance prior to FASB's issuance of ASU 2016-13 and other related ASUs.

***Proposed Revisions to SSAP No. 39—Reverse Mortgages***

**Relevant Literature**

17. Effective December 31, 2023, ~~T~~this statement rejects *ASU 2016-13 Financial Instruments–Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments, ASU 2018-19 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, ASU 2019-04 Codification Improvements to Topics 326, 815, 825, ASU 2019-10 Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842), ASU 2019-11 Codification Improvements to Topic 326, Financial Instruments—Credit Losses,* and *ASU 2020-03 Codification Improvements to Financial Instruments*. Companies should continue to apply the relevant statutory accounting impairment guidance, which may reflect U.S. GAAP guidance prior to FASB's issuance of ASU 2016-13 and other related ASUs.

***Proposed Revisions to SSAP No. 41R—Surplus Notes***

22. This statement rejects AICPA Practice Bulletin No. 15, Accounting by the Issuer of Surplus Notes, which requires surplus notes to be accounted for as debt and that interest be accrued over the life of the surplus note, irrespective of the approval of interest and principal payments by the insurance commissioner. Effective December 31, 2023, ~~T~~this statement rejects *ASU 2016-13 Financial Instruments–Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments, ASU 2018-19 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, ASU 2019-04 Codification Improvements to Topics 326, 815, 825, ASU 2019-10 Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842), ASU 2019-11 Codification Improvements to Topic 326, Financial Instruments—Credit Losses,* and *ASU 2020-03 Codification Improvements to Financial Instruments*. Companies should continue to apply the relevant statutory accounting impairment guidance, which may reflect U.S. GAAP guidance prior to FASB's issuance of ASU 2016-13 and other related ASUs.

***Proposed Revisions to SSAP No. 43R—Loan-Backed and Structured Securities***

58. Effective December 31, 2023, ~~T~~this statement rejects *ASU 2016-13 Financial Instruments–Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments, ASU 2018-19 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, ASU 2019-04 Codification Improvements to Topics 326, 815, 825, ASU 2019-10 Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842), ASU 2019-11 Codification Improvements to Topic 326, Financial Instruments—Credit Losses,* and *ASU 2020-03 Codification Improvements to Financial Instruments*. Companies should continue to apply the relevant statutory accounting impairment guidance, which may reflect U.S. GAAP guidance prior to FASB's issuance of ASU 2016-13 and other related ASUs.

***Proposed Revisions to SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance***

88. Effective December 31, 2023, ~~T~~this statement rejects *ASU 2016-13 Financial Instruments–Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments, ASU 2018-19 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, ASU 2019-04 Codification Improvements to Topics 326, 815, 825, ASU 2019-10 Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842), ASU 2019-11 Codification Improvements to Topic 326, Financial Instruments—Credit Losses,* and *ASU 2020-03 Codification Improvements to Financial Instruments*. Companies should continue to apply the relevant statutory accounting impairment guidance, which may reflect U.S. GAAP guidance prior to FASB's issuance of ASU 2016-13 and other related ASUs.

***Proposed Revisions to SSAP No. 62R—Property and Casualty Reinsurance***

129. Effective December 31, 2023, ~~T~~this statement rejects *ASU 2016-13 Financial Instruments–Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments, ASU 2018-19 Codification Improvements to*

*Topic 326, Financial Instruments—Credit Losses, ASU 2019-04 Codification Improvements to Topics 326, 815, 825, ASU 2019-10 Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842), ASU 2019-11 Codification Improvements to Topic 326, Financial Instruments—Credit Losses,* and *ASU 2020-03 Codification Improvements to Financial Instruments*. Companies should continue to apply the relevant statutory accounting impairment guidance, which may reflect U.S. GAAP guidance prior to FASB's issuance of ASU 2016-13 and other related ASUs.

***Proposed Revisions to SSAP No. 86—Derivatives***

73. This statement rejects 2020-06, Debt—Debt with Conversion and Other Options (Subtopic 470-20) and Derivatives and Hedging—Contracts in Entity's Own Equity (Subtopic 815-40), Accounting for Convertible Instruments and Contracts in an Entity's Own Equity, ASU 2020-01, Investments—Equity Securities (Topic 321), Investments—Equity Method and Joint Ventures (Topic 323), and Derivatives and Hedging (Topic 815), Clarifying the Interactions between Topic 321, Topic 323 and Topic 815, ASU 2018-03, Recognition and Measurement of Financial Assets and Financial Liabilities, and ASU 2016-03, Intangibles—Goodwill and Other, Business Combinations, Consolidation, Derivatives and Hedging. Effective December 31, 2023, ~~T~~this statement rejects *ASU 2016-13 Financial Instruments–Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments, ASU 2018-19 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, ASU 2019-04 Codification Improvements to Topics 326, 815, 825, ASU 2019-10 Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842), ASU 2019-11 Codification Improvements to Topic 326, Financial Instruments—Credit Losses,* and *ASU 2020-03 Codification Improvements to Financial Instruments*. Companies should continue to apply the relevant statutory accounting impairment guidance, which may reflect U.S. GAAP guidance prior to FASB's issuance of ASU 2016-13 and other related ASUs.

***Proposed Revisions to SSAP No. 103R—Transfer/Service of Financial Assets***

134. Effective December 31, 2023, ~~T~~this statement rejects *ASU 2016-13 Financial Instruments–Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments, ASU 2018-19 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, ASU 2019-04 Codification Improvements to Topics 326, 815, 825, ASU 2019-10 Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842), ASU 2019-11 Codification Improvements to Topic 326, Financial Instruments—Credit Losses,* and *ASU 2020-03 Codification Improvements to Financial Instruments*. Companies should continue to apply the relevant statutory accounting impairment guidance, which may reflect U.S. GAAP guidance prior to FASB's issuance of ASU 2016-13 and other related ASUs.

***Proposed Revisions to SSAP No. 105R—Working Capital Finance Investments***

**Relevant Literature**

32. Effective December 31, 2023, ~~T~~this statement rejects *ASU 2016-13 Financial Instruments–Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments, ASU 2018-19 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, ASU 2019-04 Codification Improvements to Topics 326, 815, 825, ASU 2019-10 Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842), ASU 2019-11 Codification Improvements to Topic 326, Financial Instruments—Credit Losses,* and *ASU 2020-03 Codification Improvements to Financial Instruments*. Companies should continue to apply the relevant statutory accounting impairment guidance, which may reflect U.S. GAAP guidance prior to FASB's issuance of ASU 2016-13 and other related ASUs.

***Proposed Revisions to INT 06-07: Definition of Phrase "Other Than Temporary"***

**INT 06-07 Discussion**

13. ~~On xx/xx/2024,~~ Effective December 31, 2023, ~~T~~the Working Group rejected *ASU 2016-13 Financial Instruments–Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments, ASU 2018-19 Codification Improvements to Topic 326, Financial Instruments—Credit Losses, ASU 2019-04 Codification Improvements to Topics 326, 815, 825, ASU 2019-10 Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842), ASU 2019-11 Codification Improvements to Topic 326, Financial Instruments—Credit Losses,* and *ASU 2020-03 Codification Improvements to Financial Instruments.* ~~*ASU 2016-13 Measurement of Credit Losses on Financial Instruments* and other related ASUs.~~ As a result, companies should continue to apply the relevant statutory accounting impairment guidance, which may reflect prior U.S. GAAP guidance.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2024/01 1-10-24/01 - 23-24 - ASU 2016-13 - CECL.docx

# Exhibit 1 – Summary of Changes from ASU 2016-13 and subsequent ASUs

| ASU 2016-13 Financial Instruments—Credit Losses (Topic 326) | | | |
|---|---|---|---|
| **Topic** | **Codification** | **Abbreviated Summary of Change** | **Related Paragraphs** |
| Balance Sheet—Overall | 210-10 | Removal of disclosure guidance link. | 45-15 |
| Comprehensive Income—Overall | 220-10 | Supersede content and amend AFS guidance link. | 45-10A<br>45-16A<br>55-15B |
| Statement of Cash Flows—Overall | 230-10 | Amends guidance to say amortized cost basis. | 45-21 |
| Interim Reporting—Overall | 270-10 | Amend guidance for new credit loss language and include references to transition guidance. | 50-1 |
| Receivables—Overall | 310-10 | Amends guidance for new CECL language, supersedes (or transfers to 326) several guidance paragraphs including OTTI, and adds new guidance on PCD interest income. | 05-1<br>35-1 thru 49<br>35-53A thru C<br>45-1<br>45-4A<br>45-5<br>45-6<br>50-1 thru 35<br>55-1 thru 12<br>55-16 thru 22 |
| Receivables—Nonrefundable Fees and Other Costs | 310-20 | Amends guidance for new CECL language and supersedes OTTI guidance. | 15-3<br>15-4<br>35-9<br>60-1<br>60-2 |
| Receivables—Loans and Debt Securities Acquired with | 310-30 | Supersedes entire subtopic and replaces with transition guidance. | All |

| ASU 2016-13 Financial Instruments—Credit Losses (Topic 326) | | | |
|---|---|---|---|
| **Topic** | **Codification** | **Abbreviated Summary of Change** | **Related Paragraphs** |
| Deteriorated Credit Quality | | | |
| Receivables—Troubled Debt Restructurings by Creditors | 310-40 | Amends guidance for new CECL language, supersedes OTTI guidance, and eliminates exclusion of loan pools from the scope of 310-40. | 15-11<br>15-12<br>35-7 thru 12<br>40-3<br>50-1 thru 6<br>55-7<br>55-13 thru 15 |
| Investments—Debt Securities—Overall | 320-10 | Amends guidance for new CECL language and supersedes all OTTI and credit loss guidance. | 15-4<br>15-9<br>15-10<br>35-1<br>35-17 thru 24<br>35-30<br>35-33A thru I<br>35-34 thru 37<br>35-43<br>40-1<br>40-2<br>45-7 thru 9A<br>50-1 thru 8B<br>55-16 thru 19<br>55-21A thru 23 |
| Investments—Equity Method and Joint Ventures—Overall | 323-10 | Amendment conforms terminology to match CECL guidance. | 35-25<br>55-30<br>55-34<br>55-38<br>55-42<br>55-44<br>55-46 |

| ASU 2016-13 Financial Instruments—Credit Losses (Topic 326) | | | |
|---|---|---|---|
| **Topic** | **Codification** | **Abbreviated Summary of Change** | **Related Paragraphs** |
| Investments—Other—Beneficial Interests in Securitized Financial Assets | 325-40 | Amends guidance for new CECL language and supersedes all OTTI and credit loss guidance. Also adds specific guidance for benefit interests acquired as with PCD and adds a requirement to use the PV of future cash flows to measure expected credit losses for benefit interests. | 15-3<br>15-4<br>25-2<br>30-1 thru 2<br>35-2 thru 4C<br>35-6<br>35-6A thru 10B<br>35-13<br>35-14<br>55-1 |
| Financial Instruments—Credit Losses | 326-10<br>326-20<br>326-30 | Creates Topic 326 codification; note that some guidance was moved from existing codification for inclusion within 326 and these transfers are underlined. Note that AFS and HTM classifications are not applicable for statutory accounting purposes. | All |
| Contingencies—Loss Contingencies | 450-20 | Amendment conforms terminology to match CECL guidance and includes codification links to topic 326. | 15-2<br>50-2A<br>60-2<br>60-3 |
| Guarantees—Overall | 460-10 | Amendment conforms terminology to match CECL guidance and requires that guarantees within the scope of 326 must bifurcate the instruments and apply Topic 326 guidance to the contingent portion and Topic 460 to the non-contingent portion. | 25-2<br>25-3<br>30-5<br>35-3<br>35-4<br>45-1<br>50-4<br>50-5<br>55-21<br>55-22 |

| ASU 2016-13 Financial Instruments—Credit Losses (Topic 326) | | | |
|---|---|---|---|
| **Topic** | **Codification** | **Abbreviated Summary of Change** | **Related Paragraphs** |
| Debt —Troubled Debt Restructurings by Debtors | 470-60 | Amendment conforms terminology to match CECL guidance. | 15-3<br>15-12 |
| Revenue from Contracts with Customers—Overall | 606-10 | Amendment conforms terminology to match CECL guidance and includes codification links to topic 326. | 45-3<br>45-4<br>50-4<br>55-108<br>55-109<br>55-231<br>55-237<br>55-239 |
| Business Combinations—Identifiable Assets and Liabilities, and Any Noncontrolling Interest | 805-20 | Amendment conforms terminology to match CECL and guidance on recording PCD assets which are within the scope of CECL or are purchased with credit deterioration. Additionally, guidance was simplified for indemnification assets arising from government-assisted acquisitions of a financial institution. | 30-2<br>30-4 thru 4B<br>30-10<br>30-12<br>30-26<br>35-4B |
| Consolidation—Overall | 810-10 | Amendment conforms terminology to match CECL guidance. | 30-8C |
| Derivatives and Hedging—Overall | 815-10 | Amends guidance for new CECL language and supersedes OTTI guidance. | 35-5 |
| Derivatives and Hedging—Embedded Derivatives | 815-15 | Amends OTI guidance to instead direct reader to Topic 326. | 25-5 |
| Derivatives and Hedging—Fair Value Hedges | 815-25 | Amendments conforms terminology to match CECL guidance and includes codification links to topic 326. | 35-10 thru 12<br>55-85 thru 90 |
| Derivatives and Hedging—Cash Flow Hedges | 815-30 | Amendment conforms terminology to match CECL guidance. | 35-42<br>35-43 |

| ASU 2016-13 Financial Instruments—Credit Losses (Topic 326) | | | |
|---|---|---|---|
| **Topic** | **Codification** | **Abbreviated Summary of Change** | **Related Paragraphs** |
| Fair Value Measurement—Overall | 820-10 | Amendment conforms terminology to match CECL guidance. | 55-92 |
| Financial Instruments—Overall | 825-10 | Amendment conforms terminology to match CECL guidance and supersedes old credit loss guidance. | 05-2<br>25-4<br>35-1 thru 3<br>55-8<br>55-10 |
| Foreign Currency Matters—Foreign Currency Transactions | 830-20 | Amendment conforms terminology to match CECL guidance and supersedes old AFS guidance for foreign currency debt securities. | 35-6<br>35-7 |
| Interest—Overall | 835-10 | Amendment supersedes interest income recognition on impaired or deteriorated credit quality loans. | 60-2<br>60-3 |
| Leases—Lessor | 842-30 | Amendment conforms terminology to match CECL guidance and supersedes impairment guidance/terminology with credit loss guidance. | 25-2<br>25-6<br>25-9<br>35-3<br>40-2 |
| Leases—Leveraged Lease Arrangements | 842-50 | Amendment removes original OTTI reference and adds codification references to Topic 326. | 50-2 |
| Subsequent Events—Overall | 855-10 | Amendment conforms terminology to match CECL guidance and remove examples now subject to Topic 326. | 55-1<br>55-2 |
| Transfers and Servicing—Sales of Financial Assets | 860-20 | Amendment conforms terminology to match CECL guidance and adds reference links to Topic 326 for the sale of financial assets which are receivables, purchased financial asset with credit deterioration, or is a beneficial interest that meets the criteria in paragraph 325-40-30-1A. | 30-2<br>35-3<br>35-9<br>50-5<br>55-19 |
| Financial Services—Depository and | 942-230 | Amendment terminology in implementation illustration to match CECL guidance. | 55-2<br>55-4 |

| ASU 2016-13 Financial Instruments—Credit Losses (Topic 326) | | | |
|---|---|---|---|
| **Topic** | **Codification** | **Abbreviated Summary of Change** | **Related Paragraphs** |
| Lending—Statement of Cash Flows | | | |
| Financial Services—Depository and Lending—Receivables | 942-310 | Amendment conforms terminology to match CECL guidance and supersedes impairment guidance. | 05-1<br>05-4<br>25-1<br>35-1<br>55-1 |
| Financial Services—Insurance—Insurance Activities | 944-20 | Amendment removes impairment guidance/terminology. | 55-37 |
| Financial Services—Insurance—Separate Accounts | 944-80 | Amendment supersedes impairment and unrealized gain/loss guidance/terminology with credit loss guidance. | 25-9<br>55-11<br>55-16 |
| Financial Services—Insurance—Receivables | 944-310 | Amendment conforms terminology to match CECL guidance and adds requirement to assess credit losses on insurance receivables and references to Topic 326. | 35-3<br>35-4<br>35-6<br>45-4<br>45-4A |
| Financial Services—Mortgage Banking—Receivables | 948-310 | Amendment conforms terminology to match CECL guidance and supersedes impairment guidance with Topic 326. | 30-1<br>30-4<br>35-1 thru 3<br>35-5<br>35-5A<br>50-1 |
| Health Care Entities—Income Statement | 954-225 | Amendment replaces impairment reference with credit loss language. | 45-8 |
| Health Care Entities—Receivables | 954-310 | Amendment replaces uncollectible accounts guidance with credit loss guidance. | 30-1<br>35-1 |
| Not-for-Profit Entities—Investments—Debt and Equity Securities | 958-320 | Amendment replaces impairment guidance with credit loss guidance. | 55-5 |

| ASU 2016-13 Financial Instruments—Credit Losses (Topic 326) | | | |
|---|---|---|---|
| **Topic** | **Codification** | **Abbreviated Summary of Change** | **Related Paragraphs** |
| Not-for-Profit Entities—Investments—Other | 958-325 | Amendment replaces impairment guidance with credit loss guidance. | 30-1<br>35-1 |
| Real Estate—Time-Sharing Activities—Receivables | 978-310 | Amendment replaces uncollectible accounts guidance with credit loss guidance. | 35-5<br>35-6 |

| ASU 2018-19 Codification Improvements to Topic 326, Financial Instruments—Credit Losses | | | |
|---|---|---|---|
| **Topic** | **Codification** | **Abbreviated Summary of Change** | **Related Paragraphs** |
| Financial Instruments—Credit Losses—Overall | 326-10 | Extends effective date of CECL from 2020 to 2021. | 65-1 |
| Financial Instruments—Credit Losses—Measured at Amortized Cost | 326-20 | Add clarification that operating lease receivables are in scope of Topic 842. | 15-3 |
| Various | Various | Amend the transition dates of all pending content paragraphs that link to transition guidance paragraph 326-10-65-1 from 2020 to 2021. | Various |

| ASU 2019-04 Codification Improvements to Topics 326, 815, and 825 | | | |
|---|---|---|---|
| **Topic** | **Codification** | **Abbreviated Summary of Change** | **Related Paragraphs** |
| Financial Instruments—Credit Losses—Measured at Amortized Cost<br>&<br>Financial Instruments—Credit Losses—Available-for-Sale Debt Securities | 326-20<br>&<br>326-30 | The amendments related to accrued interest receivables provide an entity with the ability to measure an allowance for credit losses on accrued interest receivables separately from the allowance for credit losses on the other components of the amortized cost basis and to make certain accounting policy elections and apply a practical expedient to operationalize the amendments in Update 2016-13. | 30-5<br>30-5A<br>35-8A<br>45-5<br>50-3A thru 3D<br><br>30-1A<br>30-1B<br>35-13A<br>45-1<br>50-3A thru 4 |
| Receivables—Overall<br>&<br>Investments—Debt Securities—Overall<br>&<br>Financial Instruments—Credit Losses—Measured at Amortized Cost<br>&<br>Financial Services—Mortgage Banking—Receivables | 310-10<br>&<br>320-10<br>&<br>326-20<br>&<br>948-10 | The amendments related to transfers between classifications or categories for nonmortgage loans and debt securities provide an entity with guidance on how to account for the allowance for credit losses or the valuation allowance when transferring loans and debt securities. | 35-47 thru 48B<br>45-2<br><br>35-10 thru 10B<br>35-15<br>35-16<br>45-8B<br>55-24<br>55-25<br><br>35-7<br><br>30-4<br>35-2A<br>35-5A<br>45-2 |
| Financial Instruments—Credit Losses—Measured at Amortized Cost<br>& | 326-20<br>&<br>326-30 | The amendments clarify that an entity should consider expected recoveries when measuring the allowance for credit losses by superseding the guidance in paragraphs 326-20-35-8 through 35-9 that may have precluded an entity from | 30-1<br>35-4<br>35-5<br>35-8<br>35-9 |

| ASU 2019-04 Codification Improvements to Topics 326, 815, and 825 | | | |
|---|---|---|---|
| **Topic** | **Codification** | **Abbreviated Summary of Change** | **Related Paragraphs** |
| Financial Instruments—Credit Losses—Available-for-Sale Debt Securities | | considering recoveries when estimating expected credit losses on financial assets measured at amortized cost basis. Additionally, the amendments clarify that expected recoveries of amounts previously written off and expected to be written off should be included in the valuation account and should not exceed the aggregate of amounts previously written off and expected to be written off by the entity. | 50-13<br>55-52<br><br>35-12<br>35-13 |
| Receivables—Troubled Debt Restructurings by Creditors | 310-40 | The amendment clarifies paragraph 310-40-55-14 by removing the incorrect cross-reference to paragraph 326-20-35-2 and, instead, properly cross-referencing paragraphs 326-20-35-4 through 35-5, which require that an entity use 41 the fair value | 55-14 |
| Investments—Equity Method and Joint Ventures—Overall | 323-10 | The amendment to paragraph 323-10-35-26 clarifies the guidance by including references to both Subtopic 326-20, Financial Instruments—Credit Losses—Measured at Amortized Cost, and Subtopic 326-30, Financial Instruments—Credit Losses—Available-for-Sale Debt Securities, to require the subsequent measurement of credit losses on financial assets after the guidance on equity method losses is applied. | 35-24<br>35-26 |
| Financial Instruments—Credit Losses—Measured at Amortized Cost | 326-20 | The amendments clarify that reinsurance recoverables that result from insurance transactions that are within the scope of Topic 944, Financial Services—Insurance, are within the scope of Subtopic 326-20 even if those reinsurance recoverables are measured on a net present value basis in accordance with Topic 944. | 05-1<br>15-2 |
| Financial Instruments—Credit | 326-20<br>& | The amendments clarify the Board's intent for how an entity should determine the effective | 30-4 |

| ASU 2019-04 Codification Improvements to Topics 326, 815, and 825 | | | |
|---|---|---|---|
| **Topic** | **Codification** | **Abbreviated Summary of Change** | **Related Paragraphs** |
| Losses—Measured at Amortized Cost<br>&<br>Financial Instruments—Credit Losses—Available-for-Sale Debt Securities | 326-30 | interest rate and estimated expected future cash flows by removing the prohibition in the guidance and requiring that the projections used for determining the effective interest rate also be used in determining the estimated expected future cash flows. The amendments also clarify that if an entity projects future interest rate environments when using a discounted cash flow method to measure expected credit losses on variable-rate financial instruments, then the entity should adjust the effective interest rate to consider the timing (and changes in the timing) of expected cash flows resulting from expected prepayments. | 35-11 |
| Financial Instruments—Credit Losses—Measured at Amortized Cost<br>&<br>Financial Instruments—Credit Losses—Available-for-Sale Debt Securities | 326-20<br>&<br>326-30 | The amendments in paragraph 326-20-30-4A permit an entity to make an accounting policy election to adjust the effective interest rate used to discount expected cash flows of a financial asset. The amendments also clarify that an entity should not adjust the effective interest rate used to discount expected cash flows for subsequent changes in expected prepayments if the financial asset is restructured in a troubled debt restructuring.<br>Paragraph 326-30-35-7A was also amended to allow an entity to make an accounting policy election to adjust the effective interest rate used to discount expected cash flows of a debt security classified as available-for-sale | 30-4A<br><br>35-7A |
| Financial Instruments—Credit Losses—Measured at Amortized Cost | 326-20 | The amendments clarify the guidance and align the measurement of credit losses using fair value of collateral when foreclosure is probable and when an entity elects the collateral-dependent | 35-4<br>35-5 |

| ASU 2019-04 Codification Improvements to Topics 326, 815, and 825 | | | |
|---|---|---|---|
| **Topic** | **Codification** | **Abbreviated Summary of Change** | **Related Paragraphs** |
| | | practical expedient by adding a requirement to adjust the fair value of the collateral for estimated costs to sell in paragraph 326- 20-35-4. Additionally, the amendments clarify the guidance that when an entity adjusts the fair value of the collateral for the estimated costs to sell, the estimated costs to sell should be undiscounted if the entity intends to sell rather than operate the collateral. | |
| Derivatives and Hedging—Hedging—General<br>&<br>Derivatives and Hedging—Fair Value Hedges | 815-20<br>&<br>815-25 | The amendments clarify that an entity may measure the change in fair value of a hedged item using an assumed term only for changes attributable to interest rate risk. They also clarify that an entity may measure the change in the fair value of the hedged item attributable to interest rate risk using an assumed term when the hedged item is designated in a hedge of both interest rate risk and foreign exchange risk. In addition, the amendments clarify that one or more separately designated partial term fair value hedging relationships of a single financial instrument can be outstanding at the same time. | 25-12<br><br>35-13B<br>55-99 |
| Derivatives and Hedging—Fair Value Hedges | 815-25 | The amendments clarify that an entity may, but is not required to, begin to amortize a fair value hedge basis adjustment before the fair value hedging relationship is discontinued. They also clarify that if an entity elects to amortize the basis adjustment during an outstanding partial-term hedge, the basis adjustment should be fully amortized by the hedged item's assumed maturity date in accordance with paragraph 815-25-35-13B. | 35-9A |

| ASU 2019-04 Codification Improvements to Topics 326, 815, and 825 | | | |
|---|---|---|---|
| **Topic** | **Codification** | **Abbreviated Summary of Change** | **Related Paragraphs** |
| Derivative and Hedging—Overall | 815-10 | The amendments clarify that an entity should disclose available-for-sale debt securities at their amortized cost and that fair value hedge basis adjustments related to foreign exchange risk should be excluded from the disclosures required by paragraph 815-10-50-4EE. | 4EE |
| Derivatives and Hedging—Cash Flow Hedges | 815-30 | The amendment clarifies that an entity should consider the contractually specified interest rate being hedged when applying the hypothetical derivative method. | 35-26 |
| Derivative and Hedging—Overall<br>&<br>Derivatives and Hedging—Hedging—General | 815-10<br>&<br>815-20 | The amendments clarify that a not-for-profit entity that does not separately report earnings is not permitted to elect the amortization approach for amounts excluded from the assessment of effectiveness under fair value hedge accounting. The amendments also update the cross-references in paragraph 815-10-15-1 to further clarify the scope of Topic 815, Derivatives and Hedging, for entities that do not report earnings separately. | 15-1<br><br>15-1<br>25-12 |
| Derivatives and Hedging—Hedging—General | 815-20 | The amendments clarify that a private company that is not a financial institution as described in paragraph 942-320-50-1 should document the analysis supporting a last-of-layer designation concurrently with hedge inception. The amendments also clarify that not-for-profit entities (except for not-for-profit entities that have issued, or are a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market) qualify for the same 60 subsequent quarterly hedge effectiveness assessment timing relief for which certain private companies qualify in accordance with paragraph 815-20-25-142. | 25-139<br>25-143 |

| ASU 2019-04 Codification Improvements to Topics 326, 815, and 825 | | | |
|---|---|---|---|
| **Topic** | **Codification** | **Abbreviated Summary of Change** | **Related Paragraphs** |
| Derivatives and Hedging—Hedging—General | 815-20 | The amendments clarify that the application of the first payments-received cash flow hedging technique to changes in overall cash flows on a group of variable interest payments continues to be permitted under Topic 815, Derivatives and Hedging. | 55-33G |
| Derivatives and Hedging—Hedging—General | 815-20 | The amendments clarify various provisions to the amendments in Update 2017-12. | 65-3<br>65-5 |
| Investments—Debt Securities—Overall<br>&<br>Investments—Equity Securities—Overall | 320-10<br>&<br>321-10 | The amendments clarify the guidance in paragraphs 320-10-15-3 and 321-10-15-3, including adding health and welfare plans to the list of entities for which Topic 320, Investments—Debt Securities, does not apply. | 15-3<br><br>15-3 |
| Investments—Debt Securities—Overall<br>&<br>Financial Services—Depository and Lending—Investments—Debt and Equity Securities | 320-10<br>&<br>942-320 | The Board intended to eliminate all fair value disclosures for financial assets measured at amortized cost basis for entities other than public business entities through the amendments in Update 2016-01. The amendments clarify the guidance in paragraph 320-10-50-5 by eliminating the requirement for entities other than public business entities to disclose aggregate fair value of held-to maturity debt securities. | 50-5<br>50-5A<br><br>50-3<br>50-3A |
| Investments—Equity Securities—Overall | 321-10 | The amendments clarify that all adjustments made under the measurement alternative upon the identified remeasurement events should be accounted for in accordance with Topic 820. | 35-2<br>50-2B |
| Foreign Currency Matters—Overall<br>&<br>Financial Instruments—Overall | 830-10<br>&<br>825-10 | The amendments clarify that an entity is required to follow paragraph 830-10-45-18 for equity securities without readily determinable fair values accounted for under the measurement alternative in accordance with paragraph 321-10-35-2. Paragraph 830-10-45-18 requires remeasurement | 45-18<br><br>65-5 |

| ASU 2019-04 Codification Improvements to Topics 326, 815, and 825 | | | |
|---|---|---|---|
| **Topic** | **Codification** | **Abbreviated Summary of Change** | **Related Paragraphs** |
| | | at historical exchange rates. The amendments to paragraph 830-10-45-18(a)(1) and (a)(2) are not intended to change items that should be remeasured at historical exchange rates. | |
| Financial Instruments—Credit Losses—Measured at Amortized Cost | 326-20 | The amendments require an entity to present the amortized cost basis of line-of-credit arrangements that are converted to term loans in a separate column, as illustrated in Example 15. | 50-6A<br>50-7<br>55-79 |
| Financial Instruments—Credit Losses—Measured at Amortized Cost<br>&<br>Financial Instruments—Credit Losses—Overall | 326-20<br>&<br>326-10 | The amendments clarify that an entity should consider extension or renewal options (excluding those that are accounted for as a derivative in Topic 815) that are included in the original or modified contract at the reporting date and are not unconditionally cancellable by the entity. | 30-6<br><br>65-1<br>65-2 |

| ASU 2019-11 Codification Improvements to Topic 326,<br>Financial Instruments—Credit Losses | | | |
|---|---|---|---|
| **Topic** | **Codification** | **Abbreviated Summary of Change** | **Related Paragraphs** |
| Financial Instruments—Credit Losses—Measured at Amortized Cost | 326-20 | The amendment intends to clarify that expected recoveries of amounts previously written off and expected to be written off should be included in the valuation account and should not exceed the aggregate of amounts previously written off and expected to be written off by an entity. In addition, the amendments clarify that when a method other than a discounted cash flow method is used to estimate credit losses, expected recoveries should not include any amounts that result in an acceleration of the noncredit discount; however, an entity may include increases in expected cash flows after acquisition | 30-13 and 30-13A<br>55-86 thru 90 |
| Financial Instruments—Credit Losses—Overall | 326-10 | The Board did not intend to introduce significant operational complexities when measuring expected credit losses on preexisting troubled debt restructurings. As a result. the amendment allows entities an accounting policy election to calculate the prepayment-adjusted effective interest rate on preexisting troubled debt restructurings using the prepayment assumptions that exist as of the date that an entity adopts the amendments in Update 2016-13, instead of the prepayment-adjusted effective interest rate immediately before the restructuring date. | 65-1 |
| Investments—Debt and Equity Securities—Overall | 320-10 | The amendment provides a practical expedient that allows an entity to exclude accrued interest receivable balances from the disclosure requirements in paragraphs 326-20-50-4 through 50-22 and 326-30-50-4 | 50-2A<br>50-5C |

| ASU 2019-11 Codification Improvements to Topic 326, Financial Instruments—Credit Losses | | | |
|---|---|---|---|
| **Topic** | **Codification** | **Abbreviated Summary of Change** | **Related Paragraphs** |
| | | through 50-10. The amendments in this Update extend the disclosure relief for accrued interest receivable balances as permitted in Update 2019-04 to certain other Topics in the Codification. | |
| Financial Instruments—Credit Losses—Measured at Amortized Cost | 326-20 | The amendment clarifies that an entity should reasonably expect the borrower to continually replenish collateral securing the financial asset(s) in accordance with the contractual terms of the financial asset to apply the practical 15 expedient. An entity is not required to consider remote scenarios in making this determination. | 35-6 |
| Business Combinations—Identifiable Assets and Liabilities, and Any Noncontrolling Interest & Financial Instruments—Credit Losses—Overall | 805-20 & 326-10 | The amendment clarifies paragraph 805-20-50-1 by removing the cross reference to Subtopic 310-30, Receivables—Loans and Debt Securities Acquired with Deteriorated Credit Quality, which was superseded by Update 2016-13. The amendment instead correctly cross-references the guidance for purchased financial assets with credit deterioration in Subtopic 326-20. | 50-1<br><br>65-4 |

| ASU 2020-03 Codification Improvements to Financial Instruments | | | |
|---|---|---|---|
| **Topic** | **Codification** | **Abbreviated Summary of Change** | **Related Paragraphs** |
| Financial Instruments—Overall | 825-10 | Amendment clarifies that because financial assets and financial liabilities on which the fair value option have been elected are measured at fair value and not at amortized cost basis, all entities are subject to the fair value option disclosures in paragraphs 825-10-50-24 through 50-32. | 50-23A<br>65-7 |
| Fair Value Measurement—Overall | 820-10 | The amendments clarify the applicability of the portfolio exception in Subtopic 820-10, Fair Value Measurement—Overall, to nonfinancial items accounted for as derivatives under Topic 815, Derivatives and Hedging. | 35-2A<br>35-18L |
| Financial Services—Depository and Lending—Investments—Debt and Equity Securities<br>&<br>Financial Instruments—Overall | 942-320<br>&<br>825-10 | The amendments on certain disclosures for depository and lending institutions clarify that the disclosure requirements in paragraphs 320-10-50-3 and 320-10-50-5 through 50-5C apply to the disclosure requirements in paragraphs 942-320-50-3 through 50-3A. | 50-1<br>50-3<br>50-3A<br><br>65-5 |
| Debt—Modifications and Extinguishments | 470-50 | The amendments clarify that paragraphs 470-50-40-17 through 40-18, which describe the accounting for fees between the debtor and creditor and third-party costs, respectively, directly related to exchanges or modifications of debt instruments, reference paragraph 470-50-40-21 for the accounting for modifications to or exchanges of line-of-credit or revolving-debt arrangements. | 40-17<br>40-18<br>40-21 |
| Fair Value Measurement—Overall | 820-10 | The amendment clarifies that the disclosure requirements in paragraph 820-10-50-2 do not | 50-2 |

| ASU 2020-03 Codification Improvements to Financial Instruments | | | |
|---|---|---|---|
| **Topic** | **Codification** | **Abbreviated Summary of Change** | **Related Paragraphs** |
| | | apply to entities using the net asset value per share (or its equivalent) practical expedient. | |
| Financial Instruments—Credit Losses—Measured at Amortized Cost<br>&<br>Financial Instruments—Credit Losses—Overall | 326-20<br>&<br>326-10 | The amendments align the contractual term to measure expected credit losses for a net investment in a lease under Topic 326 to be consistent with the lease term determined under Topic 842. | 30-6A<br>55-8<br><br>65-4 |
| Transfers and Servicing—Sales of Financial Assets | 860-20 | The amendments relate to the interaction of the guidance in Topic 326 and Subtopic 860-20, Transfers and Servicing—Sales of Financial Assets. The amendments to Subtopic 860-20 clarify that when an entity regains control of financial assets sold, an allowance for credit losses should be recorded in accordance with Topic 326. | 25-13 |

**Revisions to the**
***As of March 2024 Accounting Practices and Procedures Manual***

On **February 20, 2024**, the Statutory Accounting Principles (E) Working Group adopted the following revisions to the *As of March 2024 Accounting Practices and Procedures Manual*. Documents associated with these revisions are linked to the reference items in bold text.

| Ref # | SSAP/ Appendix | Title | Summary |
|---|---|---|---|
| **2023-28** | SSAP No. 21R | Collateral Loan Reporting<br><br>*SAP Clarification*<br><br>Effective<br>Year End 2024 | Adopted revisions to SSAP No. 21R incorporate a collateral loan disclosure for year-end 2024 to detail admitted and nonadmitted collateral loans in accordance with the underlying collateral supporting the loan |

https://naiconline.sharepoint.com/teams/frsstatutoryaccounting/national meetings/a. national meeting materials/2024/02-20-24/adoptions/00 - adoptions toc.docx

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

**Issue: Collateral Loan Reporting**

**Check (applicable entity):**

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

**Description of Issue:** This agenda item has been developed to propose an expansion of reporting for collateral loans on Schedule BA to enable regulators the ability to quickly identify the type of collateral in support of admittance of collateral loans in scope of *SSAP No. 21R—Other Admitted Assets*. This agenda item has been drafted in response to comments that the current reporting detail on Schedule BA does not provide sufficient clarity on the type of collateral used in support of admittance of collateral loans. Furthermore, with the adoption of agenda item 2022-11, the statutory accounting guidance has been clarified that the collateral must reflect a qualifying investment, meaning that it would qualify for admittance if held directly by the insurer. This amendment further clarified that collateral that represents an investment in scope of *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies* or *SSAP No. 97—Investments in Subsidiary, Controlled or Affiliated Entities* is required to be audited consistent with the admittance requirements of those SSAPs.

As detailed within, this agenda item proposes new disclosure requirements in SSAP No. 21R for collateral loans. The new disclosure requirement is proposed to be satisfied by an expansion of the reporting on Schedule BA, so that the collateral loans are separated by the type of collateral investment that secures the loan. Additionally, a new aggregated data-captured note is proposed to identify the admitted and nonadmitted collateral loans by the type of collateral that secures the loan.

**Existing Authoritative Literature:**

- **SSAP No. 21R—Other Admitted Assets - (Tracking shows the edits adopted on Oct. 23, 2023.)**

4. Collateral loans are unconditional obligations[1] for the payment of money secured by the pledge of a~~n~~ qualifying 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:

a. Loan Impairment—Determination as to the impairment of a collateral loan shall be based on current information and events. When it is considered probable that any portion of amounts due under the contractual terms of the loan will not be collected the loan is considered impaired. The impairment shall be measured based on the fair value of the collateral less estimated costs to obtain and sell the collateral. The difference between the net value of the collateral and the recorded asset shall be written off in accordance with *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets*;

b. Nonadmitted Asset—In accordance with *SSAP No. 20—Nonadmitted Assets*, collateral loans secured by assets that do not qualify as investments which would otherwise be admitted shall be nonadmitted. Further, any amount of the loan outstanding which is in excess of the permitted relationship of fair value of the pledged investment to the collateral loan shall be treated as a nonadmitted asset. To support the admissibility of collateral loans, reporting entities shall maintain documentation sufficient to support the reasonableness of the fair value measurement of the underlying collateral, which shall be made available to the applicable domiciliary regulator and independent audit firm upon request.

**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 (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 that are also secured with collateral shall continue to be captured within scope of SSAP No. 26R.

**Footnote 2:** A qualifying ~~I~~investment defined as those assets listed in Section 3 of *Appendix A-001—Investments of Reporting Entities* which would, if held by the insurer, qualify for admittance. For example, if the collateral would not qualify for admittance under SSAP No. 4 due to encumbrances or other third-party interests, then it does not meet the definition of "qualifying" and the collateral loan, or any portion thereof which is not adequately collateralized, is not permitted to be admitted. In the cases where the collateral is an equity/unit investment in a joint venture, partnership, limited liability company, and or SCA is pledged as collateral in a collateral loan, audited financial statements on a consistent annual basis are always required in accordance with SSAP No. 48 and/or SSAP No. 97.

**Effective Date and Transition**

22. This statement is effective for years beginning January 1, 2001. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with SSAP No. 3—Accounting Changes and Corrections of Errors. The guidance for structured settlements when the reporting entity acquires the legal right to receive payments is effective December 31, 2018. The clarification regarding audits of qualifying collateral pledged for collateral loans in the footnote 2 to paragraph 4, requires applicable audits to be obtained for the 2023 reporting period in the subsequent year. In periods after year-end 2023, the audits of equity collateral pledged for collateral loans are required to be obtained for the reporting year in which it was pledged and annually thereafter. The annual audit lag shall be consistent from period to period.

- **A/S Blank and Instructions** *(This reflects what is proposed to be adopted in 2023-12BWG.)*

Collateral Loans

Unaffiliated.......................................................................................................3199999
Affiliated..........................................................................................................3299999

Collateral Loans

Include: Refer to SSAP No. 21R—Other Admitted Assets for a definition of collateral loans. Loans that are backed by any form of collateral, regardless of if the collateral is sufficient to fully cover the loan, shall be captured in this category. Guidance in SSAP No. 21R shall be followed to determine nonadmittance.

In the description column, the name of the actual borrower and state if the borrower is a parent, subsidiary, affiliate, officer or director. Also include the type of collateral held.

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

- Agenda Item 2022-11: Collateral for Loans clarified guidance on the criteria for collateral in order for a collateral loan to qualify as an admitted asset.

- Blanks Agenda Item 2023-12BWG incorporates revisions as part of the bond project to capture debt securities that do not qualify as bonds on Schedule BA. The revisions within this blanks item incorporate minor revisions to the instructions for collateral loans.

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

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

**Recommendation:**
**NAIC staff recommend that the Working Group move this item to the active listing, categorized as a SAP clarification, and expose this agenda item with proposed revisions to incorporate a new disclosure to SSAP No. 21R, for initial reporting as of year-end 2024, and to sponsor a blanks proposal for a new data-captured disclosure and to expand the reporting lines on Schedule BA to separate collateral loans by the type of collateral that secures the loan. NAIC staff recommends that the Working Group direct a corresponding blanks proposal to allow for concurrent exposure.**

**Proposed Revisions to SSAP No. 21R**: *(Only new edits are tracked. Prior adopted revisions are shown clean.)*

4. Collateral loans are unconditional obligations[1] for the payment of money secured by the pledge of a qualifying 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:

a. Loan Impairment—Determination as to the impairment of a collateral loan shall be based on current information and events. When it is considered probable that any portion of amounts due under the contractual terms of the loan will not be collected the loan is considered impaired. The impairment shall be measured based on the fair value of the collateral less estimated costs to obtain and sell the collateral. The difference between the net value of the collateral and the recorded asset shall be written off in accordance with *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets*;

b. Nonadmitted Asset—In accordance with *SSAP No. 20—Nonadmitted Assets*, collateral loans secured by assets that do not qualify as investments which would otherwise be admitted shall be nonadmitted. Further, any amount of the loan outstanding which is in excess of the permitted relationship of fair value of the pledged investment to the collateral loan shall be treated as a nonadmitted asset. To support the admissibility of collateral loans, reporting entities shall maintain documentation sufficient to support the reasonableness of the fair value measurement of the underlying collateral, which shall be made available to the applicable domiciliary regulator and independent audit firm upon request.

5. Collateral loans shall be reported based on the type of qualifying investment that secures the loan. An aggregate note disclosure shall identify the total amount of collateral loans and the collateral loans admitted and nonadmitted by qualifying investment type.

**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 (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 that are also secured with collateral shall continue to be captured within scope of SSAP No. 26R.

**Footnote 2:** A qualifying investment defined as those assets listed in Section 3 of *Appendix A-001—Investments of Reporting Entities* which would, if held by the insurer, qualify for admittance. For example, if the collateral would not qualify for admittance under SSAP No. 4 due to encumbrances or other third-party interests, then it does not meet the definition of "qualifying" and the collateral loan, or any portion thereof which is not adequately collateralized, is not permitted to be admitted. In the cases where the collateral is an equity/unit investment in a joint venture, partnership, limited liability company, and or SCA is pledged as collateral in a collateral loan, audited financial statements on a consistent annual basis are always required in accordance with SSAP No. 48 and or SSAP No. 97.

**Proposed Schedule BA Reporting Changes**:

Collateral Loans – Reported by Qualifying Investment Collateral that Secures the Loan

Cash, Cash Equivalent & Short-Term Investments (SSAP No. 2R)
Unaffiliated.........................................................................................................
Affiliated.............................................................................................................

Bonds (SSAP No. 26R)
Unaffiliated.........................................................................................................
Affiliated.............................................................................................................

Asset-Backed Securities (SSAP No. 43R)
Unaffiliated.........................................................................................................
Affiliated.............................................................................................................

Preferred Stocks (SSAP No. 32R)
Unaffiliated.........................................................................................................
Affiliated.............................................................................................................

Common Stocks (SSAP No. 30R)
Unaffiliated.........................................................................................................
Affiliated.............................................................................................................

Mortgage Loans (SSAP No. 37R)
Unaffiliated.........................................................................................................
Affiliated.............................................................................................................

Real Estate (SSAP No. 40R)
Unaffiliated.........................................................................................................
Affiliated.............................................................................................................

Joint Venture, Partnerships or Limited Liability Companies (SSAP No. 48R)
Unaffiliated.........................................................................................................
Affiliated.............................................................................................................

Subsidiary, Controlled or Affiliated Investment (SSAP No. 97)
Unaffiliated.........................................................................................................
Affiliated.............................................................................................................

Other Qualifying Investment Category
Unaffiliated.........................................................................................................
Affiliated.............................................................................................................

Collateral Does Not Qualify as an Investment
Unaffiliated.........................................................................................................
Affiliated.............................................................................................................

 

Collateral Loans

Include: Refer to SSAP No. 21R—Other Admitted Assets for a definition of collateral loans. Loans that are backed by any form of collateral, regardless of if the collateral is sufficient to fully cover the loan, shall be captured in this category. Guidance in SSAP No. 21R shall be followed to determine nonadmittance.

In the description column, the name of the actual borrower and state if the borrower is a parent, subsidiary, affiliate, officer or director. Also include the type of collateral held.

Classify the collateral loan in accordance with the type of collateral held, such that if the loan was to default and the collateral was to be claimed by the reporting entity, where it would be captured (investment type by SSAP) as a directly-held investment. If more than one form of collateral secures the loan, classification should occur based on the primary collateral source. The other qualifying investment category shall only be used to capture collateral loans secured by collateral in the form of contract loans, derivatives, other invested assets not separately reported, receivables for securities, securities lending and any investments that would qualify as a write-in for invested assets.

**Proposed Data-Captured Disclosure**:

*Aggregate Collateral Loans by Qualifying Investment Collateral:*

| **Collateral Type** | **Aggregate Collateral Loan** | **Admitted** | **Nonadmitted** |
|---|---|---|---|
| Cash, Cash Equivalents & ST Investments | | | |
| Bonds | | | |
| Asset-Backed Securities | | | |
| Preferred Stocks | | | |
| Common Stocks | | | |
| Real Estate | | | |
| Mortgage Loans | | | |
| Joint Ventures, Partnerships, LLC | | | |
| Subsidiary, Affiliated and Controlled Entities | | | |
| Other Qualifying Investments | | | |
| Collateral Does not Qualify as an Investment | | | |
| ***Total*** | | | |

Pursuant to SSAP No. 21R, nonadmittance of a collateral loan is required when the fair value of the collateral is not sufficient to cover the collateral loan or if the collateral securing the loan is not a qualifying investment. This includes situations in which collateral in form of joint ventures, partnerships, LLCs or SCAs is not supported by an audit as required by SSAP No. 48 or SSAP No. 97.

The other qualifying investment category shall only be used to capture collateral loans secured by collateral in the form of contract loans, derivatives, other invested assets not separately reported, receivables for securities, securities lending and any investments that would qualify as a write-in for invested assets. All collateral loans secured by collateral that does not qualify as an investment are~~is~~ required to be nonadmitted under SSAP No. 21R.

**Staff Review Completed by:** Julie Gann - NAIC Staff, September 2023

**Status:**
On December 1, 2023, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a SAP clarification and exposed revisions to incorporate a new disclosure to SSAP No. 21R for initial reporting as of year-end 2024, and to sponsor a blanks proposal for a new data-captured disclosure and to expand the reporting lines on Schedule BA to separate collateral loans by the type of collateral that secures the loan. Comments are requested on whether any of the proposed reporting lines should be combined.

On February 20, 2023, the Statutory Accounting Principles (E) Working Group took the following two actions:

1) The Working Group **adopted** the exposed revisions to SSAP No. 21R incorporating a collateral loan disclosure for year-end 2024. With this adoption, the Working Group sponsored a blanks proposal to data-capture the disclosure. Adopted revisions to SSAP No. 21R are shown below:

    5. Collateral loans shall be reported based on the type of qualifying investment that secures the loan. An aggregate note disclosure shall identify the total amount of collateral loans, and the collateral loans admitted and nonadmitted by qualifying investment type.

2) The Working Group exposed proposed reporting lines to Schedule BA for collateral loans with a comment deadline of April 19, 2024. Although the exposure does not contain AVR reporting revisions, the Working Group is specifically requesting feedback from regulators and industry on whether collateral loans backed by certain types of collateral should flow through AVR for RBC impact. Additionally, the Working Group directed a referral to the Life Risk-Based Capital (E) Working Group on the proposed reporting lines and the AVR mapping/RBC impact for collateral loans.

**February 20, 2024, Exposed Schedule BA Reporting Changes***:*
*(Tracking shows changes from the prior exposure.)*

Collateral Loans – Reported by Qualifying Investment Collateral that Secures the Loan

~~Cash, Cash Equivalent & Short-Term Investments (SSAP No. 2R)~~
~~Unaffiliated..........................................................................................................~~
~~Affiliated..............................................................................................................~~

Bonds and Asset-Backed Securities (SSAP No. 26R & SSAP No. 43R)
Unaffiliated..........................................................................................................
Affiliated..............................................................................................................

~~Asset-Backed Securities (SSAP No. 43R)~~
~~Unaffiliated..........................................................................................................~~
~~Affiliated..............................................................................................................~~

Preferred Stocks (SSAP No. 32R)
Unaffiliated..........................................................................................................
Affiliated..............................................................................................................

Common Stocks (SSAP No. 30R)
Unaffiliated..........................................................................................................
Affiliated..............................................................................................................

Mortgage Loans (SSAP No. 37R)
Unaffiliated..........................................................................................................
Affiliated..............................................................................................................

Real Estate (SSAP No. 40R)
Unaffiliated.........................................................................................................
Affiliated.............................................................................................................

Joint Venture, Partnerships or Limited Liability Companies (SSAP No. 48)
Fixed Income Investments (Unaffiliated) ..........................................................................................
Fixed Income Investments (Affiliated) ..........................................................................................

Common Stocks (Unaffiliated) ..........................................................................................
Common Stocks (Affiliated) ..........................................................................................

Real Estate (Unaffiliated) ..........................................................................................
Real Estate (Affiliated) ..........................................................................................

Mortgage Loans (Unaffiliated) ..........................................................................................
Mortgage Loans (Affiliated) ..........................................................................................

Other (Unaffiliated) ..........................................................................................
Other (Affiliated) ..........................................................................................
~~Unaffiliated.........................................................................................................~~
~~Affiliated.............................................................................................................~~

~~Subsidiary, Controlled or Affiliated Investment (SSAP No. 97)~~
~~Unaffiliated.........................................................................................................~~
~~Affiliated.............................................................................................................~~

Other ~~Qualifying~~ Investment Category
Cash, Cash Equivalent and Short-Term Investments (Unaffiliated) ....................................................
Cash, Cash Equivalent and Short-Term Investments (Affiliated) ....................................................

Other Long-Term Invested Assets (Unaffiliated) ...............................................
Other Long-Term Invested Assets (Affiliated) ...............................................
~~Unaffiliated.........................................................................................................~~
~~Affiliated.............................................................................................................~~

~~Collateral Does Not Qualify as an Investment~~
~~Unaffiliated.........................................................................................................~~
~~Affiliated.............................................................................................................~~

**Non-Collateral Loans**

Related Party/Affiliated Loans
All Other Non-Collateral Loans
~~Unaffiliated.........................................................................................................~~
~~Affiliated.............................................................................................................~~



 

**Revisions to the**
***As of March 2024, Accounting Practices and Procedures Manual***

On **March 16, 2024**, the Statutory Accounting Principles (E) Working Group adopted the following revisions to the *As of March 2024 Accounting Practices and Procedures Manual*. Documents associated with these revisions are linked to the reference items in bold text.

| Ref # | SSAP/ Appendix | Title | Summary |
|---|---|---|---|
| **2019-21** | SSAP No. 21R | Principles-Based Bond Project & Residual Interests<br><br>*New SAP Concept*<br><br>Effective January 1, 2025 | Adopted revisions provide guidance for debt securities that do not qualify as bonds under the principles-based bond definition, with a January 1, 2025, effective date.<br><br>Adopted revisions prescribe accounting guidance (measurement method) for all residual interests regardless of legal form. This specific guidance is effective January 1, 2025, but can be early adopted for 2024. |
| **2022-14**<br><br>**2022-14a**<br>**2022-14b**<br>**2022-14c** | SSAP No. 93R<br>SSAP No. 94R<br>SSAP No. 34<br>SSAP No. 48 | New Market Tax Credit Project<br><br>*New SAP Concept*<br><br>Effective January 1, 2025 | Adopted revisions expand and amend guidance within SSAP No. 93 to include all tax credit investments regardless of structure and type of state or federal tax credit program. Revisions to SSAP No. 94R expand and amend guidance to include both purchased state and federal tax credits. Revisions in SSAP No. 34 and SSAP No. 48 include consistency revisions in response to the changes made to SSAP No. 93 and SSAP No. 94R. |
| **2023-25** | Appendix D | ASU 2023-03 – SEC Updates<br><br>*SAP Clarification*<br><br>Effective Immediately March 16, 2024 | Adopted revisions reject ASU 2023-03 as not applicable for statutory accounting. |
| **2023-27** | Appendix D | ASU 2023-04 – SEC Updates, Crypto<br><br>*SAP Clarification*<br><br>Effective Immediately March 16, 2024 | Adopted revisions reject ASU 2023-04 as not applicable for statutory accounting. |
| **2023-29** | Annual Statement Instructions | IMR Preferred Stock<br><br>Revisions will be considered by the Blanks (E) Working Group for year-end 2024. | Adopted proposed revisions to the annual statement instructions which direct perpetual preferred stock (including SVO-Identified Preferred Stock ETFs), and mandatory convertible preferred stock through the AVR. This proposal did not result in SSAP revisions. |

| Ref # | SSAP/ Appendix | Title | Summary |
|---|---|---|---|
| 2023-30 | SSAP No. 97 | SSAP No. 97 Admissibility Requirements<br><br>*SAP Clarification*<br><br>Effective Immediately March 16, 2024 | Adopted revisions align the language in SSAP No. 97, paragraph 24, with the existing guidance provided in paragraphs 26 and 27. |

https://naiconline.sharepoint.com/teams/frsstatutoryaccounting/national meetings/a. national meeting materials/2024/03-16-24 spring national meeting/adoptions/00 - adoptions 3.16.2024 toc.docx

**The Revisions Shown in this Document are Effective January 1, 2025**

## *Revisions to SSAP No. 21R—Other Admitted Assets*

## Bond Definition – Debt Securities that Do Not Qualify as Bonds

## Residual Tranches or Interests/Loss Positions

## Adopted March 16, 2024

On March 16, 2024, the Statutory Accounting Principles (E) Working Group adopted new statutory accounting guidance for "Debt Securities that Do Not Qualify as Bonds" and for "Residual Tranches or Interests/Loss Positions" within *SSAP No. 21—Other Admitted Assets.* The new sections are shown below. (Existing guidance from SSAP No. 21, paragraph 22 under 'Effective Date and Transition" is duplicated within and becomes paragraph 40 after the revisions.) The revisions are effective Jan. 1, 2025. Reporting entities may elect to adopt the residual guidance (detailed in paragraphs 28-37) for year-end 2024.

**Debt Securities That Do Not Qualify as Bonds**

20. The guidance within paragraphs 20-27 of this statement shall apply for any security, as defined in *SSAP No. 26R—Bonds*, 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 No. 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 of this standard that do not qualify as bonds under SSAP No. 26R and for which the primary source of repayment is derived through rights to underlying collateral, qualify as admitted assets if the underlying collateral primarily qualify as admitted invested assets. As detailed in paragraph 31, in the section pertaining to residual tranches, any residual tranches or first loss positions held from the same securitization that did not qualify as a bond under SSAP No. 26R also only qualify as admitted assets to the extent the underlying collateral primarily qualifies as admitted invested assets.

23. Debt securities in scope of this statement shall be initially reported at acquisition at cost, including brokerage and other related fees on *Schedule BA: Other Long-Term Invested Assets*.

24. Debt securities captured in scope of this statement shall be reported at the lower of amortized cost or fair value. Changes in measurement to reflect a 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 in the 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.

*Residual Tranches or Interests/Loss Positions*

28. A residual interest or a residual security tranche (collectively referred to as residuals) exists in investment structures that issue one or more classes of debt securities created for the primary purpose of raising debt capital backed by collateral assets. The primary source of debt repayment is derived through rights to the cash flows of a discrete pool of collateral assets. These designs could be backed directly or indirectly through a feeder fund. The collateral assets generate cash flows that provide interest and principal payments to debt holders through a contractually prescribed distribution methodology (e.g., waterfall dictating the order and application of all collateral cash flows). Once those contractual requirements are met, the remaining cash flows generated by (or with the sale of) the collateral assets are provided to the holder of the residual security/residual interest holder. When an asset within the discrete pool of assets does not perform as expected, it impacts the extent to which cash flows will be generated and distributed. The residual holders in the structure continue to receive payments from the collateral so long as there are cash flows in excess of the debt obligations. The payments to the residual holder may vary significantly, both in timing and amount, based on the underlying collateral performance.

29. The structural design of a residual interest or residual security tranche can vary, but the overall concept is that they receive the remaining cash flows after all debt holders receive contractual interest and principal payments. Determining whether an investment in a structure reflects a residual interest or tranche shall be based on the substance of the investment held rather than its legal form. Common characteristics of residual interests/residual security tranches include the items noted below, but the presence or absence of any of these factors should not be definitive in determination. Classification as a residual should be based on the substance of the investment and how cash flows to the holder are determined. Additionally, it would be expected that the equity position in an ABS Issuer, as defined in SSAP 26R, would be classified as a residual tranche.

a. Residuals often do not have contractual principal or interest.

b. Residuals may be structured with terms that appear to be stated principal or interest but that lack substance, and result in receiving the residual cash flows of the underlying collateral. The terms allow for significant variation in the timing and amount of cash flows without triggering a default of the structure.

c. Residuals do not have credit ratings or NAIC assigned designations. Rather, they are first loss positions that provide subordination to support the credit quality of the typically rated debt tranches.

d. Residuals may provide payment throughout the investment duration (and not just at maturity), but the payments received continue to reflect the residual amount permitted after debt tranche holders receive contractual principal and interest payments.

e. Frequently, there are contractual triggers that divert cash flows from the residual holders to the debt tranches if the structure becomes stressed.

30. Residual tranches or interests do not qualify for bond reporting. Residuals shall follow the accounting and admittance guidance within this statement and are required to be reported on Schedule BA: Other Long-Term Invested Assets.

31. As stated in paragraph 22, residuals are permitted to be admitted assets if debt securities from the same structure qualify (or would qualify) as admitted assets. If the debt security from a structure is (or would be) nonadmitted due to the requirements under paragraph 22, then any residual interests or first loss positions held from the same structure also do not qualify as admitted assets and shall be reported as nonadmitted assets.

32. Residuals shall be initially reported at cost, or allocated cost (using proportional fair values if acquired along with debt tranches from the securitization). Subsequent to initial acquisition, residuals shall be reported at either 1) the lower of amortized cost or fair value under the Allowable Earned Yield method detailed in paragraphs 33-34, with temporary reductions in fair value reported as an unrealized loss, or 2) at the calculated practical expedient method detailed in paragraph 35.

33. For purposes of this statement for residuals only, amortized cost shall be defined as the cost to acquire the residual reduced for distributions in excess of the Allowable Earned Yield and other-then-temporary impairments (OTTI). The Allowable Earned Yield shall be established at acquisition as the discount rate that equates the initial best estimate of the residual's cash flows to its acquisition cost. The Allowable Earned Yield is not to be updated after acquisition.

34. Interest income shall be recorded under the effective yield method using the Allowable Earned Yield, capped by the amount of cash distributions received. To the extent that the Allowable Earned Yield, applied to the current amortized cost, exceeds the cash distributions received, such unrecognized interest income may be carried forward to future periods to be recognized when sufficient cash distributions are received. To the extent cash distributions exceed the Allowable Earned Yield (including any unrecognized interest carried forward), the amortized cost shall be reduced by the excess. As a result of this method, the amortized cost shall not be increased unless there is a subsequent investment (i.e., an additional purchase with additional consideration remitted).

35. Reporting entities may elect a practical expedient in lieu of the Allowable Earned Yield detailed in paragraphs 33-34 and calculate Book/Adjusted Carrying Value (BACV) such that all distributions received are treated as a reduction in BACV. With this approach, the reporting entity will not recognize any interest or investment income until the residual tranche has a BACV of zero. Once the residual has a zero BACV, distributions received shall be recognized as interest income.

a. Reporting entities applying the practical expedient shall continue to report residuals on Schedule BA, including those with a zero BACV. Any subsequent distributions shall be reported as interest income until the structure matures/terminates, is unwound, or no longer meets the definition of a residual.

b. Reporting entities are required to apply the practical expedient to all residuals held.

c. Reporting entities that wish to discontinue use of the practical expedient approach and move towards the Allowable Earned Yield method are required to specify and disclose an explicit transition date, and only apply the Allowable Earned Yield method to residuals acquired after that date. Residuals held prior to the disclosed accounting method transition date shall continue to follow the practical expedient until those residuals mature/terminate or are unwound.

36. Residuals shall be assessed for other-than-temporary impairment (OTTI) on an ongoing basis, with required assessment anytime that fair value is less than the reported value.

a. For residuals measured using the Allowable Earned Yield method, as detailed in paragraphs 33-34, an OTTI shall be considered to have occurred if the present value of expected cash flows discounted by the Allowable Earned Yield, is less than amortized cost. Upon identification of an OTTI, the reporting entity shall recognize a realized loss equal to the difference between the amortized cost and the present value of expected cash flows, with the present value of expected cash flows becoming the new amortized cost to which the Allowable Earned Yield is applied. After the OTTI is recognized, distributions received from the residual shall continue to be recorded in accordance with paragraphs 33-34. Subsequent recoveries in cash flows shall not result in increases to the amortized cost.

b. For residuals measured under the practical expedient, as detailed in paragraph 35, an OTTI shall be considered to have occurred if the fair value of the residual is less than the BACV. The reporting entity shall recognize a realized loss equal to the difference between the fair value and the BACV, with the fair value becoming the new BACV. After the OTTI is recognized, distributions received from the residual shall continue to be recorded in accordance with paragraph 35. Subsequent recoveries in cash flows shall not result in increases to the BACV.

37. Residuals recognized on Schedule BA as of December 31, 2024, and accounted for under a different SSAP, shall follow the following measurement transition guidance as of January 1, 2025:

a. Reporting entity shall determine whether they will follow the Allowable Earned Yield method detailed in paragraphs 33-34, or the practical expedient detailed in paragraph 35, for all residuals.

b. Residuals previously accounted for under SSAP No. 26R or SSAP No. 43R shall prospectively apply the Allowable Earned Yield measurement method elected under this Statement using the amortized cost as of December 31, 2024 as the starting point in the calculation. Residuals that will follow the practical expedient shall be recognized on January 1, 2025 at the lower of amortized cost or fair value as of December 31, 2024, realizing any unrealized loss existing at that date.

c. Residuals reported under the equity method or fair value as of December 31, 2024 (as they were previously captured in scope of SSAP No. 30R, 32R or 48) with unrealized gains or losses recognized, shall recognize any unrealized position as realized, with the reported value as of December 31, 2024 becoming the January 1, 2025 cost basis for subsequent measurement under this statement.

**Effective Date and Transition**

~~22.~~40. This statement is effective for years beginning January 1, 2001. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*. The guidance for structured settlements when the reporting entity acquires the legal right to receive payments is effective December 31, 2018. The clarification regarding audits of qualifying collateral pledged for collateral loans in the footnote 2 to paragraph 4 requires applicable audits to be obtained for the 2023 reporting period in the subsequent year. In periods after year-end 2023, the audits of equity collateral pledged for collateral loans are required to be obtained for the reporting year in which it was pledged and annually thereafter. The annual audit lag shall be consistent from period to period.

41. Revisions adopted March 16, 2024, to add guidance for "Debt Securities That Do Not Qualify as Bonds" and for "Residual Tranches or Interests/Loss Positions" are initially effective Jan. 1, 2025, to correspond with the effective date of the principles-based bond definition. The guidance for residual tranches is permitted for early application. Reporting entities that apply this guidance in 2024 shall continue to follow the transition guidance in paragraph 37 using the modified dates that correspond to the reporting entity's application date.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2024/03-16-24 Spring National Meeting/Adoptions/19-21 - SSAP No. 21R - 2-1-24.docx

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

**Issue: New Market Tax Credits**

**Check (applicable entity):**

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

**Description of Issue:** The New Market Tax Credits (NMTC) Program was established by Congress in December 2000 and permits individual and corporate taxpayers to receive a non-refundable tax credit against federal income taxes for making equity investments in financial intermediaries known as Community Development Entities (CDEs). CDEs that receive the tax credit allocation authority under the program are domestic corporations or partnerships that provide loans, investments, or financial counseling in low-income urban and rural communities. The tax credit provided to the investors total 39% of the total cost of the investment and is claimed over a seven-year period. The CDEs in turn use the capital raised to make investments in low-income communities. CDEs must apply annually to the CDFI Fund to compete for NMTC allocation authority. The NMTC program is currently subject to expiration but has been extended to Dec. 31, 2025. The NMTC Extension Act of 2021 (introduced February 2021) would make the NMTC program permanent, modify the credit to provide for an inflation adjustment to the limitation amount for the credit after 2021, and allow an offset against the alternative minimum tax for the credit.

The success of the federal NMTC program has led to states adopting their own NMTC legislation. Per one noted article, the majority of state NMTC programs follow the federal rules with some modifications that vary from state to state. State modifications have been noted to specifically target smaller businesses, simplifying the application process, prohibiting the use of real estate business, and capping the amount of tax credits that can be allocated to one project. The economic impact of the state NMTC programs is typically less than the impact of federal NMTC programs because the economic return to investors for state tax credits is generally lower than what they receive for federal credits. Some states require that state tax credits can only be used in conjunction with federal credits. Pairing federal and state programs is beneficial to the qualifying business as they keep more of the investment without an obligation to return as the investors receives more tax credits.

Overview of Federal Program:

- Federal government authorizes an annual credit authority for NMTCs (amount of tax credits available).

- The Community Development Fund Institutions (CDFI fund) is a division of the U.S. Treasury responsible for implementing the NMTC program. Since there are limited tax credits each year, the CDFI fund has a competitive application process for the right to grant tax credits to investors and to make qualified NMTC investments.

- The right to grant tax credits is referred to as “NMTC Allocation” and is awarded to Community Development Entities (CDEs) that invest in low-income communities. The CDEs offer the tax credits to cash investors, and then use the cash to make investments (typically loans to a qualifying project – a “Qualifying Active Low-Income Community Business” - QALICB) that further the mission and objectives of the NMTC program.

- The program specifies that the investor must provide cash as an equity investment (qualified equity investment – QEI) and it must stay invested in the CDE and the resulting NMTC qualifying project (QALICB) for a period of seven years.
    - The restrictions are specific that the investment is an equity investment as stock (other than nonqualified preferred) in an entity that is a corporation for federal tax purposes or any capital interest in an entity that is a partnership for federal tax purposes. (The investor is generally a 99.99% or 100% equity owner.)

- NMTC investments must remain in a qualified business for a seven-year period. Any principal amount repaid during that period must be reinvested by the CDE until the seven-year period expires. Most CDEs and investors avoid the reinvestment requirement and structure interest-only loans that prohibit principal repayment within the seven-year timeframe.
    - The 39% tax credit is provided as 5% of the investment in the first 3 years and then 6% of the investment for the next 4 years.
    - For tax purposes, the basis adjustment in the qualified equity investment is reduced by the amount of any new market tax credits on each credit allowance date.
    - Programs that cease to qualify are subject to tax credit recapture.

- Investors enter these transactions recognizing that the original investment amount will not be fully returned. Rather, a portion (or perhaps all) of the equity investment will be unpaid without an obligation to return from the borrowing business. NMTC investments with these terms have specific maturing terms / actions. One approach could be that an option (put/call) is held by the investor that gives them the right to sell its equity investment to the borrower for a nominal price.

- The designs are often complex and introduce leverage lenders to maximize tax credits to the equity investor:
    - Equity investor provides $3M to acquire 100% equity interest in an investment fund.
    - Investment fund borrows $7M from a leverage lender.
    - This results with a $10M qualifying NMTC transaction, resulting with the equity investor receiving $3.9M in tax credits over 7 years from an initial $3M investment.
    - The investment fund provides two loans to the qualified low-income business (QALICB). The first loan is for the $7M leverage loan, the second is for the $3M equity investment.
    - Both loans only pay interest for the seven-year period to meet the NMTC terms.
    - At the conclusion of the 7 years, the project sponsor purchases the second loan via a ‘put/call’ agreement, converting the $3M into a permanent subsidiary for the project.
    - The borrower / project sponsor refinances the $7M loan to repay the leverage lender.
    - The ultimate result is that the equity investor received $3.9M over 7 years in tax credits for $3M.

- Example without leverage lender:
    - Investor provides a $10M NMTC Investment
    - Investor receives $3.9M in tax credits over seven years.
    - Investor receives $7.4M of original investment at the end of the seven years.
    - Borrower keeps $2.6M of the original investment to further their low-income qualifying activities.
    - Investor receives a net return of $1.3M. ($10M less $3.9M tax credits less return of 7.4M principal.)

FASB Discussion
The FASB has a current Emerging Issues Task Force project to assess whether the proportional amortization method of accounting, which is used for Low-Income Housing Tax Credits (LIHTC), should be expanded to investments in tax credit structures beyond LIHTC. The proportional amortization method results in the tax credit investment being amortized in proportion to the allocation of tax credits in each period and allows the investment amortization and tax credits to be presented on a net basis within the income tax line item. Currently, investments in other tax credit structures are typically accounted for using the equity method or the cost method. Under the equity and cost methods, investment gains/losses and tax credits are presented on a gross basis on an entity's income statement. The FASB has received two requests asking that the proportional amortization method be made applicable to New Market Tax Credit Structures as well as other investment structures that are made primarily for the purpose of receiving tax credits and other tax benefits. The FASB added a project to the Emerging Issues Task Force agenda on Sept. 22, 2021. The FASB Task Force reached a consensus-for-exposure on June 16, 2022, that the proportional amortization method can be elected on a tax credit program by tax credit program basis. This proposed ASU was exposed in August 2022, with comments due Oct. 6, 2022. A final ASU is expected later in 2022 or early in 2023 (ASU 2023-02 was issued in March of 2023).

IRS Provisions – The NMTC is captured as a nonrefundable 'general business credit' and is limited to tax liability. If tax liability is not sufficient to take the credit, then the tax credit is subject to carryforward / carryback provisions. Per instructions from the *2021 Instructions for Form 3800 – General Business Credit*, general business credits that cannot be used because of a tax liability limit are first carried-back 1 year through an amended return. If there are unused credits after carrying back 1 year, the tax credit can be carried forward to each of the 20 tax years after the year of the credit.

Inflation Reduction Act Provisions – The Inflation Reduction Act was signed by President Biden on Aug. 16, 2022. Although there are several elements within the Act, it includes a 15% corporate minimum tax rate for corporations with at least $1 billion in income and includes numerous investments in climate protection, clean energy production and tax credits aimed at reducing carbon emissions. Although the Act has been signed, several elements are pending further application guidance. From preliminary information, the act allows for general business credits, such as the low-income housing tax credit (LIHTC), new markets tax credit (NMTC), historic tax credit (HTC) and renewable energy tax credits (RETCs) to be taken against the minimum tax. **However, further monitoring of application / interpretation guidance that is still forthcoming is required to assess the actual application and impact of tax credits on companies subject to the minimum tax.**

Statutory Accounting Considerations:

- Although the design is an equity investment of stock or interest in a corporation or partnership, which would normally be subject to *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*, the intent of NMTC investments is for tax credits and not equity returns. As such, this structure is closer to the existing low-income housing tax credits guidance in SSAP No. 93 than the partnership / LLC guidance in SSAP No. 48.

- Although *SSAP No. 93—Low Income Housing Tax Credit Property Investments* provides guidance for an equity investment, that provides tax credits with a limited (or zero) residual investment value, the guidance in SSAP No. 93 is specific to LIHTC programs.

- It has been identified that there are structures that have been designed to resemble fixed-income notes that do not pay regular cash interest, but rather provide NMTC tax credits as interest returns. These structures are in substance that same as other investments in NMTC, with an underlying equity interest in the CDE that generates tax credits. However, they have been structured with a guarantee for compensatory interest in the form of cash for the amount of the tax credit expected to have been received that year. These structures are also being considered within scope of this agenda item. Such structures have to meet specific criteria to qualify for tax credits under the IRS rules.

**Existing Authoritative Literature:**

***SSAP Authoritative Guidance:***

- **<u>SSAP No. 93—Low Income Housing Tax Credit Property Investments</u>**
  This statement establishes accounting principles for investments in federal certain state sponsored Low Income Housing Tax Credit (LIHTC) properties owned through limited liability entities that are flow-through entities for tax purposes. The guidance requires LIHTC investments to be initially recorded at cost and carried at proportional amortized cost unless the investment is identified as impaired. Under the proportional amortization method, amortization of the LLC investment is recognized in the income statement as a component of net investment income/expense and the current tax credit is accounted for as a component of income tax expense:

  - Federal tax credits are recognized in the income statement as an offset to federal taxes in the tax reporting year in which the tax credit is utilized in accordance with *SSAP No. 101—Income Taxes*.

  - State tax credits shall be recognized in the income statement as an offset to state premium tax or state income tax, whichever is applicable, in the tax-reporting year in which the credit is utilized.

  - Tax benefits received, other than tax credits, shall be accounted for pursuant to SSAP No. 101.

  SSAP No. 93 indicates that immediate recognition of the entire benefit of the tax credit to be received during the term of the investment in a low-income housing project is not appropriate. It also indicates that low-income housing tax credits shall not be recognized in the financial statements before their inclusion in the investor's tax return.

- **<u>SSAP No. 94R—Transferable and Non-Transferable State Tax Credits</u>**
  This statement establishes accounting principles for investments transferable and non-transferable state tax credits, with an explicit exclusion for LIHTCs (or similar tax credits) captured in scope of SSAP No. 93.

  Guidance for admittance of state tax credits under this statement varies based on whether it is transferable or non-transferable:

  <u>Transferable – Per the SSAP, all the following criteria must be met for admittance:</u>

  1) The holder of the transferable state tax credit may sell or otherwise transfer the transferable state tax credit to another entity, which can likewise sell or transfer the credit;
  2) The transferable state tax credit will expire is not used by a predetermined date; and
  3) The transferable state tax credit can be applied against either state income tax or state premium tax.

  <u>Non-Transferable – Per the SSAP, all the following criteria must be met for admittance:</u>

  1) Successive holder of a state tax credit must redeem the credit by April 15 of the subsequent year to the entity's acquisition of the state tax credit and is not permitted to carry-over, carry-back, obtain a refund, sell or assign the credit;
  2) The non-transferable state tax credit will expire if not used by the predetermined date; and
  3) The non-transferable state tax credits can be applied against either state income tax or state premium tax.

 

Review of Existing Statutory Accounting Guidance for NMTC and Overall Application:

- Existing statutory accounting guidance does not encompass federal NMTC (or other federal tax credits), as SSAP No. 93 is limited to LIHTC and SSAP No. 94 is specific to state tax credits.

- Provisions in SSAP No. 93 do not fully address earned (received) tax credits that carryforward for future use.

- The admittance criteria in SSAP No. 94 are applied to characteristics that perhaps may not be factors that would impact admittance:

    - A tax credit that does not expire would be precluded as an admitted asset under the guidance.

    - A non-transferable tax credit that can be carried-forward, carried-back, able to be refunded or that can be sold or assigned is precluded as an admitted asset under the guidance.

***Statutory Accounting Reporting Guidance:***

Guaranteed and non-guaranteed federal low-income housing tax credits have separate reporting lines on Schedule BA along with an "all other" low-income housing tax credit line. The guidance is specific that these lines are only for low-income tax credits (or tax credits for affordable housing) that are in the form of a partnership or limited liability company. Non-qualifying LIHTC are to be reported in the "All Other" category. With this current guidance, there is no explicit reporting provision for tax credits that are not captured in LIHTC.

Reporting Lines and Instructions:

Guaranteed Federal Low Income Housing Tax Credit
Unaffiliated .......... 3599999
Affiliated .......... 3699999
Non-Guaranteed Federal Low Income Housing Tax Credit
Unaffiliated .......... 3799999
Affiliated .......... 3899999
Guaranteed State Low Income Housing Tax Credit
Unaffiliated .......... 3999999
Affiliated .......... 4099999
Non-Guaranteed State Low Income Housing Tax Credit
Unaffiliated .......... 4199999
Affiliated .......... 4299999
All Other Low Income Housing Tax Credit
Unaffiliated .......... 4399999
Affiliated .......... 4499999

Low Income Housing Tax Credit

Include: All Low-Income Housing Tax Credit Investments (LIHTC or affordable housing) that are in the form of a Limited Partnership or a Limited Liability Company including those investments that have the following risk mitigation factors:

A. Guaranteed Low Income Housing Tax Credit Investments. There must be an all-inclusive guarantee from a CRP-rated entity that guarantees the yield on the investment.

B. Non-guaranteed Low Income Housing Tax Credit Investments.

I. A level of leverage below 50%. For a LIHTC Fund, the level of leverage is measured at the fund level.

II. There is a Tax Credit Guarantee Agreement from General Partner or managing member. This agreement requires the General Partner or managing member to reimburse investors for any shortfalls in tax credits due to errors of compliance, for the life of the partnership. For a LIHTC Fund, a Tax Credit Guarantee is required from the developers of the lower tier LIHTC properties to the upper tier partnership and all other LIHTC investments.

III. There are sufficient operating reserves, capital replacement reserves and/or operating deficit guarantees present to mitigate foreseeable foreclosure risk at the time of the investment.

Non-qualifying LIHTCs should be reported in the “All Other” category.

***Statutory Accounting RBC Impact:***

Life: The RBC factors for LIHTC are captured as part of the real estate on LR007:

| | | | |
|---|---|---|---|
| (17) | Federal Guaranteed Low Income Housing Tax Credits | AVR Equity Component Column 1 Line 75 | 0.0014 |
| (18) | Federal Non-Guaranteed Low Income Housing Tax Credits | AVR Equity Component Column 1 Line 76 | 0.0260 |
| (19) | State Guaranteed Low Income Housing Tax Credits | AVR Equity Component Column 1 Line 77 | 0.0014 |
| (20) | State Non-Guaranteed Low Income Housing Tax Credits | AVR Equity Component Column 1 Line 78 | 0.0260 |
| (21) | All Other Low Income Housing Tax Credits | AVR Equity Component Column 1 Line 79 | 0.1500 |
| (22) | Total Schedule BA Real Estate | Lines (16) + (17) + (18) + (19) + (20) + (21) | |

P/C and Health: The RBC factors for LIHTC are captured as components of other long-term assets. The reporting lines and factors are the same as they are for life (as shown above).

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

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

**Convergence with International Financial Reporting Standards (IFRS):** NA

**Recommendation:**
**NAIC staff recommend that the Working Group expose additional revisions described below to SSAP No. 93 and SSAP No. 94R. Staff also recommends that the Working Group expose changes to *SSAP No. 34—Investment Income Due and Accrued* and *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*, which detail miscellaneous changes which update the scope of each statement for the proposed updates to SSAP No. 93 and SSAP No. 94R.** The following are key revisions to SSAP No. 93R and 94R are proposed for exposure:

- *SSAP No. 93R—Investments in Tax Credit Structures* – NAIC staff recommends the following revisions in response to comments, from interested parties, public comments and NAIC staff internal review:
    - o Various editorial changes to the admittance test described in paragraph 18 to clarify technical aspects of the assessment.
    - o Addition of a Glossary of key terms at the end of the SSAP.
    - o Revised guidance effective date to be 1/1/2025, applied prospectively without option to early adopt.

- Added a new paragraph to the Impairment of Tax Credit Investments section to provide guidance on tax credit programs which allocate variable amounts of tax credits.
- Clarified in footnote 4 that tax credit strips derived from tax equity investments are not an example of an investment structure exempt from the audit requirement.
- Added disclosures for unused tax credits allocated from tax credit investments as these tax credits would not be within the scope of SSAP No. 94R disclosures.

- *SSAP No. 94R—State and Federal Tax Credits* – NAIC staff recommends the following revisions in response to comments, from interested parties, public comments and NAIC staff internal review:
  - Revised guidance effective date to be 1/1/2025 with early adoption permitted.
  - Added language to clarify that awarded tax credits (neither purchased nor allocated from an investment) are not within the scope of SSAP No. 94R.
  - Added commitment and contingency guidance to the Accounting and Disclosure sections.

- Other SSAPs – In response to the proposed revisions to SSAP Nos 93 and 94R, NAIC staff recommends the following:
  - *SSAP No. 34—Investment Income Due and Accrued* – Staff proposes revisions to clarify that tax credits earned or purchased are not within the scope of SSAP No. 34.
  - *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies* – Staff proposes revisions which update paragraph 2 for the new tax credit investment language.

**Interested parties' comment letter recommended revisions which would narrow the scope of the paragraph 18 admittance test to only tax credit investments which allocate non-transferable tax credit and prohibit the sale of ownership interests. NAIC staff did not revise the SSAP No. 93R draft for these recommendations but intends to continue working with industry to address their concerns that the new guidance may nonadmit previously admitted tax credit investments.**

**Additionally, NAIC staff requests comments on the annual statement reporting categories for tax credit investment RBC. The current RBC categories are LIHTC Investment specific and are mapped to the real estate grouping.**

**Staff Review Completed by:** William Oden and Julie Gann - NAIC Staff, May 2023

**Status:**
**December 13, 2022 - Fall National Meeting Recommendation:**
NAIC staff recommends that the Working Group direct NAIC staff to draft statutory accounting guidance in the form of a new or revised SSAP that expands the current LIHTC guidance for equity investments that general federal business tax credit and state premium tax credits. Although this agenda item is focusing on NMTC, it is recommended that consideration be given to guidance that does not name specific designs, such as NMTC or other specific tax credits, so that it can be applicable for all qualifying tax equity investments. This guidance will consider the proposed FASB guidance as well as admittance and impairment provisions, recognizing that tax credits cannot be used to provide direct payment to policyholders, but rather are utilized to impact a reporting entity's tax liability. This agenda item also recommends a review of SSAP No. 94—Transferable and Non-Transferable State Tax Credits to ensure the guidance properly reflects items that should be captured in scope and appropriate admittance provisions. With the proposal of a new or revised SSAP, this agenda item is proposed to be captured as a 'New SAP Concept' with a corresponding issue paper. Along with statutory accounting revisions, a resulting blanks proposal and a potential RBC referral are anticipated to update blanks reporting and RBC references accordingly. As detailed within, all Schedule BA reporting lines and RBC instructions (for both federal and state) only reference Low-Income Housing Tax Credits. The BA instructions also need to be updated as the concept for 'guaranteed' provisions from a CRP-rated entity seems to only be applicable to limited NMTC designs, as a guarantee may disqualify an entity from being able to use tax credits under IRS provisions.

On December 13, 2022, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a new SAP concept, and exposed a discussion document to expand current statutory accounting guidance for low-income housing tax credits to capture all tax equity investments that provide general federal business tax credit and state premium tax credits if they meet specified criteria.

On February 10, 2023, NAIC staff received Interested Parties' comment letter on the exposed discussion document which were presented to the Working Group:

> Interested parties agree with having uniformity in accounting and reporting for equity investments for which the return is earned primarily through tax credits. Interested parties agree that the proportional amortization method is an appropriate method to use for any type of investment (debt or equity) where the return is primarily earned through tax credits. We are providing responses to the questions exposed in the Discussion Paper in this document. There are two key take aways from our responses:
>
> 1. Interested parties ask the Working Group to consider allowing for the reporting of both the amortization of the investments and the use of the tax credits themselves in the same income statement line similar to what is required under U.S. GAAP.
>
> 2. Interested parties have concerns regarding tax credit investments that are issued in debt form and requiring those investments to be reported on Schedule BA instead of Schedule D. Interested parties believe that tax credit investments issued in debt form are better suited for Schedule D reporting.

**March 22, 2023 – Spring National Meeting Recommendation:**
NAIC staff recommends that the Working Group direct NAIC staff to proceed with drafting revised statutory accounting guidance and a related issue paper to expand the guidance in SSAP No. 93 for tax credits, as well as to draft revisions to SSAP No. 94—Transferable and Non-Transferable State Tax Credits for future Working Group discussion. NAIC staff proposes to consider the feedback from interested parties on the discussion document as well as the revised FASB guidance, which is expected to be issued in the near future, in updating the proposed revised statutory accounting guidance for subsequent exposure consideration.

On March 22, 2023, the Statutory Accounting Principles (E) Working Group directed NAIC staff to draft statutory accounting guidance in the form of a new or revised SSAP that expands the current LIHTC guidance for equity investments that general federal business tax credit and state premium tax credits.

**May 16, 2023 – Interim Meeting Recommendation:**
NAIC staff recommend that the Working Group include this item on their maintenance agenda as a new SAP concept and expose the draft revisions to SSAP No. 93 and SSAP No. 94R, which intend to capture all tax equity investments that provide federal business tax credit and state premium tax credits if they meet specified criteria.

On May 16, 2023, the Statutory Accounting Principles (E) Working Group exposed revisions to SSAP No. 93 and 94R. The revisions to SSAP No. 93 propose adoption with modification of *ASU 2023-02–Accounting for Investments in Tax Credit Structures Using the Proportional Amortization Method* and expansion of the SSAP scope to include all tax credit programs and tax investment structures. The revisions to SSAP No. 94R expand the scope of the SSAP to include all state and federal tax credits whether purchased or allocated, and that tax received should be recorded at face value with losses realized immediately and gains deferred.

On June 20, 2023, NAIC staff received Interested Parties' comment letter on the exposed revisions to SSAP Nos. 93 and 94R. Interested Parties provided several comments on both SSAPs which are summarized below along with NAIC Staff responses.

The comments provided on SSAP No. 93 were:

1. Interested Parties noted that paragraph 3 does not provide specific direction for which SSAPs would be applicable for tax credit investment which do not fall within SSAP No. 93.
    a. NAIC Staff agreed with the recommendation and updated paragraph 3 to provide readers with specific SSAPs which could apply to non-qualifying equity or debt structure tax credit investments.
2. Interested Parties noted that the current draft directed readers to refer to SSAP 94R for how to account for tax credits allocated from tax credit investments. They felt that this cross-reference was confusing and could potentially lead to conflicting interpretations.
    a. To reduce confusion, NAIC Staff opted to remove the paragraph directing readers to SSAP 94R and instead pulled in the specific paragraphs from SSAP 94R which would be applicable to tax credits allocated from tax credit investments.
3. Interest Parties noted that they were unclear on whether the tax credits earned, or the tax credit investments were subject to the admittance criteria detailed in Paragraphs 18(a)-(c). Interested Parties feels that admissibility concerns are adequately addressed by the tax opinion and audit requirements. Additionally, if NAIC Staff's concern is the admittance of tax credits carried forward to a future period, then this should be adequately addressed by the admittance rules detailed in *SSAP No. 101–Income Taxes* for Deferred Tax Assets. Interested Parties suggested that paragraphs 18(a)-(c) be deleted in full.
    a. NAIC Staff noted that the admittance rules detailed in paragraphs 18(a)-(c) do NOT provide guidance on the admittance of allocated tax credits. For tax credit investment structures to fall within the scope of SSAP 93, substantially all benefits must be from tax credits or other tax benefits which essentially means that balance of a tax credit investment represents a future stream of tax credits and tax benefit. As such, the admittance rules in paragraph 18(a)-(c) would require a company to assess its ability to utilize that future stream of tax credits to what amount of the tax credit investment would be non-admitted. If the company's projections determine it will be unable to substantially utilize the future stream of tax credits (i.e., the tax credit investment balance) then potentially all or a portion of the tax credit investment would be considered non-admitted as the company is unable to utilize the future stream of tax credits to offset tax liabilities.
4. Interested Parties noted that GAAP requires retrospective adoption of ASU 2023-02 and that this would result in GAAP vs. Statutory accounting differences.
    a. NAIC Staff noted that prospective adoptions of accounting updates are often simpler to implement than retrospective adoptions. However, since this would lead to unintended variance between GAAP and Stat NAIC Staff has updated SSAP 93 to be adopted on the retrospective basis to conform with the GAAP adoption requirements.

The comments provided on SSAP No. 94R were:

1. Interest Parties requested that paragraph 1 of the scope of statement section be amended to clarify which types of tax credits are within scope of SSAP No. 94R. Interested Parties feel that the key difference between SSAP 94R and SSAP 93 is that the former is for purchased tax credits and the ladder is for tax credits earned from investments.
    a. NAIC Staff generally agree with the comments provided but opted to remove the term "certificate" from the requested changes. The intent of SSAP No. 94R is to provide guidance on all purchased state and federal tax credits, not just certificated tax credits. NAIC Staff also included language to clarify the scope of SSAP No. 94R for allocated tax credits, as detailed in the next bullet point.
2. Interested Parties noted that they do not believe allocated tax credits from SSAP No. 93 investments should be within the scope of SSAP No. 94R as the guidance was confusing and could potentially lead to conflicting interpretations. Additionally, Interested Parties believe that tax credits from investments vs. purchased tax credits are distinctly different assets. The only similarity in accounting for the tax credits relates to instances when the credits earned under a SSAP No. 93 investment cannot be utilized in the current year. Under that scenario, a DTA would be recorded, which would be subject to the admissibility rules under SSAP No. 101.
    a. NAIC Staff elected to remove tax credits allocated from SSAP No. 93 investments from the scope of SSAP No. 94R to avoid confusion. However, NAIC Staff note that tax credits earned from

investments bear many similarities to purchased tax credits. Irrespective of how the tax credit are acquired, they represent the same type of financial instruments which can be utilized as an offset to tax liabilities, sold, or redeemed for cash as a tax refund. Additionally, irrespective of how the tax credits are earned they are recorded at face value upon acquisition. The only significant difference is that tax credits purchased at a premium or discount may result in a recognized loss or deferred gain, respectively, whereas any premium or discount on an allocated tax credit is recognized as part of proportional amortization calculation.

   b. NAIC Staff amended the draft to exclude tax credits allocated from SSAP No. 93 investments in response to the Interested Party comments on SSAP No. 93. However, NAIC Staff did include language noting that allocated tax credits earned from tax credit investments NOT within the scope of SSAP No. 93 should refer to SSAP 94R for guidance on how to record allocated tax credits. NAIC staff noted that without this language there would be no guidance within Accounting Practices and Procedures Manual for allocated tax credits from investments which fall outside the scope of SSAP No. 93.

3. Interested Parties noted that most tax certificates reduce a reporting entity's tax liability and do not directly impact the income statement at the time they are used. In addition, interested parties believe that upon purchase, the tax credits should be reported as an other-than-invested asset since the asset represents a right to receive future benefits. As the tax credits become available for use, a reduction to the insurer's income tax payable or premium/state taxes payable should take place.
   a. NAIC Staff disagrees with this proposed change as purchased federal tax credits would be reported as other-than-invested assets, versus allocated federal tax credits which would report as a deferred tax asset. This would result in the same type of asset being reported on two separate lines based on the manner in which it was acquired. As noted above, NAIC Staff's position is that allocated and purchased tax credits are substantially the same assets irrespective of the way in which they are acquired. Additionally, the Interested Parties also propose that if a tax credit cannot be utilized in the same period in which it was purchased it should be transferred to Deferred Tax Assets. NAIC Staff notes that this does not resolve the short-term reporting discrepancy noted previously and adds further complications to the accounting process by requiring a reporting line transfer if the asset is held for longer than a year.
4. Interested Parties noted that the accounting for purchased tax credits in the SSAP No. 94R exposure is different from the current guidance in that the credits will be recorded at face value instead of at cost. This is not an issue perse but Interested Parties did want to point out this discrepancy as compared to the accounting treatment for other assets like bonds and mortgage loans.
   a. NAIC Staff's position is that tax credits, whether received via purchase or allocation, do not represent investments, and has opted to propose accounting guidance that differs from bonds or mortgage loans. The position that tax credits do not represent investments was the main reason for the original SSAP No. 94R guidance which required state tax credits be recorded to Other Than Invested Assets and effectively required companies tax credits purchased at a discount at cost and effectively defer the gain off the balance sheet. NAIC Staff felt that it would be less confusing and provide a more accurate financial picture to record the tax credit at face value and defer any gains from discount purchases on the balance sheet.
5. Interested Parties proposed changes to Exhibit B to reflect a pro-rata utilization of purchased tax credits in relation to the quarterly accrual of income tax liabilities. The main purpose of these changes were to reflect Interested Parties' proposed changes in item #2.
   a. NAIC Staff made these changes to Exhibit B and believe that this method of recognizing tax credit utilization is applicable to exposed draft of SSAP No. 94R.

Outside of the changes made in response to Interested Parties' Comment Letter, both Exhibits in SSAP No. 93 were revised to provide example journal entries of the Proportional Amortization method. Additionally, the assumptions in Exhibit B were revised so it would provide a journal entry example for a residual sale at the end of the proportional amortization period. A new footnote was also added to SSAP No. 94R on page 2 based verbal comments received from the public. The new footnote provides clarification on what processes constitute a purchase vs an allocation of tax credits.

**August 13, 2023 - Summer National Meeting Recommendation:**
NAIC staff recommend that the Working Group expose additional revisions described below to SSAP No. 93 and SSAP No. 94R. Additionally, NAIC staff recognizes that revisions to the annual statement Schedule BA reporting lines will need to be considered, as well as how those reporting lines flow through to the AVR. NAIC staff recommends that the Working Group direct staff to work with interested parties throughout the interim to discuss to allow subsequent (or interim) exposure.

On August 13, 2023, the Statutory Accounting Principles (E) Working Group exposed additional revisions made to SSAP No. 93 and SSAP No. 94R. Additionally, the Working Group directed NAIC staff to work with interested parties to draft revisions to the annual statement instructions and reporting updates.

On September 29, 2023, NAIC received Interested Parties' comment letter on the exposed revisions to SSAP No. 93 and 94R. Interested Parties provided several comments on both SSAPs which are summarized below along with NAIC Staff responses (effective October 11, 2023). The comments provided on SSAP No. 93 are below and have been summarized for brevity and clarity:

1) Interested Parties noted that SSAP 93 Paragraph 18 requires reporting entities to annually assess the future utilization of the unallocated tax credits associated with an entity's ownership interest in a tax credit investment project to determine if the investment can be admitted. However, Interested Parties suggest that this admittance criteria only be applicable to investments which do not allocate transferable or refundable tax credit and if the reporting entity is contractually restricted from selling its ownership interest. Additionally, Interested Parties suggest deleting paragraphs 18a and 18b as admissibility is adequately addressed through the impairment analysis required in paragraph 25; mainly that since both the tax credits and investment are saleable there is not a significant concern about the reporting entity's ability to utilize these investments and their tax credit returns for policyholder liabilities.

    i. NAIC staff noted that Interested Parties' argument is twofold, first is that the usage of the investment fair value as a carve out in paragraphs 18a and 18b are confusing due to the requirement to test for impairment based on fair value. NAIC staff amended paragraph 18a to clarify that the carve out allows for admittance of the fair value of <u>unallocated</u> transferable/certificated tax credits rather than the fair value of the tax credit investment. The tax credit investment balance includes other tax benefits which cannot be sold apart from the investment ownership. The intent of paragraph 18a is to allow a reporting entity to at least admit the fair value of the tax credits which can be sold, which is potentially higher than the admitted amount calculated in paragraph 18.

    ii. The second part of Interested Parties' argument is that since these investments may be sold, the admittance assessment of the reporting entity's ability to utilize the tax credits is not needed unless the reporting entity contractually restricted from the selling the investment. As part of this comment, it was noted that these investments may be actively managed and are readily saleable. NAIC staff noted that acquiring tax credit investments with the intent of re-sale puts an insurance company in a similar position as a syndicator in which tax credit investments are developed or acquired for the purpose of sale. SSAP 93 was revised under the assumption that tax credit investments are acquired for the purpose of obtaining returns through the receipt of tax credits and other tax benefits rather than through the sale of the tax credit investment. NAIC staff does not believe the paragraph 18 admittance criteria should be amended to provide a carve out for actively managed tax credit investments as it is not feasible to delineate between tax credit investments purchased for sale vs. purchased for generation of tax benefits without introducing some kind of available-for-sale and held-to-maturity framework which is not compatible with statutory accounting concepts. NAIC staff noted that restrictions which prevent investors from selling their ownership represent a minority of tax credit programs. As such, limiting the scope of paragraph 18 to only tax credit investments which cannot be sold would effectively carve out the majority of tax credit investment structures from its scope. Additionally, the assertion that these investments are readily saleable does not change the fact that the balance sheet value of a tax credit investment is predicated on the assumption that the company can use the tax credits and benefits and if they company cannot use these tax credits then the investment returns have no value. Until the investment has been sold, its ability to satisfy future policyholder obligations is beholden to the company's ability to utilize the generated tax credits and benefits. Interested Parties noted that there are other investments which do not have as stringent admittance criteria as have been proposed in paragraph 18. NAIC staff note that other investments generate returns primarily through the receipt of fungible cash income or by providing a claim to the entity's earnings and assets (bonds, stocks, joint ventures, partnerships and LLCs). In comparison, the main purpose of a tax credit investment is to provide returns in the form of tax credits and other tax benefits, and this purpose is further borne out by the commonly used partnership flip structure for tax credit investments and that once the tax credits have been fully allocated the residual value of a tax credit investment is typically nominal.

iii. Additionally, the requirement to assess tax credit investments by looking at the company's ability to realize future tax credits is not a new concept. Under existing OTTI guidance companies are required to record OTTI if the company determines it is probable that future tax benefits will not be received as expected (SSAP No. 93 paragraph 17, sentence 1). Per SSAP No. 93 paragraph 17, to determine if OTTI has occurred companies are required to assess whether the investment will continue to issue the tax credits as anticipated (see sentence 5) AND whether the company will be able to realize/utilize the future tax benefits to be received (see sentences 2 and 3). As part of the re-write of SSAP No. 93 Staff moved the requirement to assess the company's ability to utilize future tax credits out of impairment to admissibility. As currently revised, the impairment test specifically addresses the functionality of the investment whereas the paragraph 18 admittance test specifically addresses the ability of the company to realize/utilize the future tax benefits. This change intended to simplify the impairment analysis by focusing on investment functionality, but also because Staff felt that the company's ability to utilize/realize future tax benefits was more accurately characterized as an admittance concern rather than an impairment of the investment itself.

2) Interested Parties suggested a number of editorial changes to affect clearer guidance in paragraphs 18 and 18a. These included clarifying that the paragraph 18 assessment of unallocated tax credit utilization should be performed over the life of the tax credits rather than the life of the investments, including its carryforward periods. Interested Parties also suggested clarifying in paragraph 18 that tax planning strategies are to be used when assessing the utilization of unallocated tax credits, similar to the valuation allowance requirements under SSAP No. 101. In paragraph 18a Interested Parties suggested removing the sentence detailing what to do if fair value is not non-determinable.

i. NAIC staff agreed with substantially all the editorial clarifications suggested by Interested Parties and updated accordingly.

3) Interested Parties suggested adding a definitions section to the guidance regarding the following terminology:

<u>"unallocated tax credits"</u> - the portion of tax credits expected to be earned and allocated to the reporting entity through the investment structure.

"current portion" - the credits to be allocated within one year of the reporting period.

i. NAIC staff agreed with the suggestion by Interested Parties to add definitions and updated accordingly with some minor modifications. NAIC staff also added some additional definitions to provide clarifications on other terms used in SSAP 93.

4) Interested Parties suggested that the new SSAP 93 be applied prospectively effective 1/1/2025, but no early adoption.

i. NAIC staff agreed with the changes suggested by Interested Parties and updated accordingly.

The comments provided on SSAP No. 94R are below and have been summarized for brevity:

5) Interested parties suggested that the revised SSAP 94R also be applied prospectively effective 1/1/2025 with early adoption permitted. Additionally, Interested Parties suggested a clarification of the scope of SSAP 94R by adding the following language to paragraph 1:

"This statement establishes statutory accounting principles for state and federal tax credits that are purchased by the reporting entity without being ~~an~~ bond or equity investor in the entity from which the tax credit were purchased."

i. NAIC staff agrees with prospective application of SSAP 94R with an effective date of 1/1/2025, however we have elected to not include the changes to the scope of SSAP 94R. The reasoning is that this guidance intends to exclude tax credits allocated from SSAP 93 investments, which does not specifically identify which tax credit investment structures are within scope of the guidance. However, NAIC staff did make other adjustments to the scope paragraph to better clarify that tax credits from SSAP No. 93 investments are not within scope of SSAP 94R.

On December 1, 2023, the Statutory Accounting Principles (E) Working Group exposed revisions made to SSAP Nos. 34, 48R, 93, and 94R as part of the new market tax credit project. Revisions to SSAP No. 93 include a glossary of key terms, impairment guidance on variable tax credit allocations, disclosures on unused tax credits, and editorial changes to paragraph 18. Revisions to SSAP No. 94R include guidance clarifying that awarded tax credits are not within scope and commitment/contingency language. The exposure includes new revisions to SSAP Nos. 34 and 48 which clarified that tax credits are not within the scope of investment income guidance and updated for new SSAP No. 93 language, respectively. Additionally, the Working Group requested comments from regulators and industry on new RBC reporting categories.

On January 29, 2024, the Statutory Accounting Principles (E) Working Group exposed, through an evote, further revisions made to SSAP Nos. 93R and 94R as part of the New Market Tax Credit project. Revisions to SSAP No. 93 and 94R included minor consistency and clarifying revisions. More substantial revisions were made to SSAP No. 93 in response to concerns raised by interested parties over the administrative burden of the paragraph 18 admittance tests (now referred to as the Prospective Utilization Assessment). The Prospective Utilization Assessment was revised to remove the initial assessment of the current portion of unallocated tax credits and replaced with language that required companies to perform the Prospective Utilization Assessment only if certain conditions exist.

On March 16, 2024, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed revisions to SSAP No. 93, updated for the corrections to example 2, and SSAP No. 34, SSAP No. 48, and SSAP No. 94R to expand and amend statutory guidance to include all tax credit investments regardless of structure and type of state or federal tax credit program, and all state and federal purchased tax credits. The effective date of the revisions is January 1, 2025.

The Working Group also directed staff to:

1. Sponsor a blanks proposal on the annual statement reporting categories for tax credit investment RBC by using the suggestion from the interested parties comment letter to maintain the same categories but without reference to LIHTC (bullet 1) and to also update/clarify the instructions accordingly.
2. Send a referral to the Life Risk-Based Capital (E) Working Group to inform them of the planned reporting line changes, which may indicate review of the RBC charges as different categories of tax credits will be reported in the form.
3. To draft an Issue Paper to document the discussions and revisions.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2024/03-16-24 Spring National Meeting/Adoptions/22-14 - NMTC.docx

***Note:*** *The issue paper will include the final revisions made to SSAP No. 93—Low-Income Housing Tax Credit Property Investments shown as tracked changes. ASC references will be removed from the final document.*

***Spring National Meeting Adoption:*** *Revisions to SSAP No. 93 made **after** the exposure on January 31, 2024, have been shown as tracked changes highlighted in grey. This document represents the final adopted version of SSAP No. 93R.*

# Statements of Statutory Accounting Principles No. 93 - Revised

# Investments in Tax Credit Structures

## STATUS

| | |
|---|---|
| Type of Issue | Common Area |
| Issued | June 13, 2005; Conceptually revised March 16, 2024 |
| Effective Date | January 1, 2006; Conceptual revisions detailed in Issue Paper No. xxx effective January 1, 2025 |
| Affects | No other pronouncements |
| Affected by | No other pronouncements |
| Interpreted by | INT 06-07 |
| Relevant Appendix A Guidance | None |

**SCOPE OF STATEMENT**

1. This statement establishes statutory accounting principles for qualifying tax credit investments[1] in programs made primarily for the purpose of receiving allowable general business federal tax credits and/or state tax credits, including state premium tax credit programs. Although these investments are often in the form of equity, this statement shall be applied to all investments (regardless of the structure of the investment) that qualify pursuant to paragraph 2.

2. A reporting entity that invests in projects or programs that generate general business federal tax credits, corresponding state tax credits or state premium tax credits that meet the following conditions at the time of initial investment are required to capture the investment in scope of this statement:

a. It is probable that the tax credits allocable to the investor will be available.

b. Reporting entity investor does not have the ability to exercise significant influence over the operating and financial policies of the underlying projects.

c. Substantially all the projected benefits are from tax credits and other tax benefits, determined on a discounted basis using a discount rate that is consistent with the cash flow assumptions utilized by the reporting entity for the purpose of deciding to invest in the project.

d. The reporting entity's projected yield based solely on the cash flows from the tax credits and other tax benefits is positive.

3. Tax credit investments that do not meet the conditions in paragraph 2 shall be captured within the statutory accounting statement that addresses the underlying investment structure. Equity structured tax credit investments would generally fall within *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*. Debt structured tax credit investments should be assessed in accordance with *SSAP No. 26R—Bonds* to determine eligibility for reporting as a bond. ~~Investments intax credit structures that do not meet the conditions in paragraph 2 shall be captured within the statutory accounting statement applicable to the investment held.~~

4. Investments in a CAPCO (Certified Capital Company), organized as a partnership or an LLC, which is a company, authorized by state statute that borrows from investors, to make venture capital investments in "qualified" businesses, are not within the scope of this statement. Although associated with tax credits, the reporting entity is paid principal and interest on its investment with the CAPCO. Depending upon the terms of the CAPCO offering, principal and interest payments to the reporting entity will come from the CAPCO and/or the state. The CAPCO will make cash payments directly to the investors while the state will make payments in the form of premium or income tax credits. Investments in a CAPCO shall be accounted for in accordance with *Interpretation (INT) 06-02: Accounting and Reporting for Investments in a Certified Capital Company (CAPCO)* and specific statutory accounting guidance addressing CAPCOs.

**SUMMARY CONCLUSION**

5. Investments in tax credit structures are generally acquired to obtain a positive yield through tax credits and other tax benefits. The value of the investment is primarily based on the value of the remaining stream of tax credits and deductible expenses available to the reporting entity investor. The primary purpose of investing in these tax credit structures is to generate tax credits which benefit reporting entities, most

[1] The scope of *ASC 323-740–Investments—Equity Method and Joint Ventures—Income Taxes—Proportional Amortization Method* only extends to income tax equity investments, whereas this statement is intended to capture all tax credit investments which meet the criteria in paragraphs 2.a-2.d, regardless of structure. This includes, but is not limited to, tax equity investments and tax credit debt investments.

commonly through a reduction in tax liability or, when ~~transferability is~~ permitted by IRS or state tax provisions, through the sale of ~~the~~ certificated/transferable tax credits.

6. Investments in tax credit structures held by reporting entities meet the definition of an asset as specified in *SSAP No. 4—Assets and Nonadmitted Assets* and are admissible assets to the extent that they comply with the requirements of this statement.

**Accounting**

7. This guidance addresses the methodology for measuring an investment that is accounted for using the proportional amortization method. At initial recognition, investments in scope of this statement shall be recorded at cost.

8. Subsequent to initial recognition, the investment shall be carried at proportional amortized cost. Under the proportional amortization method, the reporting entity amortizes the initial cost of the investment in proportion to the tax credits and other tax benefits allocated to the investor. The amortization amount shall be calculated as follows (ASC 323-740-35-2):

a. The initial investment balance less any expected residual value of the investment, multiplied by;

b. The percentage of actual tax credits and other tax benefits allocated to the reporting entity in the current period divided by the total estimated tax credits and other tax benefits expected to be received by the reporting entity over the amortization timeframe (life of the investment)~~the life of the investment~~.

9. Reporting entities shall recognize tax credits in the period they are allocated to the investor for tax purposes. Unless all tax credits are allocated to the reporting entity at the date of initial investment, immediate recognition of the entire benefit of the tax credits to be received during the term of the investment project that generates tax credits and other tax benefits is not permitted. Tax credits shall not be recognized in the financial statements before the year in which the tax credits ~~arisesis~~ are allocated. (ASC 323-740-25-5)

10. Any expected residual value of the investment shall be excluded from the proportional amortization calculation. Non-tax related benefits received from the investment shall be included as a component of net investment income when realized or realizable. Gains or losses on the sale of the investment, if any, shall be included as a capital gain or loss at the time of the sale. (ASC 323-740-35-5) Determination of gain or loss will depend on the reported value (e.g., residual value at the end of the amortization timeframe) compared to the amount received in exchange for the investment. Liquidation of the investment commonly occurs at the end of the tax credit timeframe through a put or call agreement, often reflecting a nominal residual value that was established at the time of acquisition. The liquidation amount from such agreements shall reflect the expected residual value when available.

11. At the end of the amortization timeframe ~~(life of the investment)~~, if the reporting entity retains the investment, the investment shall be subsequently measured and assessed within the statutory accounting statement applicable to the investment held. Retained investments will remain on Schedule BA until disposal and cannot exceed the initial expected residual value.

12. Exhibit A illustrates the application of accounting guidance in two examples that generate tax credits and tax benefits using the proportional amortization method. The first example illustrates the application of a standard project. The second example illustrates the application of accounting guidance in a project that has expected residual value and generates non-tax related benefits in addition to tax credits and other tax benefits using the proportional amortization method. (ASC 323-740-35-3)

**Application of Proportional Amortization Method**

13. Under the proportional amortized cost method, the amortization of the investment is to be recognized in the income statement as an expense component of the net investment income calculation. Non-tax related benefits received from operations, or sale of the investment should be accounted for in accordance with paragraph 10.

14. Tax credits and other tax benefits, not to include amortization of the investment, shall be reflected as follows:

a. ~~Tax credits allocated are to be recorded, and assessed for admittance, in accordance with *SSAP No. 94R Transferable and Non-Transferable Tax Credits*.~~Tax credits shall be recognized in the period that they are allocated to the reporting entity for tax purposes:

i. Federal tax credits that can be utilized in the year allocated shall be reported in the income statement as an offset to federal taxes in accordance with *SSAP No. 101—Income Taxes*. Federal tax credits that cannot be utilized in the year allocated and are carried forward to a future tax year shall be reported as a deferred tax asset (DTA) in accordance with SSAP No. 101.

ii. State tax credits that can be utilized in the year allocated shall be reported in the income statement as an offset to state premium tax or state income tax, whichever is applicable, in the tax-reporting year in which the credit is utilized. State tax credits that cannot be utilized in the year allocated and are carried forward to a future tax year shall be reported gross of any related state tax liabilities and reported in the category of other-than-invested assets (not to be reported net).

iii. Use of tax credits carried forward in a~~Tax credits carried forward to a~~ future period shall be reflected as an offset to the corresponding income or premium tax in the tax reporting year in which the tax credit is utilized.

~~i.~~iv. Tax credits allocated from tax credit investments, as defined within this SSAP, and held by reporting entities meet the definition of assets as specified in SSAP No. 4 and are admitted assets to the extent that they comply with the requirements of this statement. The admissibility of tax credits ~~are~~ is subject to SSAP No. 101.

b. Federal tax benefits other than tax credits (e.g., tax benefits from investment depreciation) shall be recognized in the year allocated pursuant to SSAP No. 101~~—*Income Taxes*~~. When utilized, the federal tax benefits are recognized as a component of income tax expense.

c. State tax benefits other than tax credits shall be recognized in the year allocated ~~shall be recognized in the year allocated~~ gross of any related state tax liabilities pursuant to SSAP No. 101. When utilized, the state tax benefits are recognized as a component of taxes, licenses, and fees.

**Admittance ~~Requirements~~of Tax Credit Investments**

15. Although investments in tax credit programs do not represent investments that can be ~~directly~~ readily liquidated for policyholder claims, the reduction of tax liability or sale~~transfer~~ of allocated tax credits represents a benefit that supports admittance of these investments, but only if the tax credits will be received and can be utilized by the reporting entity. Investments in tax credit programs that will not result in any of the anticipated tax credits or that will result in tax credits which cannot be utilized or sold~~transferred~~ by the reporting entity shall be considered impaired and should refer to paragraphs 27 and 28.

16. Reporting entities shall, at initial investment, obtain a clean[2] fund level tax opinion[3] on the validity of the credits and structure of the underlying program and investment fund. Investments not supported by an initial tax opinion shall be nonadmitted. If the program is a permitted syndicated program with a yield guarantee, the opinion must verify that the investment and guarantee have~~s~~ been properly structured under IRS or state tax provisions ~~rules~~ and the guarantee does not disqualify the reporting entity from obtaining ~~federal general business~~the tax credits.

17. Reporting entities shall annually obtain U.S. GAAP or U.S. tax basis audited financial statements on the investment fund. In the event audited U.S. GAAP or U.S. tax basis financial statements are not obtained or the audit receives an opinion other than unqualified, the asset shall be nonadmitted. If the audited financial statements are in-process but not completed as of the annual statement filing deadline, the reporting entity may admit the investment based on the results of the immediately preceding prior year audited financial statements. A lag in reporting shall be consistent from period to period.

a. Other tax credit investments – If the reporting entity has a tax credit investment which by virtue of its structure cannot be audited, the investment is exempt from the annual audit requirement. One example of this type of investments would be tax credit debt investments[4] which do not involve any amount of equity ownership as a component of the investment. This type of tax credit debt investment is exempt from the annual audit requirement, but the reporting entity is still required to obtain a clean tax opinion, in accordance with paragraph 16, to support admittance at initial investment.

Prospective Utilization Assessment

18. The prospective utilization assessment, as detailed below in paragraphs 19-21, must be performed annually by the reporting entity if any of the following circumstances exist in either the current or prior reporting period:

a. Reporting entity records a valuation allowance against a deferred tax asset (DTA) balance.

b. Reporting entity becomes aware of other facts and circumstances which indicate that it will, more likely than not, be unable to substantially utilize the unallocated tax credits. Such instances include, but are not limited to:

i. If the reporting entity holds an investment which allocates state premium tax credits and intends to decrease premium volume in that state, it may affect whether or not the unallocated tax credits in that state can be utilized.

ii. If the reporting entity holds an investment allocating state income tax credits and records a valuation allowance in its U.S. GAAP financial statements against state DTA balances, including the same state as the tax credit investment, it cannot ignore the circumstances that led to the valuation allowance, even though statutory accounting does not permit state DTAs.

[2] While not quantified or defined in either the Internal Revenue Code or state regulations, common industry standards consider a "should" opinion to be the minimum degree of confidence associated with a clean tax opinion. For the purposes of this statement, a "should" opinion must represent a probability of success no less 70%. Any tax credit investment which receives a tax opinion with a degree of confidence less than "should" is to be nonadmitted.

[3] A fund level tax opinion for the purposes of this statement is defined as a full IRS Circular 230 tax opinion which covers from the fund level through to the underlying assets generating the tax credit benefits. The fund level is defined as the entity, or level, at which the investor comes directly into the investment without any intermediaries.

[4] Common examples of tax credit debt investments are Tax Credit Strips derived from tax credit bonds, Qualified Tax Credit Bonds, and Build America Tax Credit Bonds. Tax opinions received on these tax credit investments are also referred to as "bond counsels." Tax Credit Strips derived from tax equity investments would not qualify for the paragraph 17.a carve out as the source of the stripped tax credits is auditable.

19. Prospective Utilization Assessment – ~~A r~~If any of the circumstances detailed in paragraph 18 exist, the reporting entity is required to ~~first~~ assess the future utilization of the investment's ~~current portion of~~ unallocated tax credits against ~~the~~ estimated tax liabilities ~~for both the tax year in which the tax credits can be initially utilized as well as any applicable carryback periods. Based on this assessment, if the reporting entity does not expect to substantially utilize the current portion of unallocated investment tax credits, the reporting entity shall perform an expanded assessment to~~and determine the extent to which it will be able to utilize the investment's unallocated tax credits over the life of the ~~investment~~tax credits. If assessment projections identify that the investment's unallocated tax credits ~~from investments in tax credit programs~~ will exceed what can be utilized under IRS or state tax provisions ~~(current and other applicable tax periods)~~, the reporting entity shall nonadmit investments as necessary so that investments in scope of this statement (in aggregate) are only admitted to the extent tax credits are expected to be utilized within current, carryback, and carryforward periods. ~~Additionally, if the assessment indicates that the next three years of investment tax credits cannot be substantially utilized within the carryforward periods then the entire investment shall be nonadmitted.~~ In making this assessment, the reporting entity is not permitted to assume increased operations (e.g., expanded product sales) beyond those allowed under prudent and feasible tax-planning strategies ~~actual experience~~ to conclude that additional federal or state tax liability will exist that would allow additional utilization of tax credits. A reporting entity ~~can~~ may subsequently admit a previously nonadmitted tax credit investment, based on subsequent assessments in which the reporting entity determines that they will be able to utilize the unallocated tax credits.

~~18.~~20. Additional Admittance to Prospective Utilization Assessment – If the tax credit investment allocates tax credits with the following features, the reporting entity may perform a secondary assessment to determine if additional amounts of the tax credit investment nonadmitted under paragraph 19 can be admitted:

a. Tax credit investments which allocate tax credits which are certificated or transferable in accordance with permitted IRS or state tax provisions ~~are~~ shall admit~~ted~~ up to the lesser of the proportional amortized cost~~,~~ or fair value of the unallocated tax credits. ~~If the fair market value is not determinable, then the reporting entity may only admit the amount calculated in paragraph 18.~~

b. Tax credit investments which allocate tax credits eligible for direct payment ~~are~~ shall admit~~ted~~ up to the lesser of the proportional amortized cost~~,~~ or the estimated proceeds from unallocated tax credits.

~~c. For all other tax credits, if a reporting entity does not expect to fully utilize investment tax credits in the upcoming tax year or for a carryback year, the reporting entity shall perform an assessment to determine the extent it will be able to utilize the tax credits over the life of the investment. If assessment projections identify that the tax credits from investments in tax credit programs will exceed what can be utilized under IRS or state tax provisions (current and other applicable tax periods), the reporting entity shall nonadmit investments as necessary so that investments in scope of this statement (in aggregate) are only admitted to the extent tax credits are expected to be utilized. Additionally, if the assessment indicates that the next three years of investment tax credits cannot be substantially utilized then the entire investment shall be nonadmitted. In making this assessment, the reporting entity is not permitted to assume increased operations (e.g., expanded product sales) beyond actual experience to conclude that additional federal or state tax liability will exist that would allow additional utilization of tax credits. A reporting entity can subsequently admit a previously nonadmitted tax credit investment, based on subsequent assessments in which the reporting entity determines that they will be able to utilize the tax credits.~~

~~19.~~21. For tax credit investments which have an amortization timeframe greater than the tax credit allocation timeframe (as demonstrated in ~~both examples within~~ Exhibit A), the reporting entity would still, if required, perform the prospective utilization assessment ~~same assessment detailed in paragraph 18~~ but on the reporting entity's ability to utilize the remaining stream of anticipated tax benefits.

**Future Contributions and Additional Tax Credits**

~~20.~~22. Many tax credit investments require future contributions by the investor, that may be contingent on a variety of conditions, such as receiving representations, contract performance, meeting occupancy requirements, etc. A liability shall be recognized for delayed ~~equity~~ contributions which result in additional tax credits that are unconditional and legally binding, and a liability shall also be recognized for ~~equity~~ contributions which result in additional tax credits that are contingent upon a future event when that contingent event becomes probable pursuant to the loss contingency guidance in *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets*. (ASC 323-740-25-3) Liabilities or loss contingencies recognized for future contributions which result in additional tax credits shall be reported as 'Payable for Securities' until remitted or until the obligation is otherwise eliminated.

~~21.~~23. If a commitment to provide future contributions is not required to be recognized pursuant to paragraph 22, the commitment shall be disclosed in the notes to the financial statements with other commitments.

~~22.~~24. Additional contributions that do not result in additional tax credits for the reporting entity investor shall be immediately expensed as a component of net investment income.

~~23.~~25. If additional contributions result in additional tax credits for the reporting entity, the proportional amortization method for the tax credit investment shall be adjusted, on a prospective basis, to reflect the increased cost with the revised expected ~~income~~ tax credits and ~~income~~ other tax benefits.

26. In the event a reporting entity obtains additional tax credits without the reporting entity making additional contributions, the reporting entity shall not adjust the book/adjusted carrying value of the tax credit investment. (The proportional amortization method shall not be adjusted to reflect the expected additional tax credits.) Rather, the tax credit shall be recognized when allocated pursuant to paragraph 14.

**Impairment of Tax Credit Investments**

~~24.~~27. Reporting entities with investments in tax credit programs shall complete and document an impairment analysis at each reporting period. For this analysis, the reporting entity shall compare the current book/~~-~~adjusted carrying value to the fair value of the investment. (~~In lieu of~~If fair value is not determinable, an entity can compare book/~~-~~adjusted carrying value to the present value of future tax credits and other tax benefits discounted at a risk-free rate of return.) If book~~-~~/adjusted carrying value is higher, the difference between book/~~–~~adjusted carrying value and fair value shall be recognized as an other-than-temporary impairment (INT 06-07) to the tax credit investment. This will result in a new cost basis 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 ~~(discounted value present value)~~.

~~25.~~28. An other-than-temporary impairment shall also be considered to have occurred if a previously allocated tax credit has been recaptured or if it is probable that future tax credits will not be allocated as expected. If a project no longer qualifies for tax credits, the entire investment, less any residual established at initial recognition, shall be written off as other-than-temporarily impaired. If the reporting entity experiences a tax credit recapture, the reporting entity shall assess whether future tax credits and other benefits will qualify for use by the reporting entity. If future credits will not be generated or will be subject to future recapture, then the reporting entity shall write-off the investment as other-than-temporarily impaired so that the resulting investment value only reflects expected qualifying tax credits and other benefits expected to be allocated. This will result in a new cost basis 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 or revision to tax credit expectations.

~~26.~~29. Certain tax credit programs allocate variable amounts of tax credits (for example, clean energy production tax credit programs) which will result in regular differences between actual allocated tax credits and estimated tax credit allocations as calculated upon acquisition of the investment. Variable tax credits allocated in excess of estimates should be accounted for in accordance with paragraph 26. If the allocated variable tax credits are less than estimates by more than 10% or consistently allocate less than the estimated amounts over multiple allocation periods, then the reporting entity must either recognize an other-than-temporary impairment or specifically address within its impairment analysis the reason why consistently diminished tax credit returns do not represent an impairment event. Note that if the company determines it is probable that the total amount of anticipated variable tax credits will not be received, it would still be considered an other-than-temporary impairment in accordance with paragraph 28.

**Disclosures**

~~27.~~30. A reporting entity shall disclose information that enables users of its financial statements to understand the following information about its ~~tax~~ investments in projects that generate tax credits and other tax benefits from tax programs captured in scope of this statement: (ASC 323-740-50-1)

a. The nature of its investments in projects that generate tax credits and other tax benefits.

b. The effect of the recognition and measurement of its investments in projects that generate tax credits and other tax benefits and the related tax credits on its financial position and results of operations.

~~28.~~31. To meet the objective of paragraph 30, a reporting entity shall disclose the following information about its ~~tax~~ investments in projects that generate tax credits and other tax benefits from a tax credit program in scope of this statement:

a. The amount of tax credits and other tax benefits recognized during the reporting period(s).

b. The balance of the investments recognized in the statement of financial position for the reporting period(s) presented.

c. The amount of investment amortization and non-income tax related activity recognized as a component of net investment income, and other returns allocated that were recognized outside of income tax expense.

d. An aggregate schedule of tax credits expected to be generated each year for the subsequent five years and thereafter, disaggregated by transferable/certificated and non-transferable.

e. Any commitment or contingent commitment (e.g., guarantees or commitments to provide additional capital contributions) including the amount of contributions that are contingent commitments related to tax credit investments and the year(s) that contingent commitments are expected to be paid shall be disclosed.

~~29.~~32. The following disclosures shall be included if applicable to tax credit investments:

a. If the underlying ~~property~~ project is currently subject to any regulatory reviews and the status of such review. (Example: Investigations by the housing authority.)

b. Significant modifications or events that resulted in a change in the nature of the investment or a change in the relationship with the underlying project for investments in scope. (ASC 323-740-50-1A)

~~30.~~33. A reporting entity that recognizes an impairment loss shall disclose the following in the financial statements that include the period of the impairment write-down:

a. A description of the impaired assets and the facts and circumstances leading to the impairment; and

b. The amount of the impairment and how fair value was determined.

34. The following disclosures pertain only to those tax credits allocated from tax credit investments and are unused as of the reporting period(s). For purposes of this disclosure, total unused tax credits represent the entire amount of tax credits available:

a. Carrying value of tax credits, disaggregated by transferable/certificated and non-transferable, gross of any related tax liabilities by jurisdiction and in total.

b. Total unused tax credits by jurisdiction, disaggregated by transferable/certificated and non-transferable.

c. Method of estimating utilization of remaining tax credits or other projected recovery of the current carrying value.

d. Impairment amount recognized in the reporting period(s), if any.

e. Identify tax credits by transferable/certificated and non-transferable classifications and identify the admitted and nonadmitted portions of each classification.

~~31.~~35. Refer to the Preamble for further discussion regarding disclosure requirements.

**Relevant Literature**

~~32.~~36. This statement adopts with modification *Accounting Standards Update (ASU) 2023-02, Accounting for Investments in Tax Credit Structures Using the Proportional Amortization Method*. The ASU is modified for the following statutory concepts:

a. This statement is applicable to all federal and state tax credit programs earned through any tax credit investment structure that meets the requirements in paragraph 2. Under the ASU, use of the proportional amortization method is an election and only pertains to income tax equity investment structures in which the reporting entity does not exercise significant influence. With this statement, the U.S. GAAP election to use the proportional amortization method is rejected and use of proportional amortization for investments within the scope of this statement is required. The guidance is expanded for state premium tax credits.

b. Investments that meet the criteria of this statement are required to use a proportional amortization method as prescribed in this statement. This method requires the tax credits and benefits to be recognized in proportion to the percentage of actual tax credits and other tax benefits allocated to the reporting entity in the current period divided by the total estimated tax credits and other tax benefits expected to be allocated by the reporting entity over the life of the investment. This statement requires a gross presentation on the financial statements. Under the ASU, a practical expedient is allowed for the calculation of proportional amortization but has been rejected with this statement.

c. Federal tax credits shall be recognized in the income statement as an offset to federal income taxes in the tax reporting year in which the tax credit is utilized in accordance with SSAP No. 101. State tax credits shall be recognized in the income statement as an offset to state premium tax or state income tax, whichever is applicable, in the tax reporting year in which the credit is utilized.

 

d. Tax benefits allocated, other than tax credits, shall be accounted for pursuant to SSAP No. 101. Amortization shall be reported as a component of net investment income.

e. Reporting entities shall follow the guidance in paragraphs 22 and 23 regarding the recognition of contingent commitments from SSAP No. 5R to equity contributions.

f. This statement has specific impairment and nonadmittance requirements.

g. For statutory accounting purposes, deferred taxes are not reported as a component of income from continuing operations in the income statement; rather deferred taxes are recognized as a separate component of gains and losses in unassigned funds (surplus).

h. Disclosures should be followed as indicated in the disclosures section in this statement.

~~h.~~i. The examples detailed in Exhibit A were modified to better illustrate the statutory accounting method for tax credit investments.

**Effective Date and Transition**

~~33.~~37. This statement is effective for reporting periods beginning on or after January 1, 2006. Early adoption is permitted. 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 guidance previously in paragraph 3 of this statement superseded paragraph 1 of SSAP No. 48. In 2011, this guidance was moved to SSAP No. 48 and deleted from this statement. The original guidance included in this standard is retained for historical purposes in Issue Paper No. 125. The guidance from ASU 2014-01 is effective for reporting periods beginning on or after January 1, 2015, with early adoption permitted.

38. In March 2024, new SAP concept revisions, as detailed in Issue Paper No. XXX, were adopted. These revisions, effective January 1, 2025, expanded the scope of SSAP No. 93 to include all federal and state tax credit investment structures and provide new guidance on the accounting, recognition, and reporting of tax credit investment structures. As of the effective date, reporting entities shall prospectively modify the recognition, accounting, and reporting of tax credit investment structures to reflect the guidance in the conceptual revisions. Additionally, all tax credit investment structures which fall within the scope of this statement not currently reported on Schedule BA are to be transferred to Schedule BA as of the effective date.

**Glossary**

39. The following definitions are provided for the purposes of this statement.

a. Unallocated tax credits – The portion of tax credits expected to be earned and allocated to the reporting entity through the tax credit investment structure.

~~i. Current portion – The tax credits to be allocated within one year of the reporting period.~~

b. Transferable/Certificated – The tax credits are certified for sale (certificated tax credits) or saleable through the execution of a state or federal transfer form (transferable tax credits).

c. More Likely Than Not – Refers to a likelihood of more than 50%.

**REFERENCES**

**Relevant Issue Papers**

- Issue Paper No. 125—Accounting for Low-Income Housing Tax Credit Property Investments
- Issue Paper No. XX—XXX

**EXHIBIT A – APPLICATION OF PROPORTIONAL AMORTIZATION METHOD**

***Example 1: ~~Application of Proportional Amortization Method for Qualifying Investment~~Qualifying Tax Credit Investment Structure***

~~This example is based on paragraph 323-740-55-5 of the Accounting Standards Codification which illustrates the application of a standard project. The amount and timing of amortization in the proportional amortization method is consistent with the statutory modifications; therefore, the table incorporated in this exhibit is based on the proportional amortization table. The statutory income statement requires a gross presentation on the income statement, with proportional amortization of the initial cost of the investment in investment income and the tax credits and benefits included in income tax expense.~~

~~Terms:~~
~~Date of Investment: January 1, 20X1~~
~~Purchase Price of Investment: $100,000~~
On January 1, 20X1, ABC Insurance Company purchases a 5% equity stake in a tax credit investment structure for $100,000. The allocated tax credits are transferable, and ABC anticipates that all tax credits received will be fully utilized prior to expiration of the tax credit carryover period.

Assumptions:

1. All cash flows (except initial investment) occur at the end of each year.

2. Depreciation expense is computed, for book and tax purposes, using the straight-line method with a 27.5 year life (the same method is used for simplicity).

3. The investor made a $100,000 investment for a 5% limited partnership interest in the project at the beginning of the first year of eligibility for the tax credit.

4. The partnership finances the project cost of $4,000,000 with 50% equity and 50% debt.

5. The annual tax credit allocation (equal to 4% of the project's original cost) will be received for a period of 10 years.

6. The investor's tax rate is 40%.

7. For simplicity, the project will operate with break-even pretax cash flows including debt service during the first 15 years of operations.

8. The project's taxable loss will be equal to depreciation expense. The cumulative book loss (and thus the cumulative depreciation expense) recognized by the investor is limited to the $100,000 investment.

9. It is assumed that all requirements are met to retain allocable tax credits so there will be no recapture of tax credits.

10. The investor expects that the estimated residual value of the investment will be zero.

Proportional Amortization Method with Statutory Modifications

| Year | Net Investment (1) | Amortization of Investment (2) | Tax Credits (3) | Net Losses/Tax Depreciation (4) | Other Tax Benefits from Tax Depreciation (5) | Tax Credits and Other Tax Benefits (6) |
|---|---|---|---|---|---|---|
| | 100,000 | | | | | |
| 1 | 90,909 | 9,091 | 8,000 | 7,273 | 2,909 | 10,909 |
| 2 | 81,818 | 9,091 | 8,000 | 7,273 | 2,909 | 10,909 |
| 3 | 72,727 | 9,091 | 8,000 | 7,273 | 2,909 | 10,909 |
| 4 | 63,636 | 9,091 | 8,000 | 7,273 | 2,909 | 10,909 |
| 5 | 54,545 | 9,091 | 8,000 | 7,273 | 2,909 | 10,909 |
| 6 | 45,454 | 9,091 | 8,000 | 7,273 | 2,909 | 10,909 |
| 7 | 36,363 | 9,091 | 8,000 | 7,273 | 2,909 | 10,909 |
| 8 | 27,272 | 9,091 | 8,000 | 7,273 | 2,909 | 10,909 |
| 9 | 18,181 | 9,091 | 8,000 | 7,273 | 2,909 | 10,909 |
| 10 | 9,090 | 9,091 | 8,000 | 7,273 | 2,909 | 10,909 |
| 11 | 6,666 | 2,424 | | 7,273 | 2,909 | 2,909 |
| 12 | 4,242 | 2,424 | | 7,273 | 2,909 | 2,909 |
| 13 | 1,818 | 2,424 | | 7,273 | 2,909 | 2,909 |
| 14 | 0 | 1,818 | | 5,451 | 2,183 | 2,183 |
| 15 | 0 | | | | | 0 |
| Total | | 100,000 | 80,000 | 100,000 | 40,000 | 120,000 |

(1) End-of-year investment for a 5% limited liability interest in the project net of amortization in Column (2).

(2) Initial investment of \$100,000 x (total tax benefits allocated during the year in Column (6) / total anticipated tax benefits over the life of the investment of \$120,000).

(3) Annual 4% tax credit on \$200,000 tax basis of the underlying assets.

(4) Depreciation (on \$200,000 tax basis of the underlying assets) using the straight-line method over 27.5 years up to the amount of the initial investment of \$100,000.

(5) Column (4) x 40% tax rate.

(6) Column (3) + Column (5).

Initial Year

| | | |
|---|---|---|
| Tax credit investment | 100,000 | |
| Cash | | 100,000 |
| *To record the purchase of tax credit investment* | | |

Years 1-10

| | | |
|---|---|---|
| Amortization expense | 9,091 | |
| Tax credit investment | | 9,091 |
| Federal tax credits | 8,000 | |
| Income tax expense | | 8,000 |
| *To record annual receipt of allocated tax credits and proportional amortization of investment.* | | |

| | | | |
|---|---|---|---|
| | Income taxes payable | 8,000 | |
| | Federal tax credits | | 8,000 |
| | *To record annual utilization of allocated tax credits.* | | |
| Year 11-13 | | | |
| | Amortization expense | 2,424 | |
| | Tax credit investment | | 2,424 |
| | *To record annual proportional amortization of tax credit investment.* | | |
| Year 14 | | | |
| | Amortization expense | 1,818 | |
| | Tax credit investment | | 1,818 |
| | *To record annual proportional amortization of tax credit investment.* | | |

 

***Example 2: Qualifying Tax ~~Equity~~ Credit Investment~~s~~ Structure with Non-Income Tax Related Benefits***

~~This example is based on paragraphs 323-740-55-11 through 323-740-55-14 of the Accounting Standards Codification and illustrates a tax equity investment that generates non-income-tax-related benefits in addition to tax credits and other income tax benefits.~~

~~The amount and timing of amortization in the proportional amortization method is consistent with the statutory modifications; therefore, the table incorporated in this exhibit is based on the proportional amortization table. The statutory income statement requires a gross presentation on the income statement, with proportional amortization of the initial cost of the investment in investment income and the tax credits and benefits included in income tax expense.~~

~~Terms:~~
~~Date of Investment: January 1, 20X1~~
~~Purchase Price of Investment: $100,000~~
On January 1, 20X1, T&A Insurance Company purchased a 5% equity stake in a tax credit investment structure for $100,000. The allocated tax credits are non-transferable, and T&A anticipates that all tax credits received will be fully utilized prior to expiration of the tax credit carryover period.

Assumptions:

1. All cash flows (except initial investment) occur at the end of each year.

2. Depreciation expense is computed, for book and tax purposes, using the straight-line method with a 27.5 year life (the same method is used for simplicity).

3. The investor made a $100,000 investment for a 5% limited partnership interest in the project at the beginning of the first year of eligibility for the tax credit.

4. The partnership will receive production tax credits based on the energy the project produces. The credits will be allocated over a four-year period.

5. The tax equity investor will receive cash proceeds based on 2% of the project’s cash generated during the life of the ~~project~~investment.

6. The investor's tax rate is 40%.

7. All requirements are met to retain allocable income tax credits such that there will be no recapture of income tax credits.

~~8. The investor expects that the estimated residual value of the investment will be zero.~~

~~9.~~8. All of the conditions are met to require use of the proportional amortization method.

9. After 10 years, the tax equity investor has a right to require that the project sponsor purchase the tax equity investor’s equity interest for a nominal amount. It is assumed that the Put option will be exercised and has a contractually agreed upon residual value of $1,000.

10. In Years 1-3 the investor is able to utilize all allocated tax credits in the same period they were received. In Year 4, the investor is only able to utilize half of that year’s allocated tax credit and defers the remainder for utilization in Year 5.

Proportional Amortization Method with Statutory Modifications

| Year | Net Investment (1) | Amortization of Investment (2) | Tax Credits (3) | Net Losses/Tax Depreciation (4) | Other Tax Benefits from Tax Depreciation (5) | Tax Credits and Other Tax Benefits (6) | Non-Tax Related Cash Returns (7) |
|---|---|---|---|---|---|---|---|
| | 100,000 | | | | | | |
| 1 | ~~79,399~~79,605 | 20,395~~601~~ | 20,000 | 8,300 | 3,320 | 23,320 | 58 |
| 2 | ~~58,799~~59,210 | 20,395~~601~~ | 20,000 | 8,300 | 3,320 | 23,320 | 58 |
| 3 | ~~38,198~~38,815 | 20,395~~601~~ | 20,000 | 8,300 | 3,320 | 23,320 | 58 |
| 4 | ~~17,597~~18,420 | 20,395~~601~~ | 20,000 | 8,300 | 3,320 | 23,320 | 58 |
| 5 | ~~14,664~~15,516 | 2,90~~433~~ | | 8,300 | 3,320 | 3,320 | 58 |
| 6 | ~~11,731~~12,612 | 2,90~~433~~ | | 8,300 | 3,320 | 3,320 | 58 |
| 7 | ~~8,799~~9,708 | 2,90~~433~~ | | 8,300 | 3,320 | 3,320 | 58 |
| 8 | ~~5,866~~6,804 | 2,90~~433~~ | | 8,300 | 3,320 | 3,320 | 58 |
| 9 | ~~2,933~~3,900 | 2,90~~433~~ | | 8,300 | 3,320 | 3,320 | 58 |
| 10 | ~~0~~1,000 | 2,90~~033~~ | | 8,300 | 3,320 | 3,320 | 58 |
| Total | 1,000 | ~~100~~99,000 | 80,000 | 83,000 | 33,200 | 113,200 | 580 |

(1) End-of-year investment for a 5% limited liability interest in the project net of amortization in Column (2).

(2) Initial investment, less residual value of $1,000, of $~~100~~99,000 x (total tax benefits allocated during the year in Column (6) / total anticipated tax benefits over the life of the investment of $113,200).

(3) These tax credits have been generated through the production of electricity, which generates production tax credits. The tax equity investor is not receiving renewable energy credits or carbon offsets.

(4) Depreciation /other tax losses passed on to the investor.

(5) Column (4) x 40% tax rate.

(6) Column (3) + Column (5).

(7) Non-income-tax-related benefits recognized in current-period pre-tax earnings when allocated. This represents the cash proceeds allocated by the tax equity investor based on the cash generated from the project~~.~~

Initial Year

| | | |
|---|---|---|
| Tax credit investment | 100,000 | |
| Cash | | 100,000 |
| *To record the purchase of tax credit investment* | | |

Years 1-3

| | | |
|---|---|---|
| Amortization expense | 20,395 | |
| Tax credit investment | | 20,395 |
| Federal tax credits | 20,000 | |
| Income tax expense | | 20,000 |
| Cash | 58 | |
| Investment Income | | 58 |

*To record annual receipt of allocated tax credits, proportional amortization of investment, and receipt of non-tax cash returns.*

| | | |
|---|---|---|
| Income taxes payable | 20,000 | |
| Federal tax credits | | 20,000 |

*To record annual utilization of allocated tax credits.*

Year 4

| | | |
|---|---|---|
| Amortization expense | 20,395 | |
| Tax credit investment | | 20,395 |
| Federal tax credits | 20,000 | |
| Income tax expense | | 20,000 |
| Cash | 58 | |
| Investment Income | | 58 |

*To record annual receipt of allocated tax credits, proportional amortization of investment, and receipt of non-tax cash returns.*

| | | |
|---|---|---|
| Income taxes payable | 10,000 | |
| Federal tax credits | | 10,000 |
| Income tax expense | 10,000 | |
| Deferred tax expense | | 10,000 |

*To record the portion of allocated tax credits utilized in the current year and defer the remainder. (Federal tax credit account should be mapped to the DTA reporting line as any balance remaining at year-end would be a DTA)*

Year 5

| | | |
|---|---|---|
| Amortization expense | 2,904 | |
| Tax credit investment | | 2,904 |
| Cash | 58 | |
| Investment Income | | 58 |

*To record annual proportional amortization of tax credit investment and receipt of non-tax cash returns.*

| | | |
|---|---|---|
| Income taxes payable | 10,000 | |
| Federal tax credits | | 10,000 |
| Deferred tax expense | 10,000 | |
| Income tax expense | | 10,000 |

*To record utilization of deferred tax credit.*

Years 6-9

| | | |
|---|---|---|
| Amortization expense | 2,904 | |
| Tax credit investment | | 2,904 |
| Cash | 58 | |
| Investment Income | | 58 |

*To record annual proportional amortization of tax credit investment and receipt of non-tax cash returns.*

Year 10

| | | |
|---|---|---|
| Amortization expense | 2,900 | |
| Tax credit investment | | 2,900 |
| Cash | 58 | |
| Investment Income | | 58 |
| *To record annual proportional amortization of tax credit investment and receipt of non-tax cash returns.* | | |
| Cash | 1,000 | |
| Tax credit investment | | 1,000 |
| *To record sale of interest in tax credit investment at stated residual value.* | | |

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2024/03-16-24 Spring National Meeting/Adoptions/22-14a - SSAP No 93R - Investments in Tax Credit Structures.docx

***Spring National Meeting Adoption:*** *Revisions to SSAP No. 94R made **after** the exposure on January 31, 2024, have been shown as tracked changes highlighted in grey. This document represents the final adopted version of SSAP No. 94R.*

## Statements of Statutory Accounting Principles No. 94 - Revised

## ~~Transferable and Non-Transferable~~ State and Federal Tax Credits

### STATUS

| | |
|---|---|
| Type of Issue ........................................................ | Common Area |
| Issued ........................................................ | June 12, 2006; Substantively revised December 7, 2011~~,~~ Conceptually revised - March 16, 2024. |
| Effective Date ........................................................ | December 31, 2006; Substantive revisions detailed in Issue Paper No. 145 effective December 31, 2011; Conceptual revisions detailed in Issue Paper No. XXX effective XXX. |
| Affects ........................................................ | No other pronouncements |
| Affected by ........................................................ | No other pronouncements |
| Interpreted by ........................................................ | No other pronouncements |
| Relevant Appendix A Guidance ........................................................ | None |

## SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for ~~transferable and non-transferable~~ state and federal tax credits that are purchased[1] by the reporting entity ~~without being an investor in the entity from which the tax credit were earned/purchased~~. Tax credits allocated from investments NOT within the scope of *SSAP 93R—Investments in Tax Credit Structures* should refer to this statement for tax credit accounting guidance. ~~Additionally, Tax credits that are consistent with the Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy (Statement of Concepts).~~Tax credits which have been awarded[2] to the reporting entity are not within the scope of this statement and should refer to *SSAP No. 101—Income Taxes*.

2. Tax credits allocated from, and ~~I~~investments in, ~~Low-Income Housing Tt~~tax ~~Credits credits~~ credit structures,~~s~~ as discussed in SSAP No. 93R ~~SSAP No. 93R – *Low-Income Housing Tax Credit Property Investments* *Investments in Tax Credit Structures*,~~ which involve investments in projects or programs that generate general business federal tax credits or state tax credits, are not within the scope of this statement. ~~However, the tax credits received from tax credit investments are within the scope of this statement.~~

3. Investments in a CAPCO (Certified Capital Company), organized as a partnership or an LLC, which is a company, authorized by state statute that borrows from investors ~~(insurance companies)~~, in order to make venture capital investments in "qualified" businesses, are not within the scope of this statement. Although associated with tax credits, the insurance company is paid principal and interest on its investment with the CAPCO. Depending upon the terms of the CAPCO offering, principal and interest payments to the ~~insurance company~~investors will come from the CAPCO and/or the state. The CAPCO will make cash payments directly to the ~~insurance company~~investors while the state will make payments in the form of premium or income tax credits. Investments in a CAPCO shall be accounted for in accordance with *Interpretation (INT) 06-02: Accounting and Reporting for Investments in a Certified Capital Company (CAPCO)* and specific statutory accounting guidance addressing CAPCOs.

## SUMMARY CONCLUSION

4. Both state and federal governments have enacted laws that create programs by which tax credits are granted to entities under certain specified conditions. The terms of these tax credits vary based on the issuing jurisdiction and from program to program.~~The criteria in paragraphs 5 and 6 are for transferable state tax credits (i.e., credits which may be sold or assigned). The criteria in paragraphs 7 and 8 are for non-transferable state tax credits (i.e., those which cannot be sold or assigned to other parties).~~

~~5. Some states have enacted laws that create programs by which transferable state tax credits are granted to entities under certain specified conditions (e.g., an entity makes an investment in a particular industry). The terms of these state tax credits vary from state to state and, within a state, from program to program. However, many of these transferable state tax credit programs share the following four characteristics:~~

~~a. The tax credit is nonrefundable;~~

[1] The process to purchase a tax credit typically involves the acquisition of a tax credit certificate (certificated tax credits) or the execution of a state or federal transfer form (transferable tax credits). Tax credits which have been received through other means are indicative of tax credits allocated from an investment (For example, if the tax credits are received through a schedule K-1) and may be within scope of SSAP No. 93.

[2] For the purposes of this statement, awarded tax credits are tax credits issued to the reporting entity which were neither purchased nor allocated from an investment structure. A common example of an awarded tax credit are Job Creation tax credits which are a type of performance-based tax credit program.

~~b. The holder of the transferable state tax credit may sell or otherwise transfer the transferable state tax credit to another entity, which can likewise resell or transfer the credit;~~

~~c. The transferable state tax credit will expire if not used by a predetermined date; and~~

~~d. The transferable state tax credit can be applied against either state income tax or state premium tax.~~

~~6. For purposes of this statement, such programs will be referred to as "transferable state tax credits." The criteria in paragraphs 5.b., 5.c. and 5.d. must be present in order for the transferable state tax credit to receive the accounting treatment described in this statement. When a reporting entity purchases a transferable state tax credit from another entity, the transaction does not result in a continuing investment in a business entity (i.e. limited partnership).~~

**~~Non-Transferable State Tax Credits~~**

~~7. If the original or subsequent holder of the transferable tax credit is not able to transfer the tax credit, then the admissibility criteria in paragraph 8 for non-transferable tax credits apply. These non-transferable state tax credits share the following characteristics:~~

~~a. The tax credit is nonrefundable;~~

~~b. The successive holder of a state tax credit must redeem the credit by April 15 of the subsequent year to the entity's acquisition of the state tax credit and is not permitted to carry-over, carry-back, obtain a refund, sell or assign the credit;~~

~~c. The non-transferable state tax credit will expire if not used by the predetermined date; and~~

~~d. The non-transferable state tax credit can be applied against either state income tax or state premium tax.~~

5. ~~The criteria in paragraphs 7.b., 7.c. and 7.d. must be present in order for the non-transferable state tax credit to receive the accounting treatment described in this statement.~~For the purposes of this statement, "tax credits" must be issued by either a federal or state governmental entity and must be refundable[3] or can be applied against income tax or premium tax in accordance with permitted IRS or state tax provisions. Tax credits which may be sold or otherwise transferred to another entity are referred to as "transferable tax credits" whereas all other tax credits are referred to as "non-transferable."

6. When a reporting entity purchases a transferable or certificated tax credit from another entity, the transaction does not result in a continuing investment in a business entity (i.e., limited partnership)~~.~~. Direct payment elections are non-revocable and supersede the transferability of tax credits, as such, once the election has been made the tax credit would be considered a non-transferable tax credit.

**~~Transferable and non-transferable state tax credits as defined within this SSAP held by reporting entities meet the definition of assets as specified in *SSAP No. 4—Assets and Nonadmitted Assets* and~~**

[3] Direct payment tax credits are synonymous with refundable tax credits, as such the terms are used interchangeably within this statement.

~~**are admissible assets to the extent that they comply with the requirements of this statement. If the criteria in paragraphs 6 or 8 are not met, the tax credits are nonadmitted.**~~

**~~Acquisition~~Accounting**

7. All tax credits within the scope of the statement must be recognized in the period they are allocated to or purchased by the reporting entity for tax purposes and must be recorded at face value upon receipt. ~~Transferable and non-transferable state tax credits are recorded at cost at the date of acquisition.~~Tax credits acquired at a premium or discount to their face value must record the gain/loss as follows:

a. Tax credits acquired at a discount must defer the gain as a miscellaneous liability upon receipt of the tax credit.

b. Tax credits acquired at a premium must realize the loss within the income statement upon receipt of the tax credit.

8. Deferred g~~G~~ains on ~~transferable and nontransferable~~ tax credits are deferred until the value of the ~~state~~ tax credits utilized exceeds the initial acquisition cost of the tax credits, or until the ~~state~~ tax credits are transferred to other entities or the direct payment election is utilized and the payment(s) or refund ~~is greater than~~exceed the initial ~~carrying~~ acquisition ~~value~~cost.

~~**Balance Sheet Treatment**~~

9. Tax credits shall be recognized in the period that they are purchased or allocated to the reporting entity for tax purposes:

a. Federal tax credits that can be utilized in the year allocated or purchased shall be reported in the income statement as an offset to federal taxes in accordance with *SSAP No. 101–Income Taxes*. Federal tax credits that cannot be utilized in the year allocated or purchased and are carried forward to a future tax year shall be reported ~~net of~~as a deferred tax asset (DTA) in accordance with SSAP No. 101.

b. State tax credits that can be utilized in the year allocated or purchased shall be reported in the income statement as an offset to state premium tax or state income tax, whichever is applicable, in the tax-reporting year in which the credit is utilized. State tax credits that cannot be utilized in the year allocated or purchased and are carried forward to a future tax year shall be reported gross of any related state tax liabilities and reported in the category of other-than-invested-assets (not to be reported net).

10. Use of carried forward tax credits in a future period shall be reflected as an offset to the corresponding income or premiums tax in the tax reporting year in which the tax credit is utilized.

~~8. Transferable and non-transferable state tax credits shall be established gross of any related state tax liabilities and reported in the category of other-than-invested assets (not reported net).~~

~~9. As transferable and non-transferable state tax credits are redeemed, the carrying value of the tax credits is reduced dollar for dollar by the amount of state tax credits applied toward the reporting entity's applicable state tax liability.~~

~~Income Statement Treatment~~

~~10. Gains on transferable and non-transferable state tax credits are deferred until the value of the state tax credits utilized exceeds the cost of the state tax credits or until the state tax credits are sold to other entities and the payment received is greater than the book value.~~

~~11. Losses on transferable and non-transferable state tax credits are recognized when known.~~

11. Gains and losses on ~~transferable and non-transferable state~~ tax credits are reflected in other income when realized.

12. A tax credit asset is considered purchased or allocated once the tax credit is received and available for use. If the reporting entity determines a commitment to purchase tax credits has met the definition of a liability, then the asset would be reported in other-than-invested assets as tax credits receivable.

**Admittance**

13. ~~Transferable and non-transferable t~~Tax credits as defined within this SSAP held by reporting entities meet the definition of assets as specified in *SSAP No. 4—Assets and Nonadmitted Assets* and are admissible assets to the extent that they comply with the requirements of this statement. The admissibility of tax credits ~~are~~is subject to SSAP No. 101.

**Impairment**

~~12.~~14. An impairment shall be considered to have occurred if it is probable that the reporting entity will be unable to recover the book/-adjusted carrying value ~~amount~~ of the ~~transferable or non-transferable state~~ tax credits. T~~State t~~ax credits should be evaluated for impairment at each reporting date.

~~13.~~15. When there is a decline in the realizability of a ~~transferable or non-transferable state~~ tax credit owned by the reporting entity that is other-~~-~~than-~~-~~temporary[(INT 06-07)], the asset shall be written down to the expected realizable amount and the amount of the write down shall be accounted for as a realized loss. The expected realizable value is the new cost basis.

~~14.~~16. The new cost basis shall not be changed for subsequent recoveries in realizability.

**Disclosures**

~~15.~~17. The following disclosures shall be made in the financial statements for the reporting period(s) presented. For purposes of this disclosure, total unused ~~transferable and non-transferable state~~ tax credits represent the entire amount of ~~transferable and non-transferable state~~ tax credits available:

a. Carrying value of ~~transferable and non-transferable state~~ tax credits, disaggregated by transferable/certificated and non-transferable, gross of any related ~~state~~ tax liabilities by ~~state~~ jurisdiction and in total.~~,~~

b. Total unused ~~transferable and non-transferable state~~ tax credits by ~~state~~jurisdiction, disaggregated by transferable/certificated and non-transferable.~~;~~

c. Method of estimating utilization of remaining ~~transferable and non-transferable state~~ tax credits or other projected recovery of the current carrying value.

d. Impairment amount recognized in the reporting period(s), if any.

e. Identify ~~state~~ tax credits by transferable/certificated and non-transferable classifications~~,~~ and identify the admitted and ~~N~~nonadmitted portions of each classification.

~~16.~~18. Any commitment or contingent commitment to purchase tax credits shall be disclosed.

**Effective Date and Transition**

19. This statement is effective for reporting periods ending on or after December 31, 2006. Early adoption is permitted. 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. Substantive revisions to 1) revising the title; 2) incorporating the criteria for non-transferable state tax credits as described in paragraphs 7 and 8; 3) adding a disclosure; and 4) updating terminology throughout the document as appropriate, are effective for reporting periods ending on or after December 31, 2011.

20. In March 2024, new SAP concept revisions, as detailed in Issue Paper No. XXX, were adopted. These revisions, effective January 1, 2025, with early adoption permitted, expanded the scope of SSAP No. 94R to include all purchased, and certain allocated, state and federal income or premium tax credits and provide new guidance on the accounting, recognition, and reporting for state and federal tax credits within the scope of this statement. As of the effective date, reporting entities shall prospectively modify the recognition, accounting, and reporting of tax credits within the scope of this statement to reflect the guidance in the conceptual revisions. For unutilized tax credits which were carried forward from prior to the effective date:

a. Federal tax credits in other-than-invested assets are to be transferred and reported ~~net of~~as a ~~deferred tax asset (~~DTA~~)~~ in accordance with SSAP No. 101.

~~a.~~b. Tax credits previously recorded at acquisition cost should be adjusted to reflect the face value of the acquired tax credits with the corresponding loss immediately recognized or the gain deferred.

**REFERENCES**

**Relevant Issue Papers**

- Issue Paper No. 126—Accounting for Transferable State Tax Credits
- Issue Paper No. 145—Accounting for Transferable and Non-Transferable State Tax Credits
- Issue Paper No. XXX—XXX

## EXHIBIT A – ACCOUNTING FOR TRANSFERABLE ~~STATE~~ TAX CREDITS

On 1/1/X1 SAM Insurance Company purchased transferable state tax credits for a cost of $100,000. The transferable state tax credits are redeemable for $160,000 and expire at the end of 12/31/X4. SAM initially expects to utilize the tax credits before expiration in their state of domicile in the amount of $40,000 per year. In year X4, SAM sells the remaining $30,000 in transferable state tax credits for $20,000.

| | | | |
|---|---|---|---|
| 1/1/x1 | Transferable state tax credits | ~~100~~160,000 | |
| | Deferred gains on acquired tax credits | | 60,000 |
| | Cash | | 100,000 |
| | *To record the purchase of the tax credits* | | |
| 6/30/x1 | Premium tax expense | 40,000 | |
| | Premium taxes payable to domiciliary state | | 40,000 |
| | *To record premium tax expense and accrue the liability in Year 1.* | | |
| 10/1/x1 | Premium tax payable | 40,000 | |
| | Transferable state tax credits | | 40,000 |
| | *To record the use of tax credits in Year 1. The reporting entity expects to be able to utilize remaining tax credits before expiration.* | | |
| 6/30/x2 | Premium tax expense | 60,000 | |
| | Premium taxes payable to domiciliary state | | 60,000 |
| | *To record premium tax expense and accrue the liability in Year 2.* | | |
| 9/30/x2 | Premium tax payable | 60,000 | |
| | Transferable state tax credits | | 60,000 |
| | *To record the use of taxes credits in Year 2. The reporting entity expects to be able to utilize remaining tax credits before expiration.* | | |
| 6/30/x3 | Premium tax expense | 30,000 | |
| | Premium taxes payable to domiciliary state | | 30,000 |
| | *To record premium tax expense and accrue the liability in Year 3.* | | |
| 9/30/x3 | Premium tax payable | 30,000 | |
| | Transferable state tax credits~~Other income~~ | | 30,000 |
| | Deferred gains on acquired tax credits | 30,000 | |
| | Other income | | 30,000 |
| | *To record the use of premium tax credits in excess of cost and recognize a gain on premium tax credits in other income. The Company intends to sell the remaining tax credits in year 4.* | | |
| 6/30/x4 | Cash | 20,000 | |
| | Other income | 10,000 | |
| | Transferable state tax credits | | 30,000 |
| | Deferred gains on acquired tax credits | 30,000 | |
| | Other income | | ~~20~~30,000 |
| | *To record the sale of the remaining tax credits.* | | |

## EXHIBIT B – ACCOUNTING FOR NON-TRANSFERABLE ~~STATE~~ TAX CREDITS

On 7/1/X1 LJW Insurance Company purchased non-transferable ~~state~~ federal tax credits for a cost of $100,000. The ~~state~~ federal tax credits are redeemable for $110,000~~, are not transferable~~ and expire on, April 15, 20x2. LJW expects to utilize the tax credits before expiration ~~in their state of domicile~~ in the amount of $110,000. Tax credits are utilized pro-rata, approximately $36,666 every quarter, from acquisition date to expiration date. The illustration below assumes that LJW Insurance Company's quarterly income tax liability equals the amount of credits that were purchased.

| | | | |
|---|---|---|---|
| 7/1/x1 | ~~State~~ Federal tax credits | 11~~0~~0,000 | |
| | Deferred gains on acquired tax credits | | 10,000 |
| | Cash | | 100,000 |
| | *To record the purchase of the tax credits* | | |
| 9/30/x1 | ~~Premium~~ Income tax expense | ~~200,000~~36,666 | |
| | Income ~~Premium~~ taxes payable ~~to domiciliary state~~ | | ~~200,000~~36,666 |
| | *To record quarterly ~~premium tax expense and accrue the~~income tax liability.* | | |
| 10/1/x1 | Income taxes payable | 36,666 | |
| | Federal tax credits | | 36,666 |
| | *To record the use of tax credits in the quarter.* | | |
| 12/31/x1 | Income tax expense | 36,666 | |
| | Income taxes payable | | 36,666 |
| | *To record quarterly income tax liability.* | | |
| 1/1/x2 | Income taxes payable | 36,666 | |
| | Federal tax credits | | 36,666 |
| | *To record the use of tax credits in the quarter.* | | |
| 3/31/x2 | Income tax expense | 36,668 | |
| | Income taxes payable | | 36,668 |
| | *To record quarterly income tax liability.* | | |
| ~~3/15/x2~~ | ~~Premium tax payable~~ | ~~110,000~~ | |
| 4/1/x2 | Income taxes payable | 36,668 | |
| | Deferred gains on acquired tax credits | 10,000 | |
| | Other Income | | 10,000 |
| | Federal tax credits | | 36,668 |
| | ~~Other Income~~ | | ~~10,000~~ |
| | ~~Federal tax credits~~ | | ~~100~~110,000 |
| | *To record the use of ~~premium~~ tax credits in the quarter. ~~in excess of cost and recognize a gain on premium tax credits in other income. (The additional $90,000 of premium taxes payable would still be due.)~~* | | |

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2024/03-16-24 Spring National Meeting/Adoptions/22-14b - SSAP No 94R - State and Federal Tax Credits.docx

**Other SSAPs**

**Spring National Meeting Adoption:** *This document represents the final adopted version of the revisions to SSAP No. 34 and SSAP No. 48R. The changes shown to SSAP No. 48R have **not** been amended to reflect the proposed formatting changes proposed in agenda item #2024-08: Consistency Revisions for Residuals.*

Proposed revisions to ***SSAP No. 34—Investment Income Due and Accrued***

## SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for investment income due and accrued. This statement does not address the accounting for tax credits allocated or purchased, which are discussed in SSAP No. 93R—*Investments in Tax Credit Structures* and *SSAP No. 94R—State and Federal Tax Credits*.

Proposed revisions to ***SSAP No. 48R—Joint Ventures, Partnerships and Limited Liability Companies***

## SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for investments in any joint ventures, partnerships, and limited liability companies, including investments in certified capital companies (CAPCO) per *INT 06-02: Accounting and Reporting for Investments in a Certified Capital Company (CAPCO)*, whether or not it is considered to be controlled by or affiliated with the reporting entity. Single real estate property investments that are wholly-owned by an LLC that is directly and wholly-owned by the reporting entity, and that meet the criteria established in *SSAP No. 40R—Real Estate Investments*, are excluded from this statement. This statement does not address the accounting for investments in joint ventures, partnerships, and ~~and~~ limited liability companies that invest in tax credit programs ~~that~~ and are in the scope of ~~hold an equity interest in either a tax syndication structure or tax equity fund invest in Low-Income Housing Tax Credit Properties as discussed in~~ *SSAP No. 93R*—~~*Low-Income Housing Tax Credit Property Investments*~~*Investments in Tax Credit Structures*.

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

**Issue:** *ASU 2023-03—Amendments to SEC Paragraphs*

**Check (applicable entity):**

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

**Description of Issue:**
In July of 2023 FASB issued *ASU 2023-03, Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 120, SEC Staff Announcement at the March 24, 2022, EITF Meeting, and Staff Accounting Bulletin Topic 6.B, Accounting Series Release 280—General Revision of Regulation S-X: Income or Loss Applicable to Common Stock*, which amends SEC paragraphs from the Accounting Standards Codification based on the issuance of SEC Staff Accounting Bulletin (SAB) 120, the March 24, 2022 EITF meeting SEC staff announcement, and SAB Topic 6.B "Accounting Series Release No. 280 — General Revision of Regulation S-X: Income or Loss Applicable to Common Stock. This ASU updates various aspects of SEC guidance on stock compensation and equity-based payments.

**Existing Authoritative Literature:**
Historically, SEC guidance from ASUs have been rejected as not applicable for statutory accounting in Appendix D. Regardless, all ASUs are reviewed for statutory accounting purposes to determine if the guidance should be considered for statutory accounting.

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

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

**Convergence with International Financial Reporting Standards (IFRS):** None

**Staff Recommendation:**
**NAIC staff recommends that the Working Group move this item to the active listing, categorized as a SAP clarification, and expose revisions to *Appendix D—Nonapplicable GAAP Pronouncements* to reject *ASU 2023-03, Amendments to SEC Paragraphs* as not applicable to statutory accounting.** This item is proposed to be rejected as not applicable as the ASU is specific to amendment of SEC paragraphs, which are not applicable for statutory accounting purposes.

**Staff Review Completed by:** William Oden – October 2023

**Status:**
On December 1, 2023, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a SAP clarification and exposed revisions to *Appendix D—Nonapplicable GAAP Pronouncements* to reject *ASU 2023-03—Amendments to SEC Paragraphs* as not applicable for statutory accounting.

 

On March 16, 2024, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed revisions to *Appendix D—Nonapplicable GAAP Pronouncements* to reject *ASU 2023-03, Amendments to SEC Paragraphs* as not applicable to statutory accounting.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2024/03-16-24 Spring National Meeting/Adoptions/23-25 - ASU 2023-03 - SEC Updates.docx

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

**Issue:** *ASU 2023-04—Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 121*

**Check (applicable entity):**

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

**Description of Issue:**
In August of 2023 FASB issued *ASU 2023-04, Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 121*, which amends SEC paragraphs from the Accounting Standards Codification for the issuance of SEC Staff Accounting Bulletin (SAB) 121 which provides guidance on accounting for obligations to safeguard Crypto-Assets an entity holds for its platform users.

**Existing Authoritative Literature:**
Historically, SEC guidance from ASUs have been rejected as not applicable for statutory accounting in Appendix D. Regardless, all ASUs are reviewed for statutory accounting purposes to determine if the guidance should be considered for statutory accounting.

**Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups):**
In May 2021, the Working Group issued INT 21-01: Accounting for Cryptocurrencies, which provided guidance for the statutory accounting treatment of cryptocurrencies. INT 21-01 establishes that directly held cryptocurrencies have not been identified in the Accounting Practices and Procedures Manual (AP&P Manual) as an admitted asset, and do not meet the definition of any admitted asset that is defined in the AP&P Manual. Accordingly, by default they are a nonadmitted asset per *SSAP No. 4—Assets and Nonadmitted Assets*, paragraph 3, as they are not specifically identified in the Accounting Practices and Procedures Manual as an admitted asset.

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

**Convergence with International Financial Reporting Standards (IFRS):** None

**Staff Recommendation:**
**NAIC staff recommends that the Working Group move this item to the active listing, categorized as a SAP clarification, and expose revisions to *Appendix D—Nonapplicable GAAP Pronouncements* to reject *ASU 2023-04, Amendments to SEC Paragraphs* as not applicable to statutory accounting.** This item is proposed to be rejected as not applicable as the ASU is specific to amendment of SEC paragraphs, which are generally not applicable for statutory accounting purposes.

**Staff Review Completed by:** Jake Stultz – October 2023

**Status:**
On December 1, 2023, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a SAP clarification and exposed revisions to *Appendix D—Nonapplicable GAAP Pronouncements* to reject *ASU 2023-04—Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 121* as not applicable for statutory accounting.

On March 16, 2024, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed revisions to *Appendix D—Nonapplicable GAAP Pronouncements* to reject *ASU 2023-04, Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 121* as not applicable to statutory accounting.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2024/03-16-24 Spring National Meeting/Adoptions/23-27 - ASU 2023-04 - SEC Updates - Crypto.docx

 

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

**Issue: IMR / AVR Preferred Stock**

**Check (applicable entity):**

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

**Description of Issue:** This agenda item has been developed to update guidance for the Interest Maintenance Reserve (IMR) and the Asset Valuation Reserve (AVR) in the Annual Statement (A/S) Instructions for perpetual preferred stock, which includes SVO-Identified Preferred Stock ETFs. The existing IMR/AVR guidance is based on measurement of preferred stock based on NAIC designation. However, statutory accounting revisions effective in 2021 revised the measurement method for perpetual preferred stock to always reflect fair value, not to exceed any currently effective call price, regardless of NAIC designation. Furthermore, with dedicated reporting lines established to separate redeemable and perpetual preferred stock, the reporting of NAIC designations was revised and no longer references an “RP” or “P.” These revisions were incorporated as perpetual preferred stock is more akin to an equity instrument, as it is not required to be redeemed by the issuing entity or at the option of the investor. At the time of this measurement method change, corresponding revisions to the IMR/AVR instructions were not reflected. As such, the existing IMR/AVR guidance directs realized gains/loss treatment for all preferred stock based on the NAIC designation during the holding period and refers to the prior designation classifications.

This agenda item proposes to clarify that realized gains and losses on perpetual preferred stock shall not be added to the IMR, regardless of NAIC designation, and shall follow the same concepts that exist for common stock in reporting realized gains/losses to the AVR. This agenda item does not propose to change the concepts for redeemable preferred stock, which is more akin to a debt instrument, but proposes to clarify the guidance so application based on the type of structure is clear. Separate reporting of perpetual preferred stock and redeemable preferred stock is already included on Schedule D-2-1: Preferred Stock.

For the revisions proposed in this agenda item, the guidance for redeemable preferred stock will not be revised and will continue to classify realized gains/losses between the IMR and AVR based on NAIC designation. This guidance indicates that if the designation was a 4-6 at any time during the holding period, the realized gain or loss would go to AVR as non-interest related gains or losses. This agenda item does not intend to confirm that the allocation approach for redeemable preferred stock is appropriate and is strictly focused on ensuring that the current annual statement instructions for IMR/AVR corresponds with the current accounting and reporting guidance for perpetual preferred stocks. As detailed in the recommendation, discussion on whether use of NAIC designation for redeemable preferred stock is appropriate is proposed to occur as part of the long-term IMR project.

**Existing Authoritative Literature:**
- **SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve**

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for an asset valuation reserve (AVR) and an interest maintenance reserve (IMR) for life and accident and health insurance companies, excluding separate accounts. Separate account AVR/IMR reporting is addressed in *SSAP No. 56—Separate Accounts.*

SUMMARY CONCLUSION

2. Life and accident and health insurance companies shall recognize liabilities for an AVR and an IMR. The AVR is intended to establish a reserve to offset potential credit-related investment losses on all

invested asset categories excluding cash, policy loans, premium notes, collateral notes and income receivable. The IMR defers recognition of the realized capital gains and losses resulting from changes in the general level of interest rates. These gains and losses shall be amortized into investment income over the expected remaining life of the investments sold. The IMR also applies to certain liability gains/losses related to changes in interest rates. These gains and losses shall be amortized into investment income over the expected remaining life of the liability released.

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 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.

Effective Date and Transition

4. This statement is effective for years beginning January 1, 2001. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*.

- **A/S Instructions – Life, Accident and Health / Fraternal Companies**

*(This reflects 2023 guidance. Agenda item 2023-15 proposes revisions to address specific allocations to the IMR that may not reflect interest-related losses.)*

**Interest Maintenance Reserve (IMR)**

Line 2 – Current Year's Realized Pre-tax Capital Gains (Losses) of $______ Transferred into the Reserve Net of Taxes of $______

Include interest-rate-related realized capital gains (losses), net of capital gains tax thereon. All realized capital gains (losses) transferred to the IMR are net of capital gains taxes thereon. Exclude non-interest-related (default) realized capital gains and (losses), realized capital gains (losses) on equity investments, and unrealized capital gains (losses).

All realized capital gains (losses), due to interest rate changes on fixed income investments, net of related capital gains tax, should be captured in the IMR and amortized into income (Column 2, Lines 1 through 31) according to Table 1 or the seriatim method. Realized capital gains (losses) must be classified as either interest (IMR) or non-interest (AVR) related, not a combination except as specified in *SSAP No. 43R—Loan-Backed and Structured Securities*. Purchase lots with the same CUSIP are treated as individual assets for IMR and Asset Valuation Reserve (AVR) purposes.

Exclude those capital gains and (losses) that, in accordance with contract terms have been used to directly increase or (decrease) contract benefit payments or reserves during the reporting period. The purpose of this exclusion is to avoid the duplicate utilization of such gains and (losses).

Capital gains tax should be determined using the method developed by the company to allocate taxes used for statutory financial reporting purposes. By capturing the realized capital gains (losses) net of tax, the capital gains tax associated with those capital gains (losses) due to an interest rate change is charged or credited to the IMR and amortized in proportion to the before-tax amortization.

Include realized capital gains (losses) on:

Debt securities (excluding loan-backed and structured securities) and preferred stocks whose National Association of Insurance Commissioners (NAIC)/Securities Valuation Office (SVO) designation at the end of the holding period is **NOT** different from its NAIC designation at the beginning of the holding period by more than one NAIC designation. Exclude any such gains (losses) exempt from the IMR.

Exchange Traded Funds (ETFs) as listed on the SVO Identified Bond ETF List (thereafter subject to bond IMR guidelines) and the SVO Identified Preferred Stock ETF List (thereafter subject to preferred stock IMR guidelines). Include any capital gains (losses) realized by the Company, whether from sale of the ETF or capital gains distributions by the ETF. If the ETF is removed from either SVO ETF list, the ETF is reported and treated as common stock, with any capital gains/(losses) excluded from the IMR.

SVO Identified Funds designated for systematic value

Called bonds, tendered bonds, and sinking fund payments.

Mortgage loans where:

- Interest is **NOT** more than 90 days past due, or
- The loan is **NOT** in process of foreclosure, or
- The loan is **NOT** in course of voluntary conveyance, or
- The terms of the loan have **NOT** been restructured during the prior two years.

Additional Provisions for Including/Excluding Gains (Losses) from IMR:

Mortgage loan prepayment penalties are not included in IMR. Treat them as regular investment income.

Interest-related gains (losses) realized on directly held capital and surplus notes reported on Schedule BA should be transferred to the IMR in the same manner as similar gains and (losses) on fixed income assets held on Schedule D. A capital gain (loss) on such a note is classified as an interest rate gain if the note is eligible for amortized-value accounting at both the time of acquisition and the time of disposition.

Determination of IMR gain (loss) on multiple lots of the same securities should follow the underlying accounting treatment in determining the gain (loss). Thus, the designation, on a purchase lot basis, should be compared to the designation at the end of the holding period to determine IMR or AVR gain or (loss).

Realized capital gains (losses) on any debt security (excluding loan-backed and structured securities) that has had an NAIC/SVO designation of 6 at any time during the holding period should be excluded from the IMR and included as a non-interest-related gain (loss) in the AVR.

**Realized capital gains (losses) on any preferred stock that had an NAIC/SVO designation of RP4, RP5 or RP6 or P4, P5 or P6 at any time during the holding period should be reported as non-interest-related gains (losses) in the AVR.**

The holding period for debt securities (excluding loan-backed and structured securities) and preferred stocks is defined as the period from the date of purchase to the date of sale. For the end of period classification, the most recent available designation should be used. For bonds acquired before Jan. 1, 1991, the holding period is presumed to have begun on Dec. 31, 1990. For preferred stocks acquired before Jan. 1, 1993, the holding period is presumed to have begun on Dec. 31, 1992. For SVO Identified ETFs, the holding period is defined as one calendar year to expected maturity. For SVO Identified Funds designated for systematic value, the holding period is the weighted-average life of the underlying bonds.

In accordance with *SSAP No. 26R—Bonds*, securities with other-than-temporary impairment losses shall be recorded entirely to either AVR or IMR and not bifurcated between interest and non-interest components.

**Asset Valuation Reserve (AVR)**

Line 2 – Realized Capital Gains (Losses) Net of Taxes – General Account

**Report all realized non-interest-related (default) and equity capital gains (losses), net of capital gains tax, applicable to the assets in each component and sub-component. All realized capital gains (losses) transferred to the AVR are net of capital gains taxes thereon. Exclude all interest rate-related capital gains (losses) from the AVR.**

Capital gains tax should be determined using the method developed by the company to allocate taxes used for statutory financial reporting purposes.

Report all realized capital gains (losses), net of capital gains tax, on each debt security (excluding loan-backed and structured securities) whose NAIC/SVO designation at the end of the holding period is different from its NAIC/SVO designation at the beginning of the holding period by more than one NAIC/SVO designation. The holding period is defined as the period from the date of purchase to the date of sale. For end of period classification, the most recent available designation should be used. For bonds acquired before Jan. 1, 1991, the holding period is presumed to have begun on Dec. 31, 1990.

Determination of AVR gain (loss) on multiple lots of the same fixed income securities should follow the underlying accounting treatment in determining gain (loss). Thus, the designation, on a purchase lot basis, should be compared to the designation at the end of the holding period to determine IMR or AVR gain or (loss).

In accordance with *SSAP No. 26R—Bonds*, securities with other-than-temporary impairment losses shall be recorded entirely to either AVR or IMR and not bifurcated between interest and non-interest components.

In accordance with *SSAP No. 43R—Loan-Backed and Structured Securities*, for loan-backed and structured securities only:

- Other-Than-Temporary Impairment – Non-interest-related other-than-temporary impairment losses shall be recorded through the AVR. If the reporting entity wrote the security down to fair value due to the intent to sell or does not have the intent and ability to retain the investment for a period of time sufficient to recover the amortized cost basis, the non-interest-related portion of the other-than-temporary impairment losses shall be recorded through the AVR; the interest related other-than-temporary impairment losses shall be recorded through the 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.

- 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. As such, an entity shall report the loss in separate AVR and IMR components as appropriate.

- 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.

- 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.

- 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.

In addition, all gains (losses), net of capital gains tax, on mortgage loans where:

- Interest is more than 90 days past due, or
- The loan is in the process of foreclosure, or
- The loan is in course of voluntary conveyance, or
- The terms of the loan have been restructured during the prior two years

Would be classified as non-interest-related gains (losses).

The gain (loss), net of capital gains tax, on any debt security (excluding loan-backed and structured securities) that has had an NAIC/SVO designation of "6" at any time during the holding period should be reported as a credit related gain (loss).

**All capital gains (losses), net of capital gains tax, from preferred stock that had an NAIC/SVO designation of RP4, RP5 or RP6 or P4, P5 or P6 at any time during the holding period should be reported as on-interest-related gains (losses) in the AVR.**

However, for a convertible bond or preferred stock purchased while its conversion value exceeds its par value, any gain (loss) realized from its sale before conversion must be included in the Equity Component of the AVR. Conversion Value is defined to mean the number of shares available currently or at next conversion date multiplied by the stock's current market price.

Report all realized equity capital gains (losses), net of capital gains tax, in the appropriate sub-components.

The following guidance pertains to instruments in Scope of *SSAP No. 86—Derivatives*:

- For derivative instruments used in hedging transactions, the determination of whether the capital gains (losses) are allocable to the IMR or the AVR is based on how the underlying asset is treated. Realized gains (losses), net of capital gains tax, on portfolio or general hedging instruments should be included with the hedged asset. Gains (losses), net of capital gains tax, on hedges used, as specific hedges should be included only if the specific hedged asset is sold or disposed of.

- For income generation derivative transactions, the determination of whether the capital gains (losses) are allocable to the IMR or the AVR is based on how the underlying interest (for a put) or covering asset (for a call, cap or floor) is treated. Realized gains (losses), net of capital gains tax should be included in the same sub-component where the realized gains (losses) of the underlying interest (for a put) or covering asset (for a call, cap or floor) is reported. Refer to *SSAP No. 86—Derivatives* for accounting guidance.

Realized gains (losses), net of capital gains tax, resulting from the sale of U.S. government securities and the direct or guaranteed securities of agencies which are backed by the full faith and credit of the U.S. government are exempt from the AVR. This category is described in the Investment Schedules General Instructions.

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

- Agenda item 2019-04: SSAP No. 32 – Investment Classification Project, resulted with revisions to update the preferred stock accounting and reporting guidance. These revisions resulted with all perpetual preferred stock being reported at fair value, not to exceed any currently effective call price, with unrealized gains and losses accounted for in accordance *with SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve.*

- Agenda Item 2023-14: *SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve* establishes a broad project to capture accounting guidance for AVR and IMR in SSAP No. 7.

- Agenda Item 2023-15: IMR/AVR Specific Allocations considers revisions to the A/S instructions to address guidance that prescribes specific allocation to the IMR. These revisions were exposed in August 2023.

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

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

**Recommendation:**
**NAIC staff recommend that the Working Group include this item on their maintenance agenda as a SAP clarification and expose this agenda item with proposed revisions to the A/S instructions to remove the guidance that directs all preferred stock to be allocated between IMR/AVR based on NAIC designation. This agenda item proposes new guidance that corresponds to the accounting and reporting differences for redeemable and perpetual preferred stock, with all perpetual preferred stock being treated as an equity instrument similar to common stock. With this approach, all unrealized gains or losses on perpetual preferred stock will reverse to realized gains or losses in the AVR formula. The revisions also clarify that SVO-Identified Preferred Stock ETFs shall be treated as perpetual preferred stock (equities) as that is consistent with the guidance in *SSAP No. 32R—Preferred Stock*.**

*(Note: This item is proposed as a SAP Clarification as the revisions to SSAP No. 32R to revise the measurement method for perpetual preferred stock was a new SAP Concept. The revisions proposed in this agenda item simply update the IMR/AVR A/S instructions to correspond to those adopted changes.)*

**As discussed in the introduction, this agenda item does not propose to alter the current process of using NAIC designations for redeemable preferred stock in determining whether realized gains or losses should be allocated to IMR or AVR. However, it should not be perceived that this agenda item confirms retention of this existing approach. Discussion on the approach to allocate gains/losses incurred from redeemable preferred stock is recommended for review as part of the long-term project on IMR/AVR. Any comments received on this dynamic will be addressed as part of that project. As detailed in the A/S instructions, for preferred stock, the determination for AVR is based on whether the preferred stock was an NAIC 4-6 at any time during the holding period and not based on a change in NAIC designation.**

*Staff Note: Shaded guidance reflects sections that have proposed revisions that were exposed in agenda item 2023-15: IMR/AVR Specific Allocations. These changes are accepted only for ease of readability and to prevent confusion on the proposed revisions related to this agenda item. Whether the revisions from agenda item 2023-15 are adopted will depend on the discussion and action by the Working Group. With the exception of the added 'redeemable' in the first shaded paragraph, all of the edits proposed in this agenda item are in separate paragraphs from agenda item 2023-15.*

**Interest Maintenance Reserve (IMR)**

Line 2 – Current Year's Realized Pre-tax Capital Gains (Losses) of $______ Transferred into the Reserve Net of Taxes of $______

Include interest-rate-related realized capital gains (losses), net of capital gains tax thereon. All realized capital gains (losses) transferred to the IMR are net of capital gains taxes thereon. Exclude non-interest-related (default) realized capital gains and (losses), realized capital gains (losses) on equity investments, and unrealized capital gains (losses).

All realized capital gains (losses), due to interest rate changes on fixed income investments, net of related capital gains tax, should be captured in the IMR and amortized into income (Column 2, Lines 1 through 31) according to Table 1 or the seriatim method. Realized capital gains (losses) must be classified as either interest (IMR) or non-interest (AVR) related, not a combination except as specified in *SSAP No. 43R—Loan-Backed and Structured Securities*. Purchase lots with the same CUSIP are treated as individual assets for IMR and Asset Valuation Reserve (AVR) purposes.

Exclude those capital gains and (losses) that, in accordance with contract terms have been used to directly increase or (decrease) contract benefit payments or reserves during the reporting period. The purpose of this exclusion is to avoid the duplicate utilization of such gains and (losses).

Capital gains tax should be determined using the method developed by the company to allocate taxes used for statutory financial reporting purposes. By capturing the realized capital gains (losses) net of tax, the capital gains tax associated with those capital gains (losses) due to an interest rate change is charged or credited to the IMR and amortized in proportion to the before-tax amortization.

Include realized capital gains (losses) on:

Debt securities (excluding loan-backed and structured securities) and redeemable preferred stocks where the realized capital gains (losses) more predominantly reflect interest-related changes. By default, debt instruments whose National Association of Insurance Commissioners (NAIC)/Securities Valuation Office (SVO) designation at the end of the holding period, or within a reasonable amount of time after the reporting entity has sold/disposed of the instrument, are different from its NAIC designation at the beginning of the holding period by more than one NAIC designation or NAIC designation category shall not be considered to reflect interest-related changes. Gains (losses) from those debt instruments shall NOT be reported in the IMR and shall be reported in the AVR

Exchange Traded Funds (ETFs) as listed on the SVO Identified Bond ETF List (thereafter subject to bond IMR guidelines)~~ and the SVO Identified Preferred Stock ETF List (thereafter subject to preferred stock IMR guidelines)~~. ~~I~~include any capital gains (losses) realized by the Company, whether from sale of the ETF or capital gains distributions by the ETF. If the ETF is removed from either SVO ETF list, the ETF is reported and treated as common stock, with any capital gains/(losses) excluded from the IMR. (Investments on the SVO-Identified Preferred Stock List are captured as perpetual preferred stock and treated as equity investments, with gains and losses excluded from IMR.)

SVO Identified Funds designated for systematic value

Called bonds, tendered bonds, and sinking fund payments.

Mortgage loans where the realized gains (losses) more predominantly reflect interest-related changes. By default, mortgage loans that meet any of the following criteria shall not be considered to reflect interest-related losses. Realized gains (losses) from mortgage loans with these characteristics shall be reported in the AVR:

- Any mortgage loan sold/disposed with an established valuation allowance under SSAP No. 37, or
- Interest is more than 90 days past due, or
- The loan is in process of foreclosure, or
- The loan is in course of voluntary conveyance, or
- The terms of the loan have been restructured during the prior two years.

Additional Provisions for Including/Excluding Gains (Losses) from IMR:

Mortgage loan prepayment penalties are not included in IMR. Treat them as regular investment income.

Interest-related gains (losses) realized on directly held capital and surplus notes reported on Schedule BA should be transferred to the IMR in the same manner as similar gains and (losses) on fixed income assets held on Schedule D. A capital gain (loss) on such a note is classified as an interest rate gain if the note is eligible for amortized-value accounting at both the time of acquisition and the time of disposition.

Determination of IMR gain (loss) on multiple lots of the same securities should follow the underlying accounting treatment in determining the gain (loss). Thus, the designation, on a purchase lot basis, should be compared to the designation at the end of the holding period to determine IMR or AVR gain or (loss).

Realized capital gains (losses) on any debt security (excluding loan-backed and structured securities) that has had an NAIC/SVO designation of 6 at any time during the holding period should be excluded from the IMR and included as a non-interest-related gain (loss) in the AVR.

Realized capital gains (losses) on ~~any~~ redeemable preferred stock that had an NAIC/SVO designation of 4-6 ~~RP4, RP5 or RP6 or P4, P5 or P6~~ at any time during the holding period should be reported as non-interest-related gains (losses) in the AVR.

The holding period for debt securities (excluding loan-backed and structured securities) and redeemable preferred stocks is defined as the period from the date of purchase to the date of sale. For the end of period classification, the most recent available designation should be used. For bonds acquired before Jan. 1, 1991, the holding period is presumed to have begun on Dec. 31, 1990. For redeemable preferred stocks acquired before Jan. 1, 1993, the holding period is presumed to have begun on Dec. 31, 1992. For SVO Identified Bond ETFs, the holding period is defined as one calendar year to expected maturity. For SVO Identified Bond ETFs ~~Funds~~ designated for systematic value, the holding period is the weighted-average life of the underlying bonds.

In accordance with *SSAP No. 26R—Bonds*, securities with other-than-temporary impairment losses shall be recorded entirely to either AVR or IMR and not bifurcated between interest and non-interest components.

## Asset Valuation Reserve (AVR)

Line 2 – Realized Capital Gains (Losses) Net of Taxes – General Account

Report all realized non-interest-related (default) and equity capital gains (losses) (which includes, but is not limited to, common stock, perpetual preferred stock and SVO-Identified Preferred Stock ETFs), net of capital gains tax, applicable to the assets in each component and sub-component. All realized capital gains (losses) transferred to the AVR are net of capital gains taxes thereon. Exclude all interest rate-related capital gains (losses) from the AVR.

Capital gains tax should be determined using the method developed by the company to allocate taxes used for statutory financial reporting purposes.

Report all realized capital gains (losses), net of capital gains tax, on each debt security (excluding loan-backed and structured securities) where the realized capital gains (losses) more predominantly reflect non-interest-related changes. By default, debt instruments whose NAIC/SVO designation at the end of the holding period, or within a reasonable amount of time after the reporting entity has sold/disposed of the instrument, is different from its NAIC/SVO designation at the beginning of the holding period by more than one NAIC designation or NAIC designation category shall be considered to reflect non-interest-related changes. Gains (losses) from those debt instruments shall be reported in the AVR.

Determination of AVR gain (loss) on multiple lots of the same fixed income securities should follow the underlying accounting treatment in determining gain (loss). Thus, the designation, on a purchase lot basis, should be compared to the designation at the end of the holding period to determine IMR or AVR gain or (loss).

In accordance with *SSAP No. 26R—Bonds*, securities with other-than-temporary impairment losses shall be recorded entirely to either AVR or IMR and not bifurcated between interest and non-interest components.

In accordance with *SSAP No. 43R—Loan-Backed and Structured Securities*, for loan-backed and structured securities only:

- Other-Than-Temporary Impairment – Non-interest-related other-than-temporary impairment losses shall be recorded through the AVR. If the reporting entity wrote the security down to fair value due to the intent to sell or does not have the intent and ability to retain the investment for a period of time sufficient to recover the amortized cost basis, the non-interest-related portion of the other-than-temporary impairment losses shall be recorded through the AVR; the interest related other-than-temporary impairment losses shall be recorded through the 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.

- 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. As such, an entity shall report the loss in separate AVR and IMR components as appropriate.

- 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.

- 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.

- 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.

In addition, all gains (losses), net of capital gains tax, on mortgage loans where the realized gains (losses) more predominantly reflect non-interest-related changes. By default, mortgage loans that meet any of the following criteria shall be considered to reflect non-interest-related changes and realized gains (losses) from mortgage loans with these characteristics shall be reported in the AVR:

- Any mortgage loan sold/disposed with an established valuation allowance under SSAP No. 37, or
- Interest is more than 90 days past due, or
- The loan is in the process of foreclosure, or
- The loan is in course of voluntary conveyance, or
- The terms of the loan have been restructured during the prior two years

The gain (loss), net of capital gains tax, on any debt security (excluding loan-backed and structured securities) that has had an NAIC/SVO designation of "6" at any time during the holding period should be reported as a credit related gain (loss).

All capital gains (losses), net of capital gains tax, from redeemable preferred stock that had an NAIC/SVO designation of 4-6 ~~RP4, RP5 or RP6 or P4, P5 or P6~~ at any time during the holding period should be reported as non-interest-related gains (losses) in the AVR.

However, for a convertible bond or redeemable preferred stock purchased while its conversion value exceeds its par value, any gain (loss) realized from its sale before conversion must be included in the Equity Component of the AVR. Conversion Value is defined to mean the number of shares available currently or at next conversion date multiplied by the stock's current market price.

Report all realized equity capital gains (losses), net of capital gains tax, in the appropriate sub-components.

The following guidance pertains to instruments in Scope of *SSAP No. 86—Derivatives*:

- For derivative instruments used in hedging transactions, the determination of whether the capital gains (losses) are allocable to the IMR or the AVR is based on how the underlying asset is treated. Realized gains (losses), net of capital gains tax, on portfolio or general hedging instruments should be included with the hedged asset. Gains (losses), net of capital gains tax, on hedges used, as specific hedges should be included only if the specific hedged asset is sold or disposed of.

- For income generation derivative transactions, the determination of whether the capital gains (losses) are allocable to the IMR or the AVR is based on how the underlying interest (for a put) or covering asset (for a call, cap or floor) is treated. Realized gains (losses), net of capital gains tax should be included in the same sub-component where the realized gains (losses) of the underlying interest (for a put) or covering asset (for a call, cap or floor) is reported. Refer to *SSAP No. 86—Derivatives* for accounting guidance.

Realized gains (losses), net of capital gains tax, resulting from the sale of U.S. government securities and the direct or guaranteed securities of agencies which are backed by the full faith and credit of the U.S. government are exempt from the AVR. This category is described in the Investment Schedules General Instructions.

**Staff Review Completed by:** Julie Gann - NAIC Staff, September 2023

**Status:**
On December 1, 2023, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a SAP clarification and exposed revisions, as illustrated above, to the annual statement instructions to remove the guidance that directs all preferred stock to be allocated between IMR/AVR based on NAIC designation, and clarify that perpetual preferred stock, which includes SVO-Identified Preferred Stock ETFs shall reported as equities through AVR.

On March 16, 2024, the Statutory Accounting Principles (E) Working Group adopted, as final, the proposed revisions to the annual statement instructions to remove the guidance that directs all preferred stock to be allocated between IMR/AVR based on NAIC designation, and clarify that perpetual preferred stock, which includes SVO-Identified Preferred Stock ETFs, as well as all mandatorily convertible preferred stock (regardless of redeemable or perpetual) shall reported through the AVR. The adopted revisions are shown below. (Revisions from the exposure pertain to inclusion of guidance for mandatorily convertible preferred stock.) The proposed revisions will be considered by the Blanks (E) Working Group for year-end 2024. This agenda item did not result in SAP revisions.

***Adopted Revisions:***
*Staff Note: Shaded guidance reflects sections with revisions discussed under agenda item 2023-15: IMR/AVR Specific Allocations. Agenda item 2023-15 should be reviewed for the adopted revisions to those sections. With the exception of the added 'redeemable' in the first shaded paragraph, all of the edits in this agenda item are in separate paragraphs from agenda item 2023-15.*

**<u>Interest Maintenance Reserve (IMR)</u>**

Line 2 – Current Year's Realized Pre-tax Capital Gains (Losses) of $______ Transferred into the Reserve Net of Taxes of $______

Include interest-rate-related realized capital gains (losses), net of capital gains tax thereon. All realized capital gains (losses) transferred to the IMR are net of capital gains taxes thereon. Exclude non-interest-related (default) realized capital gains and (losses), realized capital gains (losses) on equity investments, and unrealized capital gains (losses).

All realized capital gains (losses), due to interest rate changes on fixed income investments, net of related capital gains tax, should be captured in the IMR and amortized into income (Column 2, Lines 1 through 31) according to Table 1 or the seriatim method. Realized capital gains (losses) must be classified as either interest (IMR) or non-interest (AVR) related, not a combination except as specified in *SSAP No. 43R—Loan-Backed and Structured Securities*. Purchase lots with the same CUSIP are treated as individual assets for IMR and Asset Valuation Reserve (AVR) purposes.

Exclude those capital gains and (losses) that, in accordance with contract terms have been used to directly increase or (decrease) contract benefit payments or reserves during the reporting period. The purpose of this exclusion is to avoid the duplicate utilization of such gains and (losses).

Capital gains tax should be determined using the method developed by the company to allocate taxes used for statutory financial reporting purposes. By capturing the realized capital gains (losses) net of tax, the capital gains tax associated with those capital gains (losses) due to an interest rate change is charged or credited to the IMR and amortized in proportion to the before-tax amortization.

Include realized capital gains (losses) on:

Debt securities (excluding loan-backed and structured securities) and redeemable preferred stocks where the realized capital gains (losses) more predominantly reflect interest-related changes. By default, debt instruments whose National Association of Insurance Commissioners (NAIC)/Securities Valuation Office (SVO) designation at the end of the holding period, or within a reasonable amount of time after the reporting entity has sold/disposed of the instrument, are different from its NAIC designation at the beginning of the holding period by more than one NAIC designation or NAIC designation category shall not be considered to reflect interest-related changes. Gains (losses) from those debt instruments shall NOT be reported in the IMR and shall be reported in the AVR

Exchange Traded Funds (ETFs) as listed on the SVO Identified Bond ETF List (thereafter subject to bond IMR guidelines)~~ and the SVO Identified Preferred Stock ETF List (thereafter subject to preferred stock IMR guidelines)~~. ~~I~~include any capital gains (losses) realized by the Company, whether from sale of the ETF or capital gains distributions by the ETF. If the ETF is removed from either SVO ETF list, the ETF is reported and treated as common stock, with any capital gains/(losses) excluded from the IMR. (Mandatory convertible preferred stocks (regardless of if redeemable or perpetual) and investments on the SVO-Identified Preferred Stock List are captured as perpetual preferred stock and treated as equity investments, with gains and losses excluded from IMR.)

SVO Identified Funds designated for systematic value

Called bonds, tendered bonds, and sinking fund payments.

Mortgage loans where the realized gains (losses) more predominantly reflect interest-related changes. By default, mortgage loans that meet any of the following criteria shall not be considered to reflect interest-related losses. Realized gains (losses) from mortgage loans with these characteristics shall be reported in the AVR:

- Any mortgage loan sold/disposed with an established valuation allowance under SSAP No. 37, or
- Interest is more than 90 days past due, or
- The loan is in process of foreclosure, or
- The loan is in course of voluntary conveyance, or
- The terms of the loan have been restructured during the prior two years.

Additional Provisions for Including/Excluding Gains (Losses) from IMR:

Mortgage loan prepayment penalties are not included in IMR. Treat them as regular investment income.

Interest-related gains (losses) realized on directly held capital and surplus notes reported on Schedule BA should be transferred to the IMR in the same manner as similar gains and (losses) on fixed income assets held on Schedule D. A capital gain (loss) on such a note is classified as an interest rate gain if the note is eligible for amortized-value accounting at both the time of acquisition and the time of disposition.

Determination of IMR gain (loss) on multiple lots of the same securities should follow the underlying accounting treatment in determining the gain (loss). Thus, the designation, on a purchase lot basis, should be compared to the designation at the end of the holding period to determine IMR or AVR gain or (loss).

Realized capital gains (losses) on any debt security (excluding loan-backed and structured securities) that has had an NAIC/SVO designation of 6 at any time during the holding period should be excluded from the IMR and included as a non-interest-related gain (loss) in the AVR.

Realized capital gains (losses) on ~~any~~ redeemable preferred stock that had an NAIC/SVO designation of 4-6 ~~RP4, RP5 or RP6 or P4, P5 or P6~~ at any time during the holding period should be reported as non-interest-related gains (losses) in the AVR.

The holding period for debt securities (excluding loan-backed and structured securities) and redeemable preferred stocks is defined as the period from the date of purchase to the date of sale. For the end of period classification, the most recent available designation should be used. For bonds acquired before Jan. 1, 1991, the holding period is presumed to have begun on Dec. 31, 1990. For redeemable preferred stocks acquired before Jan. 1, 1993, the holding period is presumed to have begun on Dec. 31, 1992. For SVO Identified Bond ETFs, the holding period is defined as one calendar year to expected maturity. For SVO Identified Bond ETFs ~~Funds~~ designated for systematic value, the holding period is the weighted-average life of the underlying bonds.

In accordance with *SSAP No. 26R—Bonds*, securities with other-than-temporary impairment losses shall be recorded entirely to either AVR or IMR and not bifurcated between interest and non-interest components.

**Asset Valuation Reserve (AVR)**

Line 2 – Realized Capital Gains (Losses) Net of Taxes – General Account

Report all realized non-interest-related (default) and equity capital gains (losses) (which includes, but is not limited to, common stock, perpetual preferred stock, mandatory convertible preferred stocks (regardless of if redeemable or perpetual) and SVO-Identified Preferred Stock ETFs), net of capital gains tax, applicable to the assets in each component and sub-component. All realized capital gains (losses) transferred to the AVR are net of capital gains taxes thereon. Exclude all interest rate-related capital gains (losses) from the AVR.

Capital gains tax should be determined using the method developed by the company to allocate taxes used for statutory financial reporting purposes.

Report all realized capital gains (losses), net of capital gains tax, on each debt security (excluding loan-backed and structured securities) where the realized capital gains (losses) more predominantly reflect non-interest-related changes. By default, debt instruments whose NAIC/SVO designation at the end of the holding period, or within a reasonable amount of time after the reporting entity has sold/disposed of the instrument, is different from its NAIC/SVO designation at the beginning of the holding period by more than one NAIC designation or NAIC designation category shall be considered to reflect non-interest-related changes. Gains (losses) from those debt instruments shall be reported in the AVR.

Determination of AVR gain (loss) on multiple lots of the same fixed income securities should follow the underlying accounting treatment in determining gain (loss). Thus, the designation, on a purchase lot basis, should be compared to the designation at the end of the holding period to determine IMR or AVR gain or (loss).

In accordance with *SSAP No. 26R—Bonds*, securities with other-than-temporary impairment losses shall be recorded entirely to either AVR or IMR and not bifurcated between interest and non-interest components.

In accordance with *SSAP No. 43R—Loan-Backed and Structured Securities*, for loan-backed and structured securities only:

- Other-Than-Temporary Impairment – Non-interest-related other-than-temporary impairment losses shall be recorded through the AVR. If the reporting entity wrote the security down to fair value due to the intent to sell or does not have the intent and ability to retain the investment for a period of time sufficient to recover the amortized cost basis, the non-interest-related portion of the other-than-temporary impairment losses shall be recorded through the AVR; the interest related other-than-temporary impairment losses shall be recorded through the 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.

- 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. As such, an entity shall report the loss in separate AVR and IMR components as appropriate.

- 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.

- 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.

- 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.

In addition, all gains (losses), net of capital gains tax, on mortgage loans where the realized gains (losses) more predominantly reflect non-interest-related changes. By default, mortgage loans that meet any of the following criteria shall be considered to reflect non-interest-related changes and realized gains (losses) from mortgage loans with these characteristics shall be reported in the AVR:

- Any mortgage loan sold/disposed with an established valuation allowance under SSAP No. 37, or
- Interest is more than 90 days past due, or
- The loan is in the process of foreclosure, or
- The loan is in course of voluntary conveyance, or
- The terms of the loan have been restructured during the prior two years

The gain (loss), net of capital gains tax, on any debt security (excluding loan-backed and structured securities) that has had an NAIC/SVO designation of “6” at any time during the holding period should be reported as a credit related gain (loss).

All capital gains (losses), net of capital gains tax, from redeemable preferred stock that had an NAIC/SVO designation of 4-6 ~~RP4, RP5 or RP6 or P4, P5 or P6~~ at any time during the holding period should be reported as non-interest-related gains (losses) in the AVR.

However, for a convertible bond or redeemable preferred stock purchased while its conversion value exceeds its par value, any gain (loss) realized from its sale before conversion must be included in the Equity Component of the AVR. Conversion Value is defined to mean the number of shares available currently or at next conversion date multiplied by the stock's current market price.

Report all realized equity capital gains (losses), net of capital gains tax, in the appropriate sub-components.

The following guidance pertains to instruments in Scope of *SSAP No. 86—Derivatives*:

- For derivative instruments used in hedging transactions, the determination of whether the capital gains (losses) are allocable to the IMR or the AVR is based on how the underlying asset is treated. Realized gains (losses), net of capital gains tax, on portfolio or general hedging instruments should be included with the hedged asset. Gains (losses), net of capital gains tax, on hedges used, as specific hedges should be included only if the specific hedged asset is sold or disposed of.

- For income generation derivative transactions, the determination of whether the capital gains (losses) are allocable to the IMR or the AVR is based on how the underlying interest (for a put) or covering asset (for a call, cap or floor) is treated. Realized gains (losses), net of capital gains tax should be included in the same sub-component where the realized gains (losses) of the underlying interest (for a put) or covering asset (for a call, cap or floor) is reported. Refer to *SSAP No. 86—Derivatives* for accounting guidance.

Realized gains (losses), net of capital gains tax, resulting from the sale of U.S. government securities and the direct or guaranteed securities of agencies which are backed by the full faith and credit of the U.S. government are exempt from the AVR. This category is described in the Investment Schedules General Instructions.



 

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

**Issue: Admissibility Requirements of Investments in Downstream Holding Companies**

**Check (applicable entity):**

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

**Description of Issue:** This agenda item is the result of regulator comments received on the existing guidance in *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*, paragraph 24, and is intended to update the language in paragraph 24 on audits and admissibility to better align with guidance in paragraphs 26 and 27 on the look-through methodology. The current SSAP No. 97, paragraph 24 guidance states "if the downstream noninsurance holding company does not meet the requirements of paragraph 26, **audited GAAP financial statements, as described in paragraph 23, are required for the downstream noninsurance holding company and its SCA and non-SCA investments** in order for the investment in the downstream noninsurance holding company to be classified as an admitted asset."

The issue with the existing paragraph 24 guidance is that as it summarizes other guidance it could be perceived as contradicting guidance provided in paragraph 27 related to the "look through" process. This process allows admitting audited investments in entities owned by an **unaudited downstream noninsurance holding company** SCA entity.

**Existing Authoritative Literature:**

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

**Admissibility Requirements of Investments in Downstream Holding Companies**

23. To meet the admissibility requirements of this statement, unless the limited exception to the audited financial statements requirement discussed in paragraphs 26 and 27 applies, an annual audit of the financial statements of SCA entities, including the downstream holding company valued under paragraphs 8.b.i through 8.b.iv. must be obtained. The requirement for audited financial statements may be met by utilizing any one of the following methods:

a. Audited US GAAP financial statements of the downstream SCA holding company. (Consolidated or combined financial statements are allowed encompassing one or more downstream holding companies, including such holding companies that directly own U.S. insurance entities, provided that the statutory financial statements of such U.S. insurance entities are audited. Annual consolidated or combined audits are allowed for insurance entities if completed in accordance with the Model Regulation Requiring Annual Audited Reports as adopted by the SCA's domiciliary state.) The audited financial statements of the downstream holding company shall include as other financial information, consolidating or combining balance sheet schedule(s) showing the equity of all relevant SCA entities and non-SCA SSAP No. 48 entities, and any required intercompany eliminations. The consolidating or combining balance sheet schedule shall separately present those entities owned directly by the downstream holding company. The consolidating or combining balance sheet shall then be adjusted for GAAP to SAP differences for paragraph 8.b.i., 8.b.ii. and 8.b.iv. entities owned directly or indirectly by the downstream holding company. The adjusted amount would then be the reported value of the investment in the downstream holding company at the higher-level reporting entity; or

b. Audited foreign GAAP-basis financial statements of the downstream SCA holding company. (Consolidated or combined financial statements are allowed encompassing one or more downstream holding companies, including such holding companies that directly own U.S. insurance entities, provided that the statutory financial statements of such U.S. insurance entities are audited. Annual consolidated or combined audits are allowed for insurance entities if completed in accordance with the Model Regulation Requiring Annual Audited Reports as adopted by the SCA's domiciliary state.) The audited foreign GAAP basis financial statements shall include an audited footnote disclosure within the financial statements that reconciles each consolidated entity's net income and equity on a foreign basis of accounting to a U.S. GAAP basis. The audited financial statements of the downstream holding company shall include as other financial information, consolidating or combining balance sheet schedule(s) showing the equity of all relevant SCA entities non-SCA SSAP No. 48 entities, and any required intercompany eliminations. The consolidating or combining balance sheet schedule shall separately present those entities owned directly by the downstream holding company. The consolidating or combining balance sheet shall then be adjusted for GAAP to SAP differences of the insurance entities and paragraph 8.b.ii. and paragraph 8.b.iv. entities owned directly or indirectly by the downstream holding company. The adjusted amount would then be the reported value of the investment in the downstream holding company at the higher-level reporting entity; or

c. Individual audits of the downstream holding company and the downstream holding company's investments in individual SCA entities.

**24. If the downstream noninsurance holding company does not meet the requirements of paragraph 26, audited GAAP financial statements, as described in paragraph 23, are required for the downstream noninsurance holding company and its SCA and non-SCA investments in order for the investment in the downstream noninsurance holding company to be classified as an admitted asset.**

25. A purchased downstream holding company is valued in accordance with the provisions of paragraphs 22-25 and the provisions of SSAP No. 68.

**Limited Exceptions to the Audit Requirements for Downstream Noninsurance Holding Companies**

26. This statement requires that investments in SCA entities be recorded using one of the valuation methods described in paragraph 8 in order to be admitted assets. Each of the paragraph 8.b. valuation methods require the financial statements of SCA entities, including downstream noninsurance holding companies, to be audited in order for the investments in SCA entities to be admitted assets. Likewise, SSAP No. 48 requires the financial statements of joint ventures, partnerships, and/or limited liability companies in which the downstream noninsurance holding company has a minor ownership interest or otherwise lacks control, i.e., ownership interest is less than 10% to be audited (U.S. GAAP) in order to be admitted assets. **There is a limited exception to the requirement to have audited financial statements of a downstream noninsurance holding company, provided that the entities owned by the downstream noninsurance holding company (paragraph 8.b.iii. entity) have audited financial statements as described in paragraphs 26 and 27.**

27. The process of admitting audited investments in entities owned by an unaudited downstream noninsurance holding company SCA entity will be known as a "look through." In order to admit the investments in audited SCAs or the audited non-SCA SSAP No. 48 entities owned by an unaudited downstream noninsurance holding company, a reporting entity may apply the look through approach, provided all of the following conditions are met:

a. The downstream noninsurance holding company is an 8.b.iii entity, and

b. The downstream noninsurance holding company does not own any other assets which are material to the downstream holding company other than the audited SCA entities and/or audited non-SCA SSAP No. 48 entities, and

d. The downstream noninsurance holding company is not subject to liabilities, commitments, contingencies, guarantees or obligations which are material to the downstream noninsurance holding company.

If an investment in a downstream noninsurance holding company meets the requirements set forth above, the reporting entity can admit the individual audited SCA entities and/or audited non-SCA SSAP No. 48 entities; however, unaudited immaterial assets of the downstream noninsurance holding company are to be carried at the lesser of the paragraph 8 valuation or nonadmitted (e.g. some equity method investments are required to be carried at a negative value due to either statutory adjustments or to parental obligations to keep funding the subsidiary). If a holding company structure has more than one downstream non-insurance holding company, each downstream non-insurance holding company may be looked through, provided each downstream non-insurance holding company meets all of the conditions in paragraph 27.

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

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

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

**Staff Recommendation: NAIC staff recommends that the Working Group move this item to the active listing, categorized as a SAP clarification, and expose revisions to *SSAP No. 97—Subsidiary, Controlled and Affiliated Entities* to revise paragraph 24 language to better align it with the existing guidance provided in paragraphs 26 and 27.**

**Proposed edits to SSAP No. 97:**

24. If the downstream noninsurance holding company does not meet the requirements of paragraph 26, audited GAAP financial statements, as described in paragraph 23, are required~~. for the downstream noninsurance holding company and its SCA and non-SCA investments~~ in order for the investment in the downstream noninsurance holding company <u>or individual SCAs</u> to be classified as an admitted asset.

**Staff Review Completed by:** Jason Farr– NAIC Staff, November 2023

**Status:**
On December 1, 2023, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a SAP clarification, and exposed consistency revisions to *SSAP No. 97—Subsidiary, Controlled and Affiliated Entities* to revise paragraph 24 language to better align it with the existing guidance provided in paragraphs 26 and 27.

On March 16, 2024, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed revisions to SSAP No. 97, paragraph 24 with modification to remove the previously exposed revision "or individual SCAs" language as suggested by interested parties as not necessary. The adopted revisions better align it with the existing guidance provided in paragraphs 26 and 27.

**Adopted edits to SSAP No. 97:**

24. If the downstream noninsurance holding company does not meet the requirements of paragraph 26, audited GAAP financial statements, as described in paragraph 23, are required~~. for the downstream~~

~~noninsurance holding company and its SCA and non-SCA investments~~ in order for the investment in the downstream noninsurance holding company to be classified as an admitted asset.



 

**Revisions to the**
***As of March 2024 Accounting Practices and Procedures Manual***

On **May 15, 2024**, the Statutory Accounting Principles (E) Working Group adopted the following revisions to the *As of March 2024 Accounting Practices and Procedures Manual*. Documents associated with these revisions are linked to the reference items in bold text.

| Ref # | SSAP/ Appendix | Title | Summary |
|---|---|---|---|
| **2023-16** | Schedule BA | Schedule BA Categories<br><br>*SAP Clarification*<br><br>No SSAP revisions | Adopted agenda item summarizing key revisions in the modified blanks proposal 2023-12BWG sponsored by the SAPWG, which is proposed to be effective January 1, 2025. This agenda item did not result in any SSAP revisions. |
| **2024-13** | SSAP No. 107 | Update SSAP No. 107 Disclosures<br><br>*SAP Clarification*<br><br>Effective Year End 2024 | Adopted revisions to SSAP No. 107 remove the transitional reinsurance program disclosures and the risk corridor disclosures as both programs have expired. In addition, the roll-forward illustration in Exhibit B was revised to remove the portion for the transitional reinsurance program and the risk corridors program. |

https://naiconline.sharepoint.com/teams/frsstatutoryaccounting/national meetings/a. national meeting materials/2024/05-15-24/adoptions/00 - adoptions toc.docx

**Statutory Accounting Principles (E) Working Group**
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**Issue: Schedule BA Reporting Categories**

**Check (applicable entity):**

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

**Description of Issue**: This agenda item has been developed to incorporate more detailed definitions for the annual statement reporting categories of *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies* (SSAP No. 48) and residual interests on Schedule BA: Other Long-Term Invested Assets. These investments are reported on designated lines divided by the reporting entity's classification as to the underlying asset characteristics:

- Bonds/Fixed-Income Instruments*
- Common Stocks
- Real Estate
- Mortgage Loans
- Other

** Bond /fixed-income instruments reported in scope of SSAP No. 48 as non-registered private funds, joint ventures, partnerships, or limited liability companies is divided between investments that have an NAIC designation assigned by the SVO and those that do not have an NAIC designation assigned by the SVO.*

The recent residual discussions have further identified that variations exist across industry on the types of investments that should be captured within each category. It has also been noted that the Annual Statement Instructions are limited with guidance and examples for determining reporting classification.

This agenda item has been drafted to propose revisions to the reporting category descriptions in the Annual Statement Instructions to improve consistency in reporting for both ease of industry classifications and for regulator assessment of the type and volume of investment types. The proposed revisions from the Statutory Accounting Principles (E) Working Group will be used to sponsor a blanks annual statement instruction change. The revisions within this agenda item will not result in statutory accounting revisions.

**Existing Authoritative Literature:**
**A/S Instructions – Life, Accident and Health/Fraternal Companies**

***Reporting Categories on Schedule BA:***

Non-Registered Private Funds with Underlying Assets Having Characteristics of:
Bonds
NAIC Designation Assigned by the Securities Valuation Office (SVO)
Unaffiliated....................................................................................................0799999
Affiliated........................................................................................................0899999
NAIC Designation Not Assigned by the Securities Valuation Office (SVO)
Unaffiliated....................................................................................................0999999
Affiliated........................................................................................................1099999
Mortgage Loans
Unaffiliated....................................................................................................1199999

Affiliated ........ 1299999

Other Fixed Income Instruments

Unaffiliated ........ 1399999
Affiliated ........ 1499999

Joint Venture, Partnership or Limited Liability Company Interests with Underlying Assets Having the Characteristics of:

Fixed Income Instruments

NAIC Designation Assigned by the Securities Valuation Office (SVO)

Unaffiliated ........ 1599999
Affiliated ........ 1699999

NAIC Designation Not Assigned by the Securities Valuation Office (SVO)

Unaffiliated ........ 1799999
Affiliated ........ 1899999

Common Stocks

Unaffiliated ........ 1999999
Affiliated ........ 2099999

Real Estate

Unaffiliated ........ 2199999
Affiliated ........ 2299999

Mortgage Loans

Unaffiliated ........ 2399999
Affiliated ........ 2499999

Other

Unaffiliated ........ 2599999
Affiliated ........ 2699999

Residual Tranches or Interests with Underlying Assets Having Characteristics of:

Fixed Income Instruments

Unaffiliated ........ 4699999
Affiliated ........ 4799999

Common Stock

Unaffiliated ........ 4899999
Affiliated ........ 4999999

Preferred Stock

Unaffiliated ........ 5099999
Affiliated ........ 5199999

Real Estate

Unaffiliated ........ 5299999
Affiliated ........ 5399999

Mortgage Loans

Unaffiliated ........ 5499999
Affiliated ........ 5599999

Other

Unaffiliated ........ 5699999
Affiliated ........ 5799999

***Schedule BA Classification Instructions/Guidance:***

**<u>Non-Registered Private Funds with Underlying Assets Having Characteristics of a Bond, Mortgage Loan or Other Fixed Income Instrument</u>**

Include: Fixed income instruments that are not corporate or governmental unit obligations (Schedule D) or secured by real property (Schedule B).

Any investments deemed by the reporting entity to possess the underlying characteristics of a bond or other fixed income instrument that has been assigned an NAIC designation by the Securities Valuation Office (SVO) pursuant to the policies in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* for this category. Report these investments on Lines 0799999 and 0899999.

Any investments deemed by the reporting entity to possess the underlying characteristics of a bond or other fixed income investment that has not been assigned an NAIC designation by the Securities Valuation Office (SVO) pursuant to the policies in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* for this category. Report these investments on Lines 0999999, 1099999, 1199999, 1299999, 1399999 and 1499999.

**<u>Joint Ventures, Partnership or Limited Liability Company Interests with Underlying Assets Having the Characteristics:</u>**

**<u>Fixed Income Instruments</u>**

Include: Leveraged Buy-out Fund.

A fund investing in the "Z" strip of Collateralized Mortgage Obligations.

Any investments deemed by the reporting entity to possess the underlying characteristics of fixed income instruments that has been assigned an NAIC designation by the Securities Valuation Office (SVO) pursuant to the policies in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* for this category. Report these investments on Lines 1599999 and 1699999.

Any investments deemed by the reporting entity to possess the underlying characteristics of fixed income instruments that has not been assigned an NAIC designation by the Securities Valuation Office (SVO) pursuant to the policies in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* for this category. Report these investments on Lines 1799999 and 1899999.

**<u>Common Stocks</u>**

Include: Venture Capital Funds.

**<u>Real Estate</u>**

Include: Real estate development interest. Reporting should be consistent with the detailed property analysis appropriate for the corresponding risk-based capital factor for this investment category. If the requisite details are not available for reporting, report under "Other" subcategory.

**<u>Mortgage Loans</u>**

Include: Mortgage obligations. Reporting should be consistent with the detailed property analysis appropriate for the corresponding risk-based capital factor for this investment category. If the requisite details are not available for reporting, report under "Other" subcategory.

 

**<u>Other</u>**

Include: Limited partnership interests in oil and gas production.

Forest product partnerships.

Investments within the Joint Venture and Partnership Interests category that do not qualify for inclusion in the "Fixed Income Instruments," "Common Stocks," "Real Estate" or "Mortgage Loans" subcategories.

Reporting should be consistent with the corresponding risk-based capital factor for this investment category (i.e., Other Long-Term Assets).

**<u>Residual Tranches or Interests with Underlying Assets Having Characteristics of:</u>**

Investment in Residual Tranches or Interests should be assigned to the subcategory with the highest underlying asset concentration. There shouldn't be any bifurcation of the underlying assets among the subcategories.

Include: Residual tranches or interests captures securitization tranches and beneficial interests as well as other structures captured in scope of *SSAP No. 43R – Loan-Backed and Structured Securities*, that reflect loss layers without any contractual payments, whether interest or principal, 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. See SSAP No. 43R for accounting guidance.

**<u>Fixed Income Instruments</u>**

Include: Investments with underlying collateral which, if held individually, would be reported on *Schedule D – Part 1 – Long-Term Bonds*

**<u>Common Stocks</u>**

Include: Investments with underlying collateral which, if held individually, would be reported on *Schedule D – Part 2 – Section 2 – Common Stocks*

**<u>Preferred Stocks</u>**

Include: Investments with underlying collateral which, if held individually, would be reported on *Schedule D – Part 2 – Section 1 – Preferred Stocks*

**<u>Real Estate</u>**

Include: Investments with underlying collateral which, if held individually, would be reported on *Schedule A – Real Estate Owned*

**<u>Mortgage Loans</u>**

Include: Investments with underlying collateral which, if held individually, would be reported on *Schedule B – Mortgage Loans*

**<u>Other</u>**

Include: Items that do not qualify for inclusion in the above subcategories.

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

- Bond Project: Under the principle-based bond definition project, revisions are proposed to combine the non-registered provide funds within the reporting category for joint ventures, partnerships and limited liability companies as those items would also be in scope of SSAP No. 48. With that change the category of "fixed income instruments" would be retained.

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

**Convergence with International Financial Reporting Standards (IFRS):** NA

**Recommendation:**
**NAIC staff recommend that the Working Group include this item on their maintenance agenda as a SAP clarification/potential blanks reporting change and expose this agenda item with a request for industry and regulator feedback to further define and provide examples for the investments captured as non-registered private funds, joint ventures, partnerships or limited liability companies, or residual interests and reported based on the underlying characteristics of assets. Specifically, comments are requested on what should be captured as investments with underlying asset characteristics of:**

- Fixed-Income Instruments
- Common Stocks
- Real Estate
- Mortgage Loans
- Other

As detailed in the current A/S instructions, descriptions are included for non-registered private funds, joint ventures, partnerships, and limited liability companies, whereas references to the SSAP the underlying assets would be captured in are included for residual interests.

This agenda item is only intended to improve the annual statement instructions and examples for the allocation of investments based on the above underlying characteristics of assets. If needed, and preferred by the Working Group, this agenda item could be expanded to propose new reporting lines (structural changes) to Schedule BA. As noted within 'Activity to Date,' revisions are currently being considered to combine and rearrange broad reporting lines under the bond project. Those revisions currently do not expand on the instructions for reporting based on underlying characteristics of assets. The proposed revisions from the Statutory Accounting Principles (E) Working Group will be used to sponsor a blanks annual statement instruction change. The revisions within this agenda item will not result in actual statutory accounting revisions.

**Staff Review Completed by:** Julie Gann - NAIC Staff, May 2023

**Status:**
On August 13, 2023, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a SAP clarification and exposed this agenda item to further define for consistency purposes the investments captured as non-registered private funds, joint ventures, partnerships or limited liability companies, or residual interests and reported based on the underlying characteristics of assets.

On December 1, 2023, the Statutory Accounting Principles (E) Working Group exposed additional revisions, as detailed below, to further define the investments captured on Schedule BA along with the continued proposed to combine non-registered private funds within the proposed reporting lines for joint ventures, partnerships, or limited liability companies. The Working Group also requested additional regulator and industry feedback on whether more specificity is needed since the existing Schedule BA descriptions are fairly broad.

**Proposed Interested Parties' Edits to the Schedule BA Instructions from Separate Attachment:**

**Non-Registered Private Funds with Underlying Assets Having Characteristics of a Bond, Mortgage Loan or Other Fixed Income Instrument**

Include: Fixed income instruments that are not corporate or governmental unit obligations (Schedule D) or secured by real property (Schedule B).

Any investments deemed by the reporting entity to possess the underlying characteristics of a bond or other fixed income instrument that has been assigned an NAIC designation by the Securities Valuation Office (SVO) pursuant to the policies in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* for this category. Report these investments on Lines 0799999 and 0899999.

Any investments deemed by the reporting entity to possess the underlying characteristics of a bond or other fixed income investment that has not been assigned an NAIC designation by the Securities Valuation Office (SVO) pursuant to the policies in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* for this category. Report these investments on Lines 0999999, 1099999, 1199999, 1299999, 1399999 and 1499999.

**Joint Ventures, Partnership or Limited Liability Company Interests with Underlying Assets Having the Characteristics:**

**Fixed Income Instruments**

Include: Investments with underlying collateral which include contractual principal and/or interest payments, excluding mortgage loans~~Leveraged Buy-out Fund~~.

~~A fund investing in the "Z" strip of Collateralized Mortgage Obligations.~~

Any investments deemed by the reporting entity to possess the underlying characteristics of fixed income instruments that has been assigned an NAIC designation by the Securities Valuation Office (SVO) pursuant to the policies in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* for this category. Report these investments on Lines 1599999 and 1699999.

Any investments deemed by the reporting entity to possess the underlying characteristics of fixed income instruments that has not been assigned an NAIC designation by the Securities Valuation Office (SVO) pursuant to the policies in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* for this category. Report these investments on Lines 1799999 and 1899999.

**Common Stocks**

Include: Venture Capital Funds or other underlying equity investments.

**Real Estate**

Include: Real estate development interest. Reporting should be consistent with the detailed property analysis appropriate for the corresponding risk-based capital factor for this investment category. If the requisite details are not available for reporting, report under "Other" subcategory.

**Mortgage Loans**

Include: Mortgage obligations. Reporting should be consistent with the detailed property analysis appropriate for the corresponding risk-based capital factor for this investment category. If the requisite details are not available for reporting, report under “Other” subcategory.

**Other**

Include: Limited partnership interests in oil and gas production.

Forest product partnerships.

Investments within the Joint Venture and Partnership Interests category that do not qualify for inclusion in the “Fixed Income Instruments,” “Common Stocks,” “Real Estate” or “Mortgage Loans” subcategories.

~~Reporting should be consistent with the corresponding risk-based capital factor for this investment category (i.e., Other Long-Term Assets).~~

**Residual Tranches or Interests with Underlying Assets Having Characteristics of:**

Investment in Residual Tranches or Interests should be assigned to the subcategory with the highest underlying asset concentration. There shouldn’t be any bifurcation of the underlying assets among the subcategories.

Include: Residual tranches or interests from securitization tranches and beneficial interests as well as other structures captured in scope of *SSAP No. 43R – Loan-Backed and Structured Securities* Investments in joint ventures, partnerships and limited liability companies captured in scope of *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies* that represent residual interests or that predominantly hold residual interests.

This category shall also include residual interests or residual security tranches within investment structures that are not captured in scope of SSAP No. 43R or SSAP No. 48 but that reflect, in substance, residual interests or residual security tranches.

**Fixed Income Instruments**

Include: Investments with underlying collateral which include contractual principal and/or interest payments, excluding mortgage loans~~, if held individually, would be reported on *Schedule D – Part 1 – Long-Term Bonds*~~.

**Common Stocks**

Include: Investments with underlying collateral which are securities that represent a subordinate equity ownership.~~, if held individually, would be reported on *Schedule D – Part 2 – Section 2 – Common Stocks*~~

**Preferred Stocks**

Include: Investments with underlying collateral which is a security that represents ownership of a corporation and gives the holder a claim prior to the claim of common stockholders on earnings and also generally on assets in the event of liquidation.~~, if held individually, would be reported on *Schedule D – Part 2 – Section 1 – Preferred Stocks*~~

**Real Estate**

Include: Investments with underlying collateral which is defined as directly-owned real estate properties and single real estate property investments that are directly and wholly-owned through a limited liability company~~,~~. ~~if held individually, would be reported on *Schedule A – Real Estate Owned*~~

**Mortgage Loans**

Include: Investments with underlying collateral which is secured by a mortgage on real estate.~~, if held individually, would be reported on *Schedule B – Mortgage Loans*~~

**Other**

Include: Items that do not qualify for inclusion in the above subcategories.

On February 20, 2024, the Statutory Accounting Principles (E) Working Group reviewed the comments received on this item as well as comments received on the exposed blanks proposal 2023-12BWG. After the discussion, the Working Group exposed this agenda item and directed a modified SAPWG-sponsored blanks proposal (2023-12BWG) to recommend for exposure during the February 21, 2024, Banks (E) Working Group conference call. (This agenda item does not propose any SSAP revisions.)

The following key modifications are reflected in the modified Schedule BA blanks proposal and for documentation within this agenda item:

1) Schedule BA has a clear statement that all investments shall be reported in the dedicated reporting line. Investments that do not fit within any specific reporting line shall be captured as an "Any Other Class of Asset."

2) The Schedule BA reporting category for investments in "Joint Ventures, Partnerships and Limited Liability Companies" has been clarified to identify that investments captured within this reporting category shall be in scope of SSAP No. 48. With this clarification, the revisions proposed by industry to clarify the "underlying characteristics of bonds" subcategory to include "collateral that has contractual principal and/or interest payments, excluding mortgage loans," as well as the other proposed industry descriptions for other subcategories, has been retained. One exception to the SSAP No. 48 restriction has been included to reference structured settlement payment rights in scope of *SSAP No. 21R—Other Admitted Assets* that have an SVO-Assigned designation. This inclusion is consistent with the guidance in SSAP No. 21R. The Schedule BA blanks proposal maintains the recommendation to eliminate the "non-registered private fund" reporting category as those items shall be reported in the "joint ventures, partnerships and limited liabilities companies" reporting category if in scope of SSAP No. 48.

3) The Schedule BA reporting category for residuals has been modified to refer to SSAP No. 21R for the residual definition, pursuant to agenda item 2019-21. As such, the proposed revisions offered by industry in their January 22, 2024, comment letter have not been reflected. Beginning Jan. 1, 2025, all residuals shall be captured in scope of SSAP No. 21R, regardless of the investment form.

On May 15, 2024, the Statutory Accounting Principles (E) Working Group reviewed the comments received on this item as well as comments received on the exposed blanks proposal 2023-12BWG, which is proposed to be effective on January 1, 2025. After the discussion, the Working Group adopted this agenda item, resulting in no SSAP revisions, the adoption is to communicate support for the adoption of 2023-12BWG with the following three additional modifications to the blanks proposal:

1) Rename "Fixed Income Instruments" to "Bonds":

Residual Tranches or Interests with Underlying Assets Having Characteristics of:
Investment in Residual Tranches or Interests should be assigned to the subcategory with the highest underlying asset concentration. There should not be any bifurcation of the underlying assets among the subcategories.

Include: Residual tranches or interests captured in scope of *SSAP No. 21R – Other Admitted Assets.* The scope of SSAP No. 21R includes all in-substance residuals regardless of the investment form. Therefore, this category shall include investments that reflect in-substance residuals in the form of 1) an investment in a securitization tranche or beneficial interest, 2) an investment in a joint venture, partnership or limited liability company, 3) an investment in preferred stock 4) an investment in common stock, or 5) any other investment structure.

**~~Fixed Income Instruments~~Bonds**

Include: Investments with underlying collateral which, if held individually, would be reported as issuer credit obligations on *Schedule D – Part 1 – ~~Long-Term Bonds~~Section 1,* or as asset-backed securities on *Schedule D – Part 1 – Section 2.* Residual tranches from collateralized loan obligations (CLOs) shall be captured within this reporting line.

Other

Include: Items that do not qualify for inclusion in the above subcategories. Examples include, but are not limited to, residual tranches from investments with underlying assets of student loans, auto loans, aircraft leases or train car leases.

2) Clarify Guidance for Schedule BA, Column 26 – Maturity Date

Column 26 – Maturity Date

The maturity date shall be reported for all investments on Schedule BA that have a stated maturity date. This is anticipated to include, but not be limited to, all investments captured as non-bond debt securities, surplus notes, capital notes, collateral loans, non-collateral loans, and investments in tax credits. However, this list should not be considered all-inclusive for investments captured on other reporting lines with stated maturity dates.

~~Use only for securities included in the following subtotal lines.~~

~~State the date the mortgage loan matures.~~

3) Correct Joint Venture, Partnerships and LLCs Reporting Line. (Change from exposure is shaded.)

**As Exposed:** Interests in Joint Ventures, Partnerships or Limited Liability ~~Company~~ Companies (Including Non-Registered Private Funds) ~~Interests with Underlying Assets Having the Characteristics of~~:

**With Correction:** Interests in Joint Ventures, Partnerships or Limited Liability ~~Company~~ Companies (Including Non-Registered Private Funds) ~~Interests~~ with Underlying Assets Having the Characteristics of:



 

**Statutory Accounting Principles (E) Working Group**
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**Issue: Update SSAP No. 107 Disclosures**

**Check (applicable entity):**

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

**Description of Issue:**
This agenda item recommends updates to disclosure requirements in *Statement of Statutory Accounting Principles No. 107—Risk-Sharing Provisions of the Affordable Care Act* to remove disclosures related to transitional reinsurance and for the risk corridors programs which have expired.

In December 2014, the NAIC Statutory Accounting Principles (E) Working Group (SAPWG) issued SSAP No. 107 to provide accounting and disclosure guidance for the three risk-sharing provision programs of the Affordable Care Act (the "3Rs programs"). SSAP No. 107 covers the three risk sharing programs that were initially part of the Affordable Care Act, a permanent risk adjustment program, a transitional reinsurance program, and a temporary risk corridors program. Since that time, the 3Rs programs have changed significantly. Most notably, the temporary transitional reinsurance and risk corridors programs terminated at the end of 2016.

SSAP No. 107 introduced significant financial statement disclosure requirements for the 3Rs programs. The disclosures are required by SSAP No. 107, paragraphs 60-62. Exhibit B of SSAP No. 107 illustrates the roll-forward disclosure required by paragraph 61. These disclosure requirements are currently satisfied through detailed data tables included in Footnote 24E of the quarterly and annual financial statements.

Despite the passage of time and the termination of two of the 3Rs programs, the disclosure requirements outlined in SSAP No. 107 and the disclosure instructions for footnote 24E have not been updated or modified since inception. As a result, companies originally subject to the 3Rs programs are still required by SSAP No. 107 to include several tables in Footnote 24E, even though the majority of the information disclosed is either zero or blank because two of the programs were terminated several years ago. This agenda item proposal removal of the disclosures for the expired programs and also removal of the related roll-forward illustration in Exhibit B of SSAP No. 107 for the expired programs.

**Existing Authoritative Literature:**

*SSAP No. 107—Risk-Sharing Provisions of the Affordable Care Act*
**Disclosures**

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

a. ACA Permanent Risk Adjustment Program

 

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

ii. Risk adjustment user fees payable for ACA Risk Adjustment

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

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

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

b. ACA Transitional Reinsurance Program

i. Amounts recoverable for claims paid due to ACA Reinsurance

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

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

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

v. Ceded reinsurance premiums payable due to ACA Reinsurance

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

vii. Ceded reinsurance premiums due to ACA Reinsurance

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

ix. ACA Reinsurance Contributions – not reported as ceded premium

c. ACA Temporary Risk Corridors Program

i. Accrued retrospective premium due from ACA Risk Corridors

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

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

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

61. In addition, beginning in annual 2014 and both quarterly and annual thereafter, a roll forward of prior year ACA risk-sharing provisions specified asset and liability balances shall be disclosed in the annual statutory Notes to Financial Statements, as illustrated in Exhibit B. Note for the roll-forward illustration, assets shall be reflected gross of any nonadmission. The reasons for adjustments to prior year balances (i.e. federal audits, revised participant counts, information which impacted risk score projections, etc.) shall also be disclosed. For year-end 2014, all columns and rows are expected to be zero since 2014 is the first year that a receivable or liability will be recorded. For reporting periods on or after March 31, 2016, the risk corridors roll forward is amended to require disclosure of the risk corridors asset and liability balances and subsequent adjustments by program benefit year. The beginning receivable or payable in the roll forward will reflect the prior year-end balance for the specified benefit.

62. For reporting periods ending on or after March 31, 2016, for both quarterly and annual reporting, the following information is required for risk corridors balances by program benefit year:

a. Estimated amount to be filed or final amounts filed with federal agency

b. Amounts impaired or amounts not accrued for other reasons (not withstanding collectability concerns)

c. Amounts received from federal agency

d. Asset balance gross of nonadmission

e. Nonadmitted amounts

f. Net admitted assets

Exhibit B of SSAP No. 107 illustrates the roll forward required by the SSAP No. 107. paragraph 61 of the disclosures.

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

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

**Convergence with International Financial Reporting Standards (IFRS):Not Applicable**

**Sponsor Recommendation**
We are respectfully requesting SAPWG to re-evaluate and amend the disclosure requirements of SSAP No. 107 and request BWG to update the quarterly and annual financial statement instructions for Footnote 24E to eliminate certain tables, or portions of tables, that are no longer applicable. Specifically, we are requesting elimination of the portions of each table related to the transitional reinsurance and risk corridors programs that are no longer valid.

Sherry Gillespie, Senior Director - Regulatory Finance
UnitedHealthcare
2884 School Ln, Green Bay, WI 54313
February 1, 2024

**Staff Recommendation:**
**NAIC staff recommends that the Working Group move this item to the active listing, categorized as a SAP clarification, and expose revisions to *SSAP No. 107—Risk-Sharing Provisions of the Affordable Care Act* as illustrated below. The revisions will remove the transitional reinsurance program disclosures and the risk corridor disclosures as both programs have expired. In addition, the roll-forward illustration in Exhibit B is also proposed to be updated to remove the portion for the transitional reinsurance program and the risk corridors program. NAIC staff recommends that the Working Group direct a Blanks proposal, allowing for concurrent consideration, to allow for the disclosures to be removed beginning with the year-end 2024 financial statements.**

**NAIC staff is aware that some states have federal waivers to operate reinsurance programs, but not all of the federal reinsurance waivers operate the same as the original transition program. To the extent the Working Group decides that new disclosures are needed for these reinsurance waiver programs, a future disclosure can be developed separately.**

**Staff Review Completed by:** Robin Marcotte - NAIC Staff

**Status:**
On March 16, 2024, the Statutory Accounting Principles (E) Working Group exposed revisions to *SSAP No. 107—Risk-Sharing Provisions of the Affordable Care Act* which would remove the transitional reinsurance program disclosures and the risk corridor disclosures as both programs have expired. In addition, the roll-forward illustration in Exhibit B is also proposed to be updated to remove the portion for the transitional reinsurance program and the risk corridors program. The Working Group also directed NAIC staff to prepare a Blanks proposal, allowing for concurrent consideration, to allow for the disclosures to be removed beginning with the year-end 2024 financial statements.

**Proposed Revisions:**
***SSAP No. 107—Risk-Sharing Provisions of the Affordable Care Act Disclosures***

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

a. ACA Permanent Risk Adjustment Program

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

ii. Risk adjustment user fees payable for ACA Risk Adjustment

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

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

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

~~b. ACA Transitional Reinsurance Program~~

~~i. Amounts recoverable for claims paid due to ACA Reinsurance~~

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

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

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

~~v. Ceded reinsurance premiums payable due to ACA Reinsurance~~

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

~~vii. Ceded reinsurance premiums due to ACA Reinsurance~~

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

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

~~c. ACA Temporary Risk Corridors Program~~

~~i. Accrued retrospective premium due from ACA Risk Corridors~~

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

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

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

61. In addition, beginning in annual 2014 and both quarterly and annual thereafter, a roll forward of prior year ACA risk-sharing provisions for the risk adjustment program specified asset and liability balances shall be disclosed in the annual statutory Notes to Financial Statements, as illustrated in Exhibit B. Note for the roll-forward illustration, assets shall be reflected gross of any nonadmission. The reasons for adjustments to prior year balances (i.e. federal audits, revised participant counts, information which impacted risk score projections, etc.) shall also be disclosed. ~~For year-end 2014, all columns and rows are expected to be zero since 2014 is the first year that a receivable or liability will be recorded. For reporting periods on or after March 31, 2016, the risk corridors roll forward is amended to require disclosure of the risk corridors asset and liability balances and subsequent adjustments by program benefit year.~~ The beginning receivable or payable in the roll forward will reflect the prior year-end balance for the specified benefit.

62. For reporting periods ending on or after March 31, 2016, for both quarterly and annual reporting, the following information is required for risk ~~corridors~~ adjustment balances by program benefit year:

a. Estimated amount to be filed or final amounts filed with federal agency

b. Amounts impaired or amounts not accrued for other reasons (not withstanding collectability concerns)

c. Amounts received from federal agency

d. Asset balance gross of nonadmission

e. Nonadmitted amounts

f. Net admitted assets

## EXHIBIT B – ACA RISK-SHARING PROVISIONS ROLL-FORWARD ILLUSTRATION

Receivables are reflected gross of any nonadmission for this illustration.

| | Accrued During the Prior Year on Business Written Before December 31 of the Prior Year | | Received or Paid as of the Current Year on Business Written Before December 31 of the Prior Year | | Differences | | Adjustments | | | Unsettled Balances as of the Reporting Date | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | Prior Year Accrued Less Payments (Col 1 – 3) | Prior Year Accrued Less Payments (Col 2 – 4) | To Prior Year Balances | To Prior Year Balances | | Cumulative Balance from Prior Years (Col 1 – 3 + 7) | Cumulative Balance from Prior Years (Col 2 – 4 + 8) |
| | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 |
| | Receivable | (Payable) | Receivable | (Payable) | Receivable | (Payable) | Receivable | (Payable) | Ref | Receivable | (Payable) |
| a. Permanent ACA Risk Adjustment Program | | | | | | | | | | | |
| 1. Premium adjustments receivable | 4,000,000 | | 3,000,000 | | 1,000,000 | | -800,000 | | A | 200,000 | 0 |
| 2. Premium adjustments (payable) | | 8,000,000 | | 9,000,000 | | -1,000,000 | | 1,000,000 | B | | 0 |
| **3. ~~Sub~~T~~t~~otal ACA Permanent Risk Adjustment Program** | **4,000,000** | **8,000,000** | **3,000,000** | **9,000,000** | **1,000,000** | **-1,000,000** | **-800,000** | **1,000,000** | | **200,000** | **0** |
| ~~b. Transitional ACA Reinsurance Program~~ | | | | | | | | | | | |
| ~~1. Amounts recoverable for claims paid~~ | ~~22,000,000~~ | | ~~15,000,000~~ | | ~~7,000,000~~ | | ~~-7,000,000~~ | | ~~C~~ | ~~0~~ | |
| ~~2. Amounts recoverable for claims unpaid (contra liability)~~ | ~~8,000,000~~ | | ~~9,000,000~~ | | ~~-1,000,000~~ | | ~~990,000~~ | | ~~D~~ | ~~-10,000~~ | |
| ~~3. Amounts receivable relating to uninsured plans~~ | ~~3,000,000~~ | | ~~2,800,000~~ | | ~~200,000~~ | | ~~-100,000~~ | | ~~E~~ | ~~100,000~~ | |
| ~~4. Liabilities for contributions payable due to ACA Reinsurance – not reported as ceded premium~~ | | ~~90,000~~ | | ~~75,000~~ | | ~~15,000~~ | | ~~-14,000~~ | ~~F~~ | | ~~1,000~~ |
| ~~5. Ceded reinsurance premiums payable~~ | | ~~100~~ | | ~~200~~ | | ~~-100~~ | | ~~100~~ | ~~G~~ | | ~~0~~ |
| ~~6. Liability for amounts held under uninsured plans~~ | | ~~125,000~~ | | ~~15,000~~ | | ~~110,000~~ | | ~~90,000~~ | ~~H~~ | | ~~200,000~~ |
| **~~7. Subtotal ACA Transitional Reinsurance Program~~** | **~~33,000,000~~** | **~~215,100~~** | **~~26,800,000~~** | **~~90,200~~** | **~~6,200,000~~** | **~~124,900~~** | **~~-6,110,000~~** | **~~76,100~~** | | **~~90,000~~** | **~~201,000~~** |
| ~~c. Temporary ACA Risk Corridors Program~~ | | | | | | | | | | | |
| ~~1. Accrued retrospective premium~~ | ~~12,000,000~~ | | ~~14,000,000~~ | | ~~-2,000,000~~ | | ~~1,750,000~~ | | ~~I~~ | ~~-250,000~~ | |
| ~~2. Reserve for rate credits or policy experience rating refunds~~ | | ~~150,000~~ | | ~~250,000~~ | | ~~-100,000~~ | | ~~100,000~~ | ~~J~~ | | ~~0~~ |
| **~~3. Subtotal ACA Risk Corridors Program~~** | **~~12,000,000~~** | **~~150,000~~** | **~~14,000,000~~** | **~~250,000~~** | **~~-2,000,000~~** | **~~-100,000~~** | **~~1,750,000~~** | **~~100,000~~** | | **~~-250,000~~** | **~~0~~** |
| **~~d. Total for ACA Risk-Sharing Provisions~~** | **~~49,000,000~~** | **~~8,365,100~~** | **~~43,800,000~~** | **~~9,340,200~~** | **~~5,200,000~~** | **~~-975,100~~** | **~~-5,160,000~~** | **~~1,176,100~~** | | **~~40,000~~** | **~~201,000~~** |

Explanation of adjustments:

A. Adjusted due to federal audit.

B. Adjusted because of revised participant count.

C. Adjusted due to poor experience of other participants in the reinsurance pool.

D. Revised risk score information in the state of substantially impacted risk scores.

On May 15, 2024, the Statutory Accounting Principles (E) Working Group incorporated additional revisions into what was exposed which also deleted SSAP No. 107, paragraph 62 as recommended by interested parties. The adopted revisions, which are effective for year-end 2024 reporting, are reflected below. Similar revisions will be recommended to the Blanks (E) Working Group proposal 2024-10BWG in the May meeting. The deletion of SSAP No. 107, paragraph 62 will also result in the deletion of Note 24E/F (2) and 24E/F (3) tables on the proposal 2024-10BWG.

**Adopted SSAP No. 107 revisions:**

***SSAP No. 107—Risk-Sharing Provisions of the Affordable Care Act Disclosures***

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

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ii. Risk adjustment user fees payable for ACA Risk Adjustment~~–~~

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

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

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

~~b. ACA Transitional Reinsurance Program~~

~~i. Amounts recoverable for claims paid due to ACA Reinsurance~~

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

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

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

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~~i. Accrued retrospective premium due from ACA Risk Corridors~~

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61. In addition, beginning in annual 2014 and both quarterly and annual thereafter, a roll forward of prior year ACA risk-sharing provisions for the risk adjustment program specified asset and liability balances shall be disclosed in the annual statutory Notes to Financial Statements, as illustrated in Exhibit B. Note for the roll-forward illustration, assets shall be reflected gross of any nonadmission. The reasons for adjustments to prior year balances (i.e. federal audits, revised participant counts, information which impacted risk score projections, etc.) shall also be disclosed. ~~For year-end 2014, all columns and rows are expected to be zero since 2014 is the first year that a receivable or liability will be recorded. For reporting periods on or after March 31, 2016, the risk corridors roll forward is amended to require disclosure of the risk corridors asset and liability balances and subsequent adjustments by program benefit year.~~ The beginning receivable or payable in the roll forward will reflect the prior year-end balance for the specified benefit.

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~~b. Amounts impaired or amounts not accrued for other reasons (not withstanding collectability concerns)~~

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~~d. Asset balance gross of nonadmission~~

~~e. Nonadmitted amounts~~

~~f. Net admitted assets~~

## EXHIBIT B – ACA RISK-SHARING PROVISIONS ROLL-FORWARD ILLUSTRATION

Receivables are reflected gross of any nonadmission for this illustration.

| | Accrued During the Prior Year on Business Written Before December 31 of the Prior Year | | Received or Paid as of the Current Year on Business Written Before December 31 of the Prior Year | | Differences | | Adjustments | | | Unsettled Balances as of the Reporting Date | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | Prior Year Accrued Less Payments (Col 1 – 3) | Prior Year Accrued Less Payments (Col 2 – 4) | To Prior Year Balances | To Prior Year Balances | | Cumulative Balance from Prior Years (Col 1 – 3 + 7) | Cumulative Balance from Prior Years (Col 2 – 4 + 8) |
| | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 |
| | Receivable | (Payable) | Receivable | (Payable) | Receivable | (Payable) | Receivable | (Payable) | Ref | Receivable | (Payable) |
| a. Permanent ACA Risk Adjustment Program | | | | | | | | | | | |
| 1. Premium adjustments receivable | 4,000,000 | | 3,000,000 | | 1,000,000 | | -800,000 | | A | 200,000 | 0 |
| 2. Premium adjustments (payable) | | 8,000,000 | | 9,000,000 | | -1,000,000 | | 1,000,000 | B | | 0 |
| **3. ~~Sub~~T~~t~~otal ACA Permanent Risk Adjustment Program** | **4,000,000** | **8,000,000** | **3,000,000** | **9,000,000** | **1,000,000** | **-1,000,000** | **-800,000** | **1,000,000** | | **200,000** | **0** |
| ~~b. Transitional ACA Reinsurance Program~~ | | | | | | | | | | | |
| ~~1. Amounts recoverable for claims paid~~ | ~~22,000,000~~ | | ~~15,000,000~~ | | ~~7,000,000~~ | | ~~-7,000,000~~ | | ~~C~~ | ~~0~~ | |
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| ~~3. Amounts receivable relating to uninsured plans~~ | ~~3,000,000~~ | | ~~2,800,000~~ | | ~~200,000~~ | | ~~-100,000~~ | | ~~E~~ | ~~100,000~~ | |
| ~~4. Liabilities for contributions payable due to ACA Reinsurance – not reported as ceded premium~~ | | ~~90,000~~ | | ~~75,000~~ | | ~~15,000~~ | | ~~-14,000~~ | ~~F~~ | | ~~1,000~~ |
| ~~5. Ceded reinsurance premiums payable~~ | | ~~100~~ | | ~~200~~ | | ~~-100~~ | | ~~100~~ | ~~G~~ | | ~~0~~ |
| ~~6. Liability for amounts held under uninsured plans~~ | | ~~125,000~~ | | ~~15,000~~ | | ~~110,000~~ | | ~~90,000~~ | ~~H~~ | | ~~200,000~~ |
| **~~7. Subtotal ACA Transitional Reinsurance Program~~** | **~~33,000,000~~** | **~~215,100~~** | **~~26,800,000~~** | **~~90,200~~** | **~~6,200,000~~** | **~~124,900~~** | **~~-6,110,000~~** | **~~76,100~~** | | **~~90,000~~** | **~~201,000~~** |
| ~~c. Temporary ACA Risk Corridors Program~~ | | | | | | | | | | | |
| ~~1. Accrued retrospective premium~~ | ~~12,000,000~~ | | ~~14,000,000~~ | | ~~-2,000,000~~ | | ~~1,750,000~~ | | ~~I~~ | ~~-250,000~~ | |
| ~~2. Reserve for rate credits or policy experience rating refunds~~ | | ~~150,000~~ | | ~~250,000~~ | | ~~-100,000~~ | | ~~100,000~~ | ~~J~~ | | ~~0~~ |
| **~~3. Subtotal ACA Risk Corridors Program~~** | **~~12,000,000~~** | **~~150,000~~** | **~~14,000,000~~** | **~~250,000~~** | **~~-2,000,000~~** | **~~-100,000~~** | **~~1,750,000~~** | **~~100,000~~** | | **~~-250,000~~** | **~~0~~** |
| **~~d. Total for ACA Risk-Sharing Provisions~~** | **~~49,000,000~~** | **~~8,365,100~~** | **~~43,800,000~~** | **~~9,340,200~~** | **~~5,200,000~~** | **~~-975,100~~** | **~~-5,160,000~~** | **~~1,176,100~~** | | **~~40,000~~** | **~~201,000~~** |

Explanation of adjustments:

A. Adjusted due to federal audit.
B. Adjusted because of revised participant count.
C. Adjusted due to poor experience of other participants in the reinsurance pool.
D. Revised risk score information in the state of substantially impacted risk scores.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2024/05-15-24/Adoptions/24-13 - Update SSAP No 107 Disclosures.docx

**Revisions to the**
***As of March 2024, Accounting Practices and Procedures Manual***

On **August 13, 2024**, the Statutory Accounting Principles (E) Working Group adopted the following revisions to the *As of March 2024 Accounting Practices and Procedures Manual*. Documents associated with these revisions are linked to the reference items in bold text.

| Ref # | SSAP/ Appendix | Title | Summary |
|---|---|---|---|
| 2019-21 | **Issue Paper No. 169** | Principles-Based Bond Definition<br><br>*New SAP Concept*<br><br>Issue Papers are Not Authoritative | Adopted Issue Paper No. 169 documents the discussions and decisions related to the principles-based bond project.<br>The adopted SSAPs impacted by the principles-based bond definition are effective January 1, 2025, and should be used as the source of authoritative guidance. |
| **2022-12** | SSAP No. 25<br>SSAP No. 63<br><br>**INT 03-02** | Review of *INT 03-02: Modification to an Existing Intercompany Pooling Arrangement*<br><br>*SAP Clarification*<br><br>Effective Immediately (August 13, 2024) | Adopted revisions to SSAP No. 25 and SSAP No. 63 address transfers of assets when modifying intercompany pooling agreements. This agenda item also nullifies INT 03-02. |
| **2023-26** | SSAP No. 15<br>SSAP No. 86 | *ASU 2023-06, Disclosure Improvements*<br><br>*SAP Clarification*<br><br>Effective Immediately (August 13, 2024) | Adopted revisions in SSAP No. 15 and SSAP No. 86 adopt, with modification, certain disclosures from ASU 2023-06.<br>The ASU 2023-06 disclosures originally recommended for inclusion in SSAP No. 103R are to be added to agenda item 2024-04: Conforming Repurchase Agreements for further consideration as part of the larger project looking at statutory guidance for repurchase agreements and secured lending. |
| **2024-02** | SSAP No. 19<br>SSAP No. 73 | *ASU 2023-01, Leases (Topic 842), Common Control Arrangements*<br><br>*SAP Clarification*<br><br>Effective Immediately (August 13, 2024) | Adopted revisions in SSAP No. 19 and SSAP No. 73 adopt, with modification, ASU 2023-01. |

| Ref # | SSAP/ Appendix | Title | Summary |
|---|---|---|---|
| **2024-03** | SSAP No. 20<br>**INT 21-01** | *ASU 2023-08, Accounting for and Disclosure of Crypto Assets*<br><br>*SAP Clarification*<br><br>Effective Immediately (August 13, 2024) | Adopted revisions in SSAP No. 20 adopt, with modification, ASU 2023-08 and nullify *INT 21-01: Accounting for Cryptocurrencies*. |
| **2024-08** | SSAP No. 26R<br>SSAP No. 30R<br>SSAP No. 32R<br>SSAP No. 43R<br>SSAP No. 48 | Residual Consistency Revisions<br><br>*SAP Clarification*<br><br>Effective January 1, 2025 | Adopted revisions result with identified SSAPs referring to SSAP No. 21 for the formal residual definition and for accounting and reporting guidance. |
| **2024-09** | SSAP No. 2 | SSAP No. 2 Clarification<br><br>*SAP Clarification*<br><br>Effective January 1, 2025 | Adopted revisions eliminate lingering references implying that asset-backed securities, mortgage loans, or other Schedule BA items are permitted to be reported as cash equivalents or short-term investments. |
| **2024-14EP** | Various | Spring 2024<br><br>Editorial Revisions<br><br>Effective Immediately (August 13, 2024) | Adopted editorial revisions to the *Accounting Practices and Procedures Manua*l remove "Revised" and "R" identifiers from SSAP titles and SSAP references throughout the Manual. |

https://naiconline.sharepoint.com/teams/frsstatutoryaccounting/national meetings/a. national meeting materials/2024/08-13-24 summer national meeting/adoptions/00 - adoptions 8.13.2024 toc.docx

# Statutory Issue Paper No. 169

# Principles-Based Bond Definition

**STATUS**
**Adopted –August 13, 2024**

**Original SSAP: SSAP No. 26 and SSAP No. 43**

**Current Authoritative Guidance: SSAP No. 21, SSAP No. 26 and SSAP No. 43**

**Type of Issue:**
**Common Area**

## SUMMARY OF ISSUE

1. The guidance within this issue paper details the new statutory accounting concept revisions to *SSAP No. 26—Bonds* (SSAP No. 26), *SSAP No. 43—Loan-backed and Structured Securities* (SSAP No. 43) and *SSAP No. 21—Other Admitted Assets* (SSAP No. 21) pursuant to the Statutory Accounting Principles (E) Working Group's (Working Group) Investment Classification Project as well as in response to expanding investment structures that have been reported on Schedule D-1: Long-Term Bonds. The revisions and discussions detailed within reflects a comprehensive review, referred to as the "Principles-Based Bond Project," to establish principal concepts for determining whether a debt security qualifies for reporting as a bond. Although SSAP No. 26 was previously revised pursuant to the Investment Classification Project in 2017, it was identified that some entities were classifying securities issued from special purpose vehicles (SPVs) in scope of SSAP No. 26 instead of SSAP No. 43. As the focus of this Principles-Based Bond Project is on the substance of investments, regardless of whether they include an SPV for issuance, this project includes all debt securities and encompasses both SSAP No. 26 and SSAP No. 43.

## SUMMARY CONCLUSION

2. Investments eligible for reporting as bonds on Schedule D-1[1] shall comply with the principles-based definition of a bond or be specifically noted in scope of SSAP No. 26 or SSAP No. 43. Revisions to reflect the principles-based bond definition have been incorporated to SSAP No. 26, with SSAP No. 43 revised for accounting and reporting guidance for investments that qualify as asset-backed securities under the SSAP No. 26 bond definition. SSAP No. 21 has been revised to detail accounting and reporting guidance for debt securities that do not qualify as bonds under SSAP No. 26 and to provide guidance for the accounting and reporting of residual interests. Lastly, various revisions to other SSAPs have been incorporated to update guidance and/or references to the bond guidance. The final adopted SSAPs and other revisions are shown in the exhibits to this issue paper.

## DISCUSSION

3. The discussion of this issue originally began in August 2019 with agenda item 2019-21: SSAP No. 43 – Equity Investments. This agenda item was drafted to consider clarification to SSAP No. 43 particularly with regards to collateralized fund obligations and similar structures that reflect underlying equity interests. In response to the discussion of comment letters in January 2020, this project was expanded to include a

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[1] Pursuant to reporting changes adopted in response to the principles-based bond definition, issuer credit obligations (ICO) in scope of *SSAP No. 26—Bonds* will be reported *on Schedule D-1-1: Bonds* and asset-backed security (ABS) investments that qualify as bonds under SSAP No. 26 but follow *SSAP No. 43—Asset-Backed Securities* for accounting and reporting will be reported on *Schedule D-1-2: Asset-Backed Securities*. Throughout this issue paper, these bond investments (both ICO and ABS) are collectively referred to as bonds reported on Schedule D-1.

 

comprehensive review of SSAP No. 43 under the Working Group's Investment Classification Project, with NAIC staff directed to prepare a discussion document for subsequent review.

4. A preliminary discussion document was exposed for comment on March 18, 2020. Although there were no proposed recommendations in that exposed document, it captured the following:

a. History of the definition / scope development of SSAP No. 43. (This history has been retained in this issue paper, beginning with paragraph 124.)

b. Definitions of asset backed securities (ABS) from the Code of Federal Regulations (CFR), the Securities Exchange Act of 1934 and NAIC Model 280, Investments of Insurers Model Act (Defined Limits Version).

c. Potential options for the accounting and reporting of ABS based on whether they were considered traditional securitizations in accordance with the Code of Federal Regulations (CFR) (17 CFR 229.1101(c)) definition of an ABS or non-traditional securitizations that did not comply with the CFR definition.

5. In response to this initial exposure, a detailed comment letter dated July 31, 2020, was received from interested parties. Although a variety of elements were noted, two key issues were the primary focus:

a. Separation between SSAP No. 26 and SSAP No. 43: Pursuant to the comments, it was identified that many insurers had different interpretations of the adopted 2010 revisions that separated investments between SSAP No. 26 and SSAP No. 43 due to the presence of a "trust" or an "SPV" structure. As such, investment designs that had been identified as concerning due to the underlying investments in the SPV (e.g., equity-driven investments) believed by some to be limited to SSAP No. 43 were, under some interpretations, eligible to be captured in scope of SSAP No. 26.

b. Defining an asset backed security: The comments received focused heavily on whether the 17 CFR definition captured securities within the 1933 or 1934 Securities Act. The proposed use of the 17 CFR definition, which is the ABS definition used by the SEC as a nationally recognized statistical ratings organization (NRSRO) registered for asset-backed securities, was intended to allow consistency in ABS items permitted for NRSRO designations. Furthermore, it was only the first "broad brush" in determining whether an investment would be initially captured in scope of SSAP No. 43. Regardless, based on the comments received, which noted variations between the 1933 and 1934 Securities Act, differences of assessments based on whether an entity is the issuer or acquirer, the legal scrutiny that may be required in determining whether an investment complies with the definition, as well as a recommendation for independent principles for determining an investment as an asset backed security, it was identified that further discussion should occur before utilizing the CFR definition of an asset-backed security.

6. After considering the interested parties' July 31, 2020, comments, the Working Group directed that a small group of industry work with Iowa representatives and NAIC staff to define what should be considered a bond for reporting on Schedule D-1. It was identified that some investment designs, which have been previously captured on Schedule D-1 or are proposed for inclusion on that schedule, may be well-performing assets, but are not bonds and should not be captured on Schedule D-1. It was also noted that regulators are not anticipating these sorts of investment structures when reviewing D-1 and assessing investment risk. These small group discussions began December 1, 2020, and continued until the bond proposal was initially exposed for public comment on May 20, 2021.

7. After considering the comment letters from the May 2021 exposure, on August 26, 2021, the Working Group affirmed the direction of the principle-based bond concepts and directed NAIC staff to

utilize those concepts in proposing statutory accounting revisions. With this explicit direction, it was noted that all elements of the principles-based bond proposal, and the reflection of those concepts in statutory accounting guidance, is subject to continued discussion and deliberation. Revised guidance for Schedule D-1 investment classification will not be considered authoritative statutory guidance until the specific effective date detailed in adopted authoritative SSAP. With the direction to proceed with the development of statutory guidance to reflect the principle-based concepts, the Working Group directed that NAIC staff continue to work with the small group of regulators and industry to discuss concepts, review proposed language and consider innovating investment designs. (During this meeting, the small group was repurposed and referred to as the "study" group with additional regulators participating.)

8. From September 2021 through January 2022, the study group of regulators and industry met to continue discussions on the bond proposal definition. Key elements discussed during this timeframe included 1) the requirement for a credit enhancement that puts the holder of an ABS in a different economic position from holding the underlying collateral directly, 2) the contractual stapling restriction, and 3) guidance for when a debt instrument is issued from an SPV that owns a portfolio of equity interests. Revisions from these discussions, as well as other aspects to clarify the definition and an initial issue paper were presented to the Statutory Accounting Principles (E) Working Group on March 2, 2022, and exposed. Subsequently, the full Working Group discussed and exposed revisions to the draft guidance until adoption.

9. This issue paper intends to provide information on discussions that occurred when considering the principles-based bond definition and the statutory accounting revisions to specify the types of investments that shall be reported on Schedule D-1: Long-Term Bonds. A summary of the exposure periods and adoption actions are detailed below:

a. On March 2, 2022, this issue paper, along with the principles-based bond definition, was exposed, with comments due May 6, 2022. The Working Group heard comments on July 18, 2022, and directed limited edits to be reflected while also deciding not to incorporate revisions for a number of industry-proposed comments.

b. On August 10, 2022, this issue paper, along with the principles-based bond definition, and proposed revisions to SSAP No. 26 and SSAP No. 43 was exposed, with comments due October 7, 2022. Comments were received from Interested Parties, Fermat Capital and the industry Lease-Backed Securities Working Group. After considering comments, the Working Group incorporated certain revisions.

c. On November 16, 2022, after considering comments from the August 2022 exposure, the Working Group exposed revisions to SSAP No. 26 and SSAP No. 43. The Working Group also exposed revisions to other SSAPs that will be impacted with the bond project revisions. These edits included revisions to detail the short-term and cash equivalent restriction for ABS in *SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments* as well as guidance for debt securities that do not qualify as bonds in SSAP No. 21. This guidance was exposed until February 10, 2023.

d. On March 22, 2023, during the 2023 Spring National Meeting, the Working Group considered comments received and exposed updated guidance, with a comment period ending June 9, 2023, to reflect most of the interested party comments.

e. On August 13, 2023, during the 2023 Summer National Meeting, the Working Group adopted the exposed revisions to SSAP No. 26, SSAP No. 43 and the document detailing revisions to other SSAPs with an effective date of January 1, 2025. With this action, it was noted that no comments had been received on these exposed items. Also on August 13, 2023, the Working Group considered comments on the exposed SSAP No. 21 on the guidance for non-bond debt securities that do not qualify as bonds and on residual interests and exposed a revised SSAP No. 21 until September 29, 2023.

f. On December 1, 2023, during the 2023 Fall National Meeting, the Working Group considered comments received on SSAP No. 21, predominantly focused on the accounting and measurement of residual interests and exposed an updated SSAP No. 21 until January 22, 2024.

g. On February 20, 2024, the Working Group received a revised SSAP No. 21 that was updated to reflect interested parties' comments during the interim. The Working Group exposed the revised SSAP No. 21 for a shortened comment period ending March 7, 2024, to allow for possible adoption consideration during the 2024 Spring National Meeting.

h. On March 16, 2024, during the 2024 Spring National Meeting, the Working Group adopted new statutory accounting guidance within SSAP No. 21 for "Debt Securities That Do Not Qualify as Bonds" and for "Residual Tranches or Interests/Loss Positions." The new sections are effective January 1, 2025, but reporting entities may elect to adopt the residual guidance for year-end 2024. With this action, all planned statutory accounting guidance for the principles-based bond definition was adopted.

**<u>Discussion of Principles-Based Bond Concepts</u>**

10. Pursuant to the "small group" discussions comprised of industry, Iowa regulators and NAIC staff, the broad principle-based bond concepts discussed on August 26, 2021, reflected the following key concepts:

a. Definition of a bond requires a security structure, representing a creditor relationship, that is considered an Issuer Credit Obligation (ICO) or an Asset Backed Security (ABS).

b. The assessment of whether a security represents a creditor relationship requires consideration of the substance, rather than the legal form of the document, as well as consideration of other investments owned in the investee and other contractual arrangements. A security that possesses equity-like characteristics or that represents an ownership interest in the issuer in substance does not represent a creditor relationship.

c. An ABS is a bond issued by an entity 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.

d. There are two defining characteristics that must be present for a security to meet the definition of an ABS: 1) 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, and 2) When the assets owned by the ABS are non-financial assets, the assets are expected to generate a meaningful level of cash flows towards repayment of the bond other than through the sale or refinancing of the non-financial assets.

11. Various discussions and components were addressed in the establishment of these broad concepts and throughout the development of the principles-based bond definition. Specific elements and discussion points are detailed within this issue paper.

**<u>Security Structure Representing a Creditor Relationship</u>**

12. Similar to long-standing guidance in defining a bond, the principles-based bond concepts only permit security structures to be considered eligible for Schedule D-1 reporting. Although the concepts continue reference to the adopted security definition from U.S. GAAP, the guidance is expanded to require

that the evaluation of the structure under the security definition considers the substance of the instrument rather than solely its legal form.

13. The consideration of whether a structure reflects a "security" is a key factor in determining the appropriate SSAP for accounting and reporting. A structure with one or more future payments that qualifies as a security has historically been captured as a bond, with measurement and risk-based capital (RBC) charges based on the NAIC designation. Under the prior SSAP guidance, bond securities did not require additional provisions for admittance and would likely only be subject to nonadmittance based on state investment limits. This treatment is distinctly different than a "non-security' structure considered to be a loan under SSAP No. *20—Nonadmitted Assets* or SSAP No. 21. For these structures, the ability to admit the loan under the SSAP provisions is contingent on the nature of the loan and qualifying collateral or related party assessments. (State investment limits may have additional loan-to-value requirements that impact admittance.) Loans (other than mortgage loans) are captured on Schedule BA: Other Long-Term Invested Assets and are likely limited by state investment limits along with other invested assets reported on Schedule BA. Although the RBC charge for admitted collateral loans is lower than other Schedule BA investments, the RBC charge is still higher than Schedule D-1 investments with most NAIC designations.

14. Over time, since the codification of statutory accounting principles, various industry comments have been received questioning the difference between loans and securities (e.g., bonds), particularly with the different reporting outcomes. This discussion was also revisited as part of the principles-based bond proposal, and it was concluded that structures must meet the security definition to be captured as a bond on Schedule D-1. Although industry requested "loans with recourse" to be added to the bond scope paragraph as well as an explicit reference to "loans" as a type of investment captured in the bond definition, these proposals were not supported for inclusion. This discussion highlighted that the security definition is not a high threshold to meet, and direct loans should not be reflected as bonds if they do not qualify as securities. With this discussion it was noted that an investment could meet the definition of a bond regardless of the legal form (paper) it was written on and/or how it was described (such as a bond, note, obligation, etc.). Although an instrument could be described as a "loan," if it meets the security definition requirements and other principle concepts, it shall be captured as a bond. The same concept would be true for instruments named as a "bond" but that do not meet the security or other principle-based bond requirements, as they would not be permitted for reporting as a bond on Schedule D-1.

15. The statutory accounting guidance in SSAP No. 26 and *SSAP No. 37—Mortgage Loans* adopts the U.S. GAAP definition of a security as it is used in FASB Codification Topic 320 and 860:

a. 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:

i. It is either represented by an instrument issued in bearer or registered form or, if not represented by an instrument, is registered in books maintained to record transfers by or on behalf of the issuer.

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

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

16. The "security/non-security" discussion highlighted that the naming convention of an investment (as a "note," "bond," "obligation," "loan," or other such term) does not determine the correct underlying SSAP or reporting location. Non-security structures (other than mortgage loans) shall be captured as collateral or non-collateral loans pursuant to SSAP No. 20 or SSAP No. 21 as applicable. To prevent incorrect assumptions that all loans could be captured as issuer credit obligations, the group agreed not to

include explicit reference to loan structures within the principles-based bond concepts and instead refer to the substance of the investment structure. Additionally, the following existing guidance was noted as support for this conclusion and to further highlight that the naming convention does not override the structural design of an investment when it comes to reporting or the application of statutory accounting principles.

a. Existing guidance in SSAP No. 21 states that if an instrument meets the definition of a bond, but has supporting collateral, then the investment is not classified as a collateral loan. This concept was affirmed as part of the principles-based bond discussion, noting that investments that qualify for bond reporting on Schedule D-1 shall not be classified as collateral loans regardless of whether there is collateral backing the investment.

b. Guidance in *SSAP No. 25—Affiliates and Other Related Parties* applies to all transactions, regardless of the SSAP that governs the underlying accounting and reporting. As such, the provisions in SSAP No. 25 that require assessment of "loans or advances (including debt, public or private)" are intended to apply to all forms of lending from a reporting entity to a related party. As such, this guidance applies regardless of the naming convention of the agreement (e.g., loan, bond, note, obligation, etc.). Investments reported as bonds on Schedule D-1 that reflect related party transactions shall only be admitted if the requirements in SSAP No. 25 are met. In addition to having a specific due date and written agreements, these requirements include specific assessments based on whether the arrangement is with a parent or principal owner or to other related parties.

17. After determining whether a structure represents a security, the next component for the principle-based bond definition is assessing whether the security represents a creditor relationship. Although the reference to a "creditor relationship" may seem very similar to prior guidance in SSAP No. 26, that prior guidance did not explicitly detail the intended meaning of a "creditor relationship" but simply identified that such structures have a fixed schedule for one or more future payments. This prior guidance resulted with interpretations that structures qualified as "bonds" strictly on legal form. With the focus of the principles-based definition, it is explicit that the assessment of a whether a security represents a creditor relationship requires consideration of the substance, rather than just the legal form, along with consideration of other investments owned in the investee and other contractual arrangements.

18. Original regulator concerns with the historical guidance and reporting were in part due to the identification of investments with underlying equity interests that were structured to resemble bond instruments. Discussions that occurred as part of the principles-based bond project identified that there is a significant incentive for insurers to characterize equity exposures, which would traditionally be captured on Schedule BA, as bonds due to the favorable capital treatment. Transferring or acquiring them as debt issued by an SPV (such as through a collateralized fund obligation (CFO) structure) is a mechanism to reclassify these equity instruments and characterize them as bonds. These discussions noted that the lack of historical safeguards in existing SSAPs also provides significant opportunity for these reclassifications.

19. Equity investments differ from other types of financial assets in that they generally do not have contractual pre-determined principal or interest payments. Distributions are typically at the discretion of whichever decision maker has control of the entity. However, certain types of entities have greater likelihood and predictability of cash flows than others. For example, private equity and debt funds are often designed to have finite lives that begin with a capital raising and investment phase, and once the portfolio is built and seasoned, investments are monetized, returns are realized, and distributed to investors. Therefore, while there can be variability in timing and amounts of cash flows, distributions can be expected with some level of predictability compared to other types of equity investments (e.g., publicly traded companies). Private debt funds are more predictable still given that the underlying investments of the fund have contractual cash flows. If a large, diversified pool of seasoned funds are securitized, (often in the form of a CFO), there can be a level of predictable cash flows that is suited to support a bond, when coupled with the overcollateralization, liquidity facilities, and other protections that are built into the structure.

20. Regulator concerns arise when features that facilitate the production of predictable cash flows are not present. In such situations, when there are not predictable cash flows equipped to service the debt, repayment may rely on sale or refinancing of the underlying equity investments at maturity in order to satisfy the debt. In that case, equity valuation risk may be the primary risk for the non-payment of the issued debt. If repayment predominantly relies on a point-in-time equity valuation (such as at maturity), then the substance of the risk is not consistent with what is expected of a bond reported on Schedule D-1.

21. Although the full disallowance of equity-backed debt would prevent these regulator concerns, there is a position that there are CFO securitizations (or other investments) of well-diversified, seasoned funds for which there is compelling evidence that there will be sufficient cash distributions to amortize the debt and structure protections that minimize the residual equity exposure. The approach to allow such CFO securitizations/investments to be reported as bonds only works when there are appropriate safeguarding principles established, which require a relatively high standard of proof.

22. An investment for which the primary non-payment risk is equity devaluation is not consistent with the substance-intent for what is expected to be reported as a bond on Schedule D-1 under the principles-based definition. Allowing such investments to be reported as bonds on Schedule D-1 could result with the regulatory arbitrage that regulators are concerned about without any real mitigants. This could ultimately result in a situation where industry has taken on significantly more equity risk that they have historically, all while characterizing the investment as a bond exposure. As such, it was noted as critical that appropriate safeguards be incorporated into the principles-based bond definition to address this concern. This is why the guidance reflects a rebuttable presumption that equity-backed ABS do not qualify to be reported as bonds on Schedule D-1 unless a documented analysis supporting the predictability of cash flows is completed that demonstrates bond-like cashflows that supports different treatment from that presumption.

23. The principles-based bond definition is clear that a security that possesses equity-like characteristics or that represents an ownership interest in the issuer in substance does not represent a creditor relationship. Examples of equity investments, equity holdings and equity-like interests include any security ultimately reflecting an ownership or membership interest in an entity (such as common stock, preferred stock, private equity holdings, investments in joint ventures, partnerships, and LLCs) as well as any structure that reflects the performance of an entity (such as dividends or capital gains). Furthermore, examples of equity instruments also include any debt instrument where the risk/reward profile is substantially similar to an equity interest.

24. With the prohibition of equity-like structures or items that represent ownership interests, there is a rebuttable presumption that debt instruments collateralized by equity interests do not qualify as bonds because they do not reflect 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.

25. With the establishment of the principles-based bond definition, this rebuttable presumption was specifically discussed, and it was concluded that the determination of whether debt instruments collateralized by equity interests qualify as bonds inherently requires significant judgment and analysis. Unlike debt instruments collateralized with contractual cash flows, or debt instruments collateralized by cash-generating non-financial assets, debt instruments collateralized by equity interests may be dependent on cash flow distributions that are not contractually required to be made, predetermined, and/or may not be controlled by the issuer of the debt. In some instances, sale or refinancing of the underlying equity interests may be the only means of generating cash flows to service the debt instruments. If this is the situation, then it is expected that compensating factors from other characteristics of the structure will be present that supports classifying the investment as a bond. For example, if the source of cash flows is driven from the sale or refinancing, then an appropriate, compensating level of overcollateralization would be required to overcome the presumption that the structure does not qualify as a bond.

26. For debt instruments that are collateralized by equity interests, various factors should be considered in determining whether debt collateralized by equity interests qualify as bonds. Additionally, to overcome the presumption that the structure does not qualify as a bond, it is presumed that reporting entities will have sufficient documentation supporting this conclusion. Factors to consider include, but are not limited to, the following:

a. Number and diversification of the underlying equity interests

b. Characteristics of the equity interests

c. Liquidity facilities

d. Overcollateralization

e. Waiting period for the distributions / paydowns to begin

f. Capitalization of interest

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

h. Reliance on ongoing sponsor commitments

i. Source(s) of expected cash flows to service the debt (i.e., dividend distributions from the underlying collateral vs. sale of the underlying collateral)

27. The assessment of equity-backed securities should be looked at, not only in form, but in substance. For example, a common arrangement exists where debt is issued from a feeder fund, and the feeder fund has an equity interest in another fund which predominantly holds debt instruments. The fund passes those fixed-income cash flows through the structure to the ultimate feeder fund debt holder(s), in a way that produces substantially the same risk profile to the debt holders as a collateralized loan obligation (CLO). Accordingly, such an arrangement may have its substance aligned with a debt investment rather than a single equity investment, despite the direct holding being a fund investment. This conclusion would be supported if the terms of the structure ensure that the underlying fixed-income cash flows are passed through. Factors that add additional uncertainty as to the timing and/or amount of the pass-through of cash flows from the underlying debt instruments may call into question a conclusion that a feeder fund structure is a debt-backed structure in substance. For example, discretion of an underlying fund manager to withhold distribution of the underlying cash flows passed through from underlying debt instruments may create uncertainties as to the timing and/or amount of cash flows in such a manner that is more characteristic of an equity investment. Likewise, a feeder fund structure that is not expected to provide for regular cash interest payments would also call into question the substance as a debt-backed investment. Features that are customary to CLOs and other asset-backed securities would not ordinarily call the investment’s substance into question on its own. For example, a waterfall structure dictating the pass-through and order of payments or retaining sufficient funds for covering contractual underlying fund level payments (e.g., investment management fees, legal costs, and other customary fund level expenses) are common to CLOs and other ABS, as are customary payment in kind (PIK) features designed to address temporary liquidity issues where the PIK then gets prioritized in the waterfall structure. These customary features do not constitute manager discretion that would call into question a conclusion that a feeder fund structure is a debt-backed structure in substance.

28. Conversely, if the feeder fund debt ultimately relies on equity interests for repayment (the final fund holds equity interests that generate the pass-through cash flows), the held debt instrument from the feeder fund would have to meet the requirements of paragraph 26 while looking at the substance of equity interests supporting the debt. Regardless of the underlying collateral, feeder fund arrangements would have to meet the other relevant parts of the standard (e.g., have a substantive credit enhancement, etc.) to qualify for bond reporting. Investments that resemble feeder fund structures will require entity review to determine the

underlying source of cash flows and identify the uncertainties or vulnerabilities that could impact the cash flows that will be passed through to the reporting entity holder. Ultimately, the conclusion that a structure represents a feeder fund shall not automatically qualify the structure for bond classification but shall not automatically preclude bond classification. Substance over form should be the determining factor in these and similar situations.

**Determination of Issuer Credit Obligation or Asset Backed Security (ABS)**

29. Security structures that qualify as creditor relationships are divided between ICO and ABS. The initial distinction between ICO and an ABS is a key factor with the principle-based bond concepts. Given their differing characteristics, investments that qualify as ICO are not required to complete assessments for qualifying credit enhancements or meaningful cash flow generation. As such, it is critical to ensure that structures which should be considered ABS or that reflect non-qualifying Schedule D-1 structures, are not classified as ICO to avoid those detailed assessments.

30. Determining whether an investment reflects an ICO or an ABS focuses on the issuer and the primary source of repayment of the instrument. An ICO represents a bond structure where the repayment is supported primarily[2] by the general creditworthiness of an operating entity or entities. The support for this structure consists of direct or indirect recourse to an operating entity or entities. An "operating entity" can be any sort of business entity, not-for-profit organization, or other provider of goods or services, but cannot be a natural person or an Asset Backed Security (ABS) Issuer. An ABS 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 owed 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.

31. The prior assessments to divide structures between SSAP No. 26 and SSAP No. 43 seemed to focus primarily on legal form (issued by trust/SPV that held pledged assets) or on the basis of prepayment risk within the structure (meaning, that the expected timing of cash flows may vary, impacting the effective interest rate). Under the principle-based bond definition, neither of these components shall be used as a determinant in concluding whether a structure represents an ICO or an ABS.

a. The prior guidance which focused on the use of an SPV relied more on legal form than the substance of the transaction. Although it is common that many ABS Issuers are in the form of a trust or SPV, the presence or lack of a trust or SPV is not a definitive criterion in determining that a security meets the definition of bond intended as a Schedule D-1 investment, or that it is limited to a classification as an ABS. A key component of the principles-based bond definition is that it will not be possible for insurers to classify a non-qualifying investment as a bond simply by moving it to a debt-issuing SPV that resembles a creditor relationship with a future payment obligation. Furthermore, the guidance does not preclude the use of SPVs in ICO structures. Such structures are commonly utilized in project finance arrangements to separate business operations that support specific debt instruments, or to facilitate efficient marketing of an specific ICO design (e.g., funding agreement backed notes). Although packaging investments together in an SPV, with an

[2] To clarify the phrase "supported primarily by the general creditworthiness of an operating entity," this means that the full repayment is expected to come from cash flows generated by the operating entity, not from collateral, although secondary recourse to collateral may be present. If it is expected that a majority of repayment will come from operating entity cash flows, but it is expected that some cash flows will come from collateral, this investment does not qualify as an issuer credit obligation and shall be assessed as an asset-backed security. The expectation must be that full repayment will be generated from operating entity cash flows. For asset-backed securities, the expectation is that the source of cash flows will come from collateral, even though there may be secondary recourse to an operating entity.

SPV-issued note may currently result with better RBC charges due to the current ability to report such items as bonds, structures that simply reflect a pass-through of cash flows or performance from the underlying collateral and provide no economic difference than if holding the underlying collateral items directly shall not be characterized as bonds under the principles-based bond definition.

b. With regards to the prior interpretation that SSAP classification was based on the presence of prepayment risk, which was not an interpretation based on any explicit guidance to that effect, under the principles-based bond definition, the presence or absence of prepayment risk will continue to play no role in SSAP classification. Classification is based on whether the investment has the substance of an ICO or ABS. This distinction aligns the accounting and measurement with the characteristics of the bond structure. As ABS rely on the cash flows of underlying collateral, the measurement method described in SSAP No. 43, which requires a quarterly review of underlying cash flow assumptions, is appropriate regardless of whether variations in timing of cash flows impact the effective yield. This methodology captures variations in both timing and amount of the underlying cash flows.

32. Whether an issuer of debt represents an operating entity or ABS Issuer is expected to be clear in most instances, but certain instances may be less clear. Ultimately, for an ICO, it comes down to whether support for repayment consists of direct or indirect recourse to an operating entity or entities. In addition to “traditional bond” structures previously included in SSAP No. 26, examples of issuer credit obligations include:

a. Investments in the form of securities for which repayment is fully supported by an underlying contractual obligation of a single operating entity. Examples can include credit tenant loans (CTLs), equipment trust certificates (ETCs), other lease backed securities, Funding Agreement Backed Notes (FABNs), etc. For purposes of applying this principle 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.

b. Bonds issued by real estate investment trusts (REITS) or similar property trusts.

c. Bonds issued by business development corporations, closed-end funds or similar operating entities, in each case registered under the 1940 Act. With this inclusion, it is important to highlight that the intent is specific to bonds issued from SEC-registered entities. The reference to “similar entities” is not intended to capture items issued from collateralized fund obligations (CFOs), feeder funds or other such structures. Although some may consider CFOs to be similar to closed-end funds, that assessment is not supported for classification as an ICO. Instruments considered to reflect CFOs (and other like structures) are required to be assessed as ABS for inclusion as a bond reported on Schedule D-1. Paragraphs 27-28 also detail the assessment expected in classifying feeder funds, and the requirement to determine the source of the underlying cash flows in determining classification and if the structure qualifies for reporting as a bond on Schedule D-1.

Note: Paragraph 32.c. will be revised with adoption of agenda item 2024-01.

d. Project finance debt issued by operating entities. These investments reflect financing of a single asset or “operation” (such as a toll road or power generation facility) that collateralizes a debt issuance and the cash flows produced by the asset/operation service the debt, where the issuer may also represent an operating entity. These designs have characteristics of both ICO, as the operation constitutes a stand-alone business, as well as characteristics of ABS, 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 holistically, these issuing entities are typically used to facilitate the financing of an operating component of a project sponsor or municipality. Although the use of a bankruptcy-remote entity (e.g., SPV) facilitates the efficient raising of debt as a source of financing, the primary purpose is to finance an operating project. Therefore, when 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, the issuing entity shall be considered an operating entity despite certain characteristics that resemble ABS issuances.

i. It is important to highlight that the guidance for project finance is strictly for instruments issued by operating entities, similar to other instruments that qualify as ICO under the principles-based bond definition. Consistent with other concepts, the naming convention (e.g., referring to an instrument as project finance) or the presence or absence of an SPV/trust structure are not definitive components in determining whether an investment qualifies for reporting as a bond on Schedule D-1, or is classified as an ICO or ABS. Instruments (even if identified as "project finance") that do not qualify as ICO as they are not issued by operating entities, shall be assessed for qualification for reporting on Schedule D-1 as ABS. If the instruments do not qualify for reporting as ABS, they shall not be reported on Schedule D-1.

e. U.S. Treasury Inflation-Protected Securities (TIPs): The inclusion of U.S. TIPs specifically as an ICO intends to highlight a specific exception to the determination as a creditor relationship as the variation is due to plain-vanilla inflation adjustment mechanisms. Although U.S. TIPs are specific as ICO, under the bond definition, in order for a debt instrument to represent a creditor relationship for both ICO and ABS, 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 (e.g., performance) of any underlying collateral value or other non-debt variable[3]. 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 variables are precluded from bond treatment as they do not reflect creditor relationships. Although US TIPS are indexed to the consumer price index and grow with inflation, these securities shall be captured as ICO on Schedule D-1-1.

33. This principles-based bond project is not expected to reconsider certain investments previously considered by the Working Group and explicitly permitted for bond reporting on Schedule D-1. As such, unless subsequently addressed, the following investment types are expected to continue to qualify as Schedule D-1 investments, classified as ICO. (By including these investments as ICO, these investments are not subject to the assessments of sufficient credit enhancement or meaningful cash flow generation required for ABS securities.)

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[3] The principles-based bond definition requirement for pre-determined principal and interest payments with contractual payments that do not vary based on the performance of an underlying collateral value or other non-debt variable does not intend to encompass nominal interest rate adjustments. Nominal interest rate adjustments are those that are too small to be taken into consideration when assessing the investment's substance as a bond. Nominal adjustments are not typically influential factors in an investors' evaluation of investment return and are often included to incentivize certain behavior of the issuer. An example would include sustainability-linked bonds where failure to achieve performance metrics could cause interest rate adjustments. In general, interest rate adjustments that adjust the total return from interest by more than 10% (e.g., >0.4% for a 4% yielding bond), would not be considered nominal. Further, any such adjustments that cause an investment to meet the definition of a structured note would not be considered nominal.

 

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.

c. Debt instruments in a certified capital company (CAPCO).

d. SVO-Identified Bond ETFs.

34. The investment structures explicitly permitted for Schedule D-1 reporting no longer includes a generic reference to "hybrid securities." Under prior guidance in SSAP No. 26, hybrid securities, defined in the annual statement instructions as securities with characteristics of both debt and equity securities, were included and captured on a specific Schedule D-1 reporting line. Examples in the annual statement instructions included Trust Preferred Securities and Yankee Tier 1 bonds, however, both types of securities are no longer overly prevalent, although some insurers may continue to have them in their portfolios. Pursuant to the intent of the principle-based bond definition, a broad exception for securities that have characteristics of both debt and equity is not viable. Rather, to ensure that securities are classified and reported based on the substance of the investments, securities with characteristics of both debt and equity shall be assessed for inclusion as a bond for reporting on Schedule D-1 in accordance with the principal-based bond definition. If the securities qualify as ICO or ABS, then they can be reported on Schedule D-1.

a. 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 holds 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 in 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 on Schedule D-1 under the principal-based bond definition. If these securities do not qualify as a bond for reporting on Schedule D-1, presumably, these securities would be reported as preferred stock on Schedule D-2-1.

b. Yankee Bond – A Yankee bond is one issued by a foreign bank or company but that is traded in the U.S and priced in U.S. dollars. Yankee bonds are normally issued in tranches, with a large debt structure financing arrangement, with each tranche having different levels of risk, interest rates and maturities. The non-U.S. issuers have to register Yankee bonds with the SEC before offering the bond for sale. If these securities are held by insurers, they should be assessed for reporting as a bond on Schedule D-1 under the principal-based bond definition.

c. Other Hybrid Securities – From information received, it was noted that some reporting entities have previously reported securities on Schedule D-1 as hybrids due to a code in Bloomberg that identified the security as having characteristics of both debt and equity. Such securities shall be reviewed in accordance with the principles-based bond definition and reported as a bond on Schedule D-1 only if they qualify.

35. For securities that represent principal-protected securities and structured notes that have been previously captured within SSAP No. 26 or SSAP No. 43, the principles-based bond definition will no longer permit these security structures to be reported as bonds on Schedule D-1. Fundamentally, these structures have the potential for variable principal or interest / returns, or both, due to appreciation or depreciation (i.e., performance) of an underlying collateral value or other non-debt variable. This structural characteristic precludes these investments from being captured as ICO or ABS as the investment does not represent a creditor relationship in substance. It should be clear that 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 to determine bond reporting on Schedule D-1 when the structure also includes other collateral with the potential to generate additional interest or returns. Such structures must be viewed holistically within the principles-based bond definition, with all potential returns considered in determining whether the structure qualifies as a creditor relationship.

a. A principal-protected security is defined in *the Purposes and Procedures Manual of the NAIC Investment Analysis Office*, but 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, along with performance components where payments originate from, or are determined by, non-fixed-income securities. These returns, often based on underlying equity factors, prevent 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 safeguards principal returns, but the structure includes 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 reporting as a bond on Schedule D-1 as they would not qualify as ICO 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. These investments shall follow the guidance for non-bond debt securities in *SSAP No. 21—Other Admitted Assets*.

b. A structured note is a security that otherwise meets 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 failure of the borrower to pay the principal amount due. These instruments, 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 current fluctuations are not structured notes.

36. The guidance in the principles-based bond definition requires "assessment at origination" in determining whether a security qualifies for reporting as a bond on Schedule D-1. This provision intends to reflect the reporting entity's understanding of the intent and ultimate structure of the security's focus at origination, not simply what a structure holds on the day of origination. It is not permissible to conclude that a principal-protected security is an ICO at origination (when the structure includes only a US Treasury and cash) and disregard the intended use of the cash in the structure to subsequently acquire other investments to generate additional returns. The determination of whether an investment qualifies as a

creditor-relationship, and then as an ICO or ABS (as applicable), requires an assessment by the reporting entity of the full structure at the time of acquisition as it was ultimately intended by the issuer at the time of origination.

37. Consistent with prior guidance in SSAP No. 26, mortgage loans and other real estate lending activities, which are not securities, made in the ordinary course of business are excluded from bond classification on Schedule D-1. Those investments shall follow the applicable statutory accounting guidance in SSAP No. 37 and *SSAP No. 39—Reverse Mortgages*.

**<u>Asset Backed Securities and Required Components</u>**

38. An ABS 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 owed 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. 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. As previously noted, ABS Issuers are often in the form of a trust or special purpose vehicle, though the presence or lack of a trust or special purpose vehicle is not a definitive criterion for determining that a security meets the definition of an asset backed security.

39. To qualify for bond reporting on Schedule D-1 as an ABS, there are two defining characteristics that must be present. If the structure is a not an ICO or identified for specific inclusion on Schedule D-1, and does not meet these ABS requirements, the instrument is not permitted to be reported as a bond. Assessment on these aspects is investment specific, with determination at origination by the reporting entity based on the overall intent and ultimate expected holdings of the structure:

a. Substantive Credit Enhancement: The holder of the debt obligation issued by the ABS Issuer is in a different economic position than if the holder owned the ABS Issuer's assets directly.

b. Cash Generating Collateral Assets: The assets owed 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 source of cash flows for 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.

40. <u>Substantive Credit Enhancement</u>: The component for substantive credit enhancement is required for all ABS structures. There are no practical expedients or thresholds that can be applied in determining whether a structure reflects substantive credit enhancement. Although certain structures may only require a limited analysis (such as agency-backed mortgage-backed securities—MBS), and insurers may benefit from prior analysis when acquiring similar subsequent structures, an automatic assessment is not permitted for this requirement.

41. To qualify as an ABS, the holder of the debt obligation is required to be in a different economic position than if the holder owned the ABS issuer's assets directly. For purposes of this assessment, the holder of the instrument is considered to be in a different economic position if the instrument benefits from substantive credit enhancement through guarantees (or other similar forms of recourse), subordination and/or overcollateralization. This element is required for all ABS designs, regardless of the collateral that is backing the ABS.

42. The requirement for substantive credit enhancement is intended to address investment designs crafted to appear as a debt / bond structure for reporting and RBC purposes, but for which the holder does

not have a "more than nominal" change to the risk or reward profile than if they held the underlying investment directly. This guidance prevents using a specifically designed legal form (such as transferring assets to an SPV and acquiring an SPV-issued note), but which lacks any economic substance, to obtain favorable measurement and RBC impact or to avoid nonadmittance that would occur if the assets were directly held by the reporting entity.

43. The intent of the "substantive" threshold 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 a bond 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 ICO 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 ABS. If substantive credit enhancement did not exist, the substance of the investment 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.

44. The original exposure (May 2021) detailed this ABS requirement as a "sufficient" credit enhancement and detailed the provision as the level of credit enhancement a market participant (i.e., reasonable investor) would conclude is expected to absorb losses (or decreases in cash flows) to the same degree as other debt instruments of similar quality, under a range of stress scenarios (i.e., scenarios are similar to stress scenarios performed for other debt instruments of the same quality). This original proposal noted that losses are those a market participant would estimate with consideration of historical losses (including loss recoveries) on similar collateral, current market conditions, reasonable and supportable forecasts, and prepayment assumptions associated with the collateral. Excluded from the estimate of expected losses are historical gains on similar collateral and expected market appreciation on the collateral. After further discussion of this concept, it was identified that the term sufficient and its proposed definition implied a quantitative assessment of credit quality was required. As a result, the proposed concept could be interpreted to mean that a reperformance of the credit underwriting process would be needed to support accounting classification, which is not the intent and could be seen to violate the policy that credit ratings do not determine accounting classification, as well as introduce an administrative reporting burden that is both duplicative and lacking any added value. Further, a misinterpretation could occur that would permit satisfaction of this component if a credit rating or NAIC designation was obtained. The intent of the concept is not to address credit quality. Rather, the intent is to require that there must be economic substance to support the transformation of the underlying collateral risk, to bond risk. As a result of these discussions, revisions were incorporated to revise the terminology and related definition to reflect a "substantive credit enhancement." In addition to eliminating a perception that reporting entities could use credit ratings to support this distinction, this guidance incorporates principle concepts to ensure that the provision cannot be satisfied with structural elements that are merely nominal or lack economic substance.

45. Substantive credit enhancement can come in various forms, including but not limited to, subordination/overcollateralization, guarantees, or other forms of recourse. In whatever form the credit enhancement comes in, it must be of a level of significance that the holder of the debt instrument is in a substantively different position than owning the underlying collateral directly. Assessment of whether a credit enhancement has substance may involve an evaluation of the level of overcollateralization (loan-to-value or LTV) or the capacity of whatever form of subordination, guarantee or recourse to absorb collateral losses. The guidance intends to be specific that an NAIC designation, obtained from either the NAIC Securities Valuation Office (SVO) or from a Credit Rating Provider (CRP) does not provide standalone evidence to support a conclusion that the structure includes a substantive credit enhancement. Although the presence of independent market validation may provide evidence supporting the substance of a credit enhancement, that provision shall not be interpreted to indicate that the presence of an NRSRO rating is automatic validation that the substantive threshold has been met.

46. The following elements were specifically discussed with regards to the requirement for a substantive credit enhancement:

a. Agency-Backed Pass-Through Structures (e.g., RMBS/CMBS): These structures, when they have an agency guarantee, are expected to meet the substantive credit enhancement requirement with little analysis. 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 mortgages directly because the credit risk has been redistributed and assumed by the agencies.

b. Non-Agency Backed Pass-Through Structures: Unlike the above agency-backed example, a pass-through MBS without a credit enhancement, if one were to exist, would not put the holder in a different economic position as owning the mortgage loans directly as they would participate proportionally in the first dollar of losses on the underlying loans. Pursuant to the intent of the overall principles-based bond / Schedule D-1 project and required substantive credit enhancement, the guidance does not permit use of an SPV to recharacterize an asset to qualify for reporting as a bond on Schedule D-1 if the holder is in the same economic position as holding the underlying investments directly. This would apply to any type of underlying asset. In contrast, if a debt instrument represents a senior interest in the pool of loans, through existence of a subordinated tranche for example, the holder may conclude that it is in a different economic position from holding the loans directly, provided the subordination is determined to be substantive.

c. Loan-To-Value (LTV) Assessments: An assessment of LTV at origination may provide evidence of substantive credit enhancement through overcollateralization. The review should be a holistic assessment, evaluating the expected LTV over the life of the transaction, in conjunction with the liquidity and market value volatility of the underlying collateral, particularly in points in time when the underlying equipment is expected to be off-lease or at the time of maturity if refinancing or sale is required. It is appropriate to consider any expected economic depreciation, but it is not appropriate to factor in any expected economic appreciation. Although an expected decline in the LTV ratio may support the presence of a credit enhancement, a declining LTV is not required, and an increasing LTV is not prohibited, as long as the structure continues to provide a substantive credit enhancement. An expected high LTV at maturity, relative to the market value volatility of the underlying collateral, is considered to lack substantive overcollateralization and would require other forms of credit enhancement in order to meet the substantive credit enhancement criteria.

d. The first loss position may be issued as part of an ABS structure in the form of debt or equity interest, or it may be retained by the sponsor and not be issued as part of the structure. The holder of the loss position, regardless of if it is issued as a tranche or retained by the issuer, does not impact the determination of whether the loss position provides substantive credit enhancement. Rather, the assessment focuses on whether the holder of the debt instrument is in a substantively different position than owning the underlying collateral directly. This assessment includes consideration on the first loss position (or more senior positions, if the first loss position is not sufficient) regardless of the holder of the loss positions. If the first loss position (or a more senior position(s), if the first loss position(s) lacks substantive credit enhancement) is issued as part of the structure and does not have substantive credit enhancement and is held by a reporting entity, the investment(s) does not qualify for reporting as a bond as it is a residual interest. All residual interests shall follow the accounting and reporting guidance in SSAP No 21.

47. <u>Meaningful Level of Cash Flows to Service Debt</u>: The element for meaningful cash flow generation is only a requirement for ABS that are backed by non-financial assets. ABS designs backed by financial

assets, when there is no future performance obligation outside of default risk that could impact the ability to generate cash flows to service the debt, are not required to be assessed under the meaningful cash flow requirement.

48. To qualify as an ABS, there must be a meaningful level of cash flows generated from non-financial assets backing an ABS to service the debt, other than through the sale or refinancing of the assets. The evaluation is specific to each transaction and should consider the market volatility and remarketing potential of the underlying collateral, the variability of the cash flows produced, as well as the diversification of the source of cash flows within the structure. The main intent of this guidance is to ensure that non-financial assets supporting structures reported as bonds on Schedule D-1 encompass a level of "cash generation" that is conducive to servicing traditional bond-like cash flows.

49. Consistent with the substance theme of the principles-based bond proposal, this guidance intends to prohibit situations in which the legal form of an investment is utilized to receive favorable accounting and reporting treatment, while the primary non-payment risk is the point-in-time valuation of an underlying asset. The prior guidance in SSAP No. 43 that focused on placing collateral assets in trust, with the SPV issuing a debt instrument, enabled situations in which non-cash generating structures could be reported as bonds on Schedule D-1. As a simple example, this guidance prevents artwork from being captured as the collateral backing a debt instrument issued by an SPV, with the reporting entity then reporting the SPV-issued note as a bond investment that reflects the expected future value that will be received upon the ultimate sale of the artwork.

50. The guidance requires meaningful cash generation to satisfy the debt instrument throughout the duration of the debt term. The timing of the cash generation, at points prior to maturity of the investment, is a key element as it intends to specifically exclude transactions in which the underlying assets must be sold or refinanced at maturity to produce cash to meet the meaningful requirement. However, this restriction is not intended to automatically exclude all structures that may incorporate collateral asset sales or refinancing throughout the debt duration as part of the expected cash generation. An example could be the securitization of short-term rental car receivables. Such a design could encompass both the rental car lease payments as well as periodic sales of the rental cars as the means to generate meaningful cash flows to service the debt. This design, with planned periodic sales of the non-financial collateral assets over the debt term, is distinctly different than a structure in which cash flows are not meaningfully generated over the course of the debt term and would rely predominantly on the sale or refinancing of the underlying collateral at maturity to satisfy the debt obligation. This restriction also does not exclude all structures that have any amount of sales or refinancing at the end of the debt term. Such investments can qualify for reporting as a bond on Schedule D-1 if they meet the meaningful cash generation criteria throughout the term of the instrument other than through the sale/refinancing at maturity.

51. The assessment of meaningful cash flows may require detailed evaluations as it is not permissible to conclude that the presence of any cash flows generated within the structure will result with the investment reaching the "meaningful" threshold. It is also not expected to commonly see ABS structures that include both financial and non-financial collateral. Such designs shall be reviewed to determine that the structure is in line with the principle intent of the bond definition and has not been developed to circumvent separate assessment or reporting of non-financial asset components. As a simplistic example, including mortgage-backed securities and artwork in a single structure, and identifying that the cash flows of the MBS satisfies the meaningful threshold with the artwork representing a minimal residual element, with a conclusion that the full structure qualifies for reporting as a bond on Schedule D-1 is not reflective of the intent of the principles-based standard. If there are instances in which financial asset and non-financial asset collateral are combined in a single ABS structure, consideration should occur on the intent of commingling these collateral elements pursuant to the intent of the principles-based bond definition and in assessing the meaningful cash flow requirements. Structures identified that have been developed to circumvent the provisions of the principle-based bond definition are not permitted to be reported as a bond on Schedule D-1 and shall be captured as a non-bond debt security in scope of SSAP No. 21.

52. The assessment of meaningful cash flows is specific to each transaction, determined at origination, and should consider various factors collectively in determining if the meaningful threshold is met. For this assessment, it is noted that an increase in price volatility or variability of cash flows requires a greater percentage of cash flows generated to service the debt from sources other than the sale or refinancing of the underlying collateral. On the flip side, 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 is permitted to decrease. The following factors should be considered with the assessment of meaningful cash flows:

a. Price volatility in the principal market in the underlying collateral.

b. Liquidity in the principal market for the underlying collateral.

c. Diversification characteristics of the underlying collateral (i.e., types of collateral, geographic locations, sources of cash flows within the structure, etc.,)

d. Overcollateralization of the underlying collateral relative to the debt obligation.

e. Variability of cash flows, from sources other than sale or refinancing, expected to be generated from the underlying collateral.

53. The assessment of meaningful cash flows does permit a practical expedient under the principles-based bond definition. 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 cash-flow generating criteria. (A structure with contractual cash flows that does not satisfy all of the interest stipulated in the structure does not qualify under the practical expedient.) 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 the sale or refinancing to service any interest, an amount greater than 50% of the original principal or if they rely on cash flows that are not contracted at origination. Rather, such instances do not qualify under the practical expedient and would require a complete analysis of the noted factors in determining whether the meaningful cash-generating criteria has been met.

**<u>Additional Elements for Asset Backed Securities</u>**

54. When establishing the ABS definition and required components, various aspects were discussed to improve clarity on the application of the guidance.

55. <u>Determination of "Assets" Backing Securities</u>: Although the definition of an asset detailed in *SSAP No. 4—Assets and Nonadmitted Assets*, is applied throughout statutory accounting principles, the question was raised as to where the asset definition would be applied in determining a qualifying ABS. For example, an entity that expects to have subsequent receivables from future operations does not have recognized "assets" from those expectations as the requirements of the asset definition have not been met. However, if that entity were to sell the rights to future cash flows from expected operations, the selling entity would receive cash (a qualifying asset), and the acquiring entity would also have a recognized asset from the acquired right to future cash flows.

56. For purposes of qualifying as an "asset" permitted in an ABS structure, the definition of an asset must be met by the ABS Issuer. In some situations, particularly when the asset represents a right to future cash flows, the asset may not be in a form that could be liquidated to provide payment towards the debt obligations. (For example, if the asset represents acquired rights to future royalties, those royalty rights would have to materialize to have liquid assets available toward the debt obligations.) The ability to liquidate the backing collateral asset at a single point in time does not impact the structural determination of whether the issued security meets the definition of an ABS provided that the assets are expected to produce meaningful cash flows to service the debt terms. Additionally, the inability to liquidate the assets

backing the instrument may impact the assessment of what constitutes substantive credit enhancement. Failure of cash flows to materialize may impact recoverability and require impairment of an ABS.

57. There is no requirement for a collateral asset backing an ABS structure to qualify as an admitted asset under statutory accounting. Assessing whether the underlying asset qualifies for admittance is not necessary as non-financial assets backing ABS must meet the meaningful cash-generating criteria. If the structure fails to meet the meaningful cash-generating requirement, the instrument does not qualify for reporting as a bond on Schedule D-1. Statutory accounting has not historically restricted bonds backed by inadmissible assets from being admissible, nor has it included any kind of evaluation of the cash flow producing ability of underlying assets. The principles-based bond definition adds a requirement to evaluate the cash flow producing ability of the underlying collateral, but continues to recognize that assets that may not be admissible if held individually on an insurer's balance sheet, may be well suited to support bond-like cash flows when securitized in large numbers with appropriate structuring (e.g. prioritization of cash flows).

58. Determining Whether the Structure Reflects "Financial" or "Non-Financial" Assets: The definition of a "financial asset" has previously been adopted from U.S. GAAP and is reflected in *SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* as cash, evidence of an ownership interest in an entity, or a contract that conveys to one entity a right 1) to receive cash or another financial instrument from a second entity or 2) to exchange other financial instruments on potentially favorable terms with the second entity.

59. For purposes of excluding financial assets from the ABS meaningful cash generation criteria, the financial asset definition was clarified, for the avoidance of doubt, to not include assets for which the realization of benefits from the rights to receive or exchange financial assets depends on the completion of a performance obligation such as with a lease, mortgage servicing right, royalty rights, etc. For purposes of applying the ABS guidance, when there is a performance obligation required before the cash flows are generated, the assets represent non-financial assets, or a means through which non-financial assets produce cash flows, until the performance obligation has been satisfied. As another way to assess this clarification, if the assets backing the ABS are only subject to default risk (meaning the risk of nonpayment is solely based on failure of the underlying payer to satisfy its unconditional promise to pay), then the asset is a financial asset. If the asset is subject to any other risk in addition to default risk, then the assets represent non-financial assets. As simple illustrative examples:

a. A mortgage-backed security (MBS), where the underlying mortgages have been securitized into a structure, the mortgage receivables represent unconditional promises to pay, with no further performance obligation of the lender or any other party. This structure is considered to be backed by financial assets. Although this structure is excluded from the meaningful cash flow assessment, it must still comply with the substantive credit enhancement requirement.

b. A structure that represents the securitization of rental car leases is contingent on the lessor performing its side of the transaction (providing the car for use) before the lessee is obligated to pay. Therefore, a lease is a non-financial asset due to the performance obligation that must be satisfied in order for payment to become unconditional. Additionally, as is the case with short-term car rentals, the lease (rental agreement) may not be in place and the structure may represent a securitization of the rights to future rental payments, which adds an additional performance condition. This structure combines performance risk with default risk, resulting with the structure not qualifying for classification as being backed by financial assets. For this structure, the reporting entity would have to complete assessments that 1) the structure results with substantive credit enhancement and 2) the structure produces meaningful cash flows over the term of the instrument to satisfy the debt obligation other than through the sale or refinancing at maturity. If at origination, the contractual cash flows from the underlying collateral (leased rental cars) would be sufficient to satisfy all of the interest and at least 50% of the original principal, then the meaningful criteria would be met through the practical expedient. That means, as discussed in SSAP No. 26, paragraph 9.b., that the practical expedient can only be used if less than 50% of the principal relies upon sale or refinancing.

60. Whole-Business Securitizations: In most ABS structures, the assets backing the cash flows are specified and limited to a distinct collateral pool. For example, dedicated cash flows from specific lease arrangements, or specific receivables from credit cards or mortgages. However, ABS structures can exist that represent an entire range of operating revenues or cash flows generated by the business. These structures are often referred to as “whole business” or “operating asset” securitizations. These structures, which could only include cash flows from certain operating segments, and not necessarily the entire business of a company’s operations, transfer the cash flows from the dedicated operations first to the investment holders, with the operating entity receiving their “operation proceeds” after the investment holders have been paid. This is different from a traditional bond structure where the operating entity first receives the proceeds from their operations and has discretion on how it uses those proceeds to continue operations and pay expenses and then ultimately pay the bond holders according to the debt terms. Further, debt holders in a whole-business securitization generally only have recourse to the cash flow streams pledged to support the debt, unlike a general credit obligation of the operating entity.

61. For the principles-based bond definition, structures that refer to whole-business securitizations, or that refer to operation proceeds as the collateral for the source of debt repayment still meet the definition as an ABS and do not reflect ICO. For these structures, the dedicated operational cash flows represent the defined collateral pool and should not be classified as ICO based on an interpretation that the proceeds represent the cash flows of an operating entity as they are not supported by the general creditworthiness of an operating entity, but rather only on referenced cash flow streams from the entity’s operations.

62. Residual Tranches / “Equity” Components of Schedule D-1 Qualifying Structures: The assessment of qualifying Schedule D-1 investments has to consider the overall investment structure but focuses primarily on the specific instrument held by the reporting entity. Structures, particularly ABS, may include residual tranches that provide payment after pre-determined principal and interest payments have been made to other tranches or interests based on remaining available funds. Although payments to residual note holders could 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 interest and principal payments. In all instances, despite whether other tranches of the investment structure qualify for reporting as a bond on Schedule D-1 reporting, residual tranches do not qualify for bond reporting on Schedule D-1.

63. Under prior guidance in SSAP No. 43, there was no exclusion that restricted residual tranches of qualifying securitizations from being captured in scope and being reported as bonds. From the outreach performed in developing the principles-based bond definition, it was identified that several insurers have historically reported these residual tranches on Schedule BA: Other Long-Term Invested Assets. However, it was noted that some reporting entities have reported these items as a bond on Schedule D-1 as a component of the securitization or as a beneficial interest in scope of SSAP No. 43. Although residual tranches (first loss tranches) do not receive CRP ratings or NAIC SVO designations, when reported on Schedule D-1, an NAIC designation is required. From information obtained, entities reporting residual tranches on Schedule D-1 have either been reporting as self-assigned 6* or they applied the NAIC 5GI concept to self-designate these securities. Under the 5GI concept, the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual) permits self-designation as an NAIC 5 if the documentation necessary for a full SVO credit analysis does not exist, the issuer is current on all principal and interest payments, and the reporting entity has an expectation that they will receive all contracted interest and principal. The use of the NAIC 5GI concept to self-designate residual tranches on Schedule D-1 is a misapplication of this guidance. It is faulty to conclude that an investment is current and will provide all contractual interest and principal payments when the investment provides payments based on remaining funds after obligations to other issued debt instruments from the structure are satisfied. Furthermore, the

5GI provision was intended to prevent an NAIC 6 designation simply because the documentation for a full credit analysis could not be provided or reviewed, such as situations involving foreign securities when the supporting documents are in a foreign language. The NAIC 5GI provision was not intended to permit self-assignment of an NAIC 5 designation to securities that would not qualify as a fixed-income instrument eligible for an NAIC designation under the P&P Manual.

64. With the identification that residual tranches are inconsistently reported, with some entities reporting as bonds on D-1 and others reporting on Schedule BA, the Working Group drafted and exposed agenda item 2021-15: SSAP No. 43 – Residual Tranches in September 2021 as an interim action prior to the conclusion of the bond project. The guidance within that agenda item clarified that residual tranches shall be reported on Schedule BA at lower of amortized cost or fair value. The guidance also clarified that the reference to residual tranches intends to capture securitization tranches and beneficial interests, as well as other structures captured in scope of SSAP No. 43 that reflect loss layers where failing to remit contractual interest or principal payments does not result in an act of default. Payments to holders of residual interests occur after contractual interest and principal payments have been made to holders of other tranches or interests and are based on the remaining available funds. Although payments can occur throughout an investment's duration, such instances still reflect the residual amount permitted to be distributed after other holders have received contracted interest and principal payments.

65. On November 10, 2021, the Statutory Accounting Principles (E) Working Group adopted agenda item 2021-15, clarifying that residual tranches are required to be reporting on Schedule BA: Other Long-Term Assets beginning December 31, 2022, with early adoption permitted. The effective date of this action allowed time for reporting entities to implement this change and to correspond with a Blanks (E) Working Group proposal to incorporate separate reporting lines for residuals, based on underlying characteristics of the structure, on Schedule BA. With the adoption of this guidance, the Working Group noted that reporting entities may elect to reclassify residual tranches or interests to Schedule BA in advance of the effective date. As of the effective date, residual tranches or interests previously reported on Schedule BA shall be reclassified to the appropriate residual tranche Schedule BA reporting line based on the underlying characteristics of the investment structure.

66. Along with the action to specify the Schedule BA reporting for residuals, the Statutory Accounting Principles (E) Working Group and the Valuation of Securities (E) Task Force provided a joint memorandum to the Blanks (E) Working Group to specifically identify that application of the NAIC 5GI process to residuals is an inaccurate application. Residual tranches or interests reported on Schedule D-1 for year-end 2021 shall be reported with an NAIC 6. The Task Force also received a referral requesting clarification of the NAIC 5GI process so future misapplications could be mitigated. The Task Force considered specific changes to address residuals and adopted those revisions during the 2021 Fall National Meeting.

67. Subsequent to the guidance adopted in agenda item 2021-15, additional revisions were adopted to *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies* (agenda item 2023-12) and to *SSAP No. 30—Unaffiliated Common Stock* and *SSAP No. 32R—Preferred Stock* (agenda item 2023-23) to clarify that all residuals, regardless of legal form of the investment, shall be reported on the dedicated residual reporting lines on Schedule BA.

68. The adoption of SSAP No. 21 in accordance with the principles-based bond project, incorporated guidance for non-bond debt securities and residual interests. The residual guidance includes the definition, common traits in identifying residuals as well as accounting and reporting guidance. Although adopted with a January 1, 2025 effective date consistent with the bond project, reporting entities are permitted to early-adopt the residual guidance in 2024.This SSAP No. 21 residual guidance has the following key aspects:

a. Residuals are permitted to be admitted assets if debt securities from the same securitization qualify (or would qualify) as admitted assets. If a debt security held from the same structure is (or would be) nonadmitted, then any residual interests or first loss positions held from the same structure do not qualify as admitted assets. Residuals in the legal form of a SSAP

No. 48 investment are not subject to the SSAP No. 48 audit requirements for admittance as they are captured in scope of SSAP No. 21 and not SSAP No. 48.

b. Residuals shall be initially reported at cost, or allocated cost (using proportional fair values) if acquired along with debt tranches from the securitization. Subsequent to initial acquisition, residuals shall be reported at either 1) the lower of adjusted cost or fair value under the Allowable Earned Yield method, with temporary reductions in fair value reported as unrealized losses, or 2) at the calculated practical expedient method permitted in SSAP No. 21. For the residual guidance, amortized cost is defined as the cost the residual reduced for distributions in excess of the Allowable Earned Yield and other-then-temporary impairments (OTTI). The Allowable Earned Yield is established at acquisition as the discount rate that equates the initial best estimate of the residual's cash flows to its acquisition cost. With this approach, interest income is recorded under the effective yield method using the Allowable Earned Yield, capped by the amount of cash distributions received. Amounts received in excess of the Allowable Earned Yield reduces amortized cost. The practical expedient calculates book/adjusted carrying value (BACV) such that all distributions received are treated as a reduction in BACV. With this approach, the reporting entity will not recognize any interest or investment income until the residual tranche has a BACV of zero.

c. Residuals shall be assessed for OTTI on an ongoing basis, with required assessment anytime that fair value is less than the reported value. For residuals measured using the Allowable Earned Yield method, an OTTI is considered to have occurred if the present value of expected cash flows discounted by the Allowable Earned Yield is less than amortized cost. For residuals measured under the practical expedient, an OTTI shall be considered to have occurred if the fair value of the residual is less than the BACV.

d. The residual guidance is adopted prospectively and includes transition guidance in applying the revised measurement method for securities previously captured in scope of another SSAP. This guidance mirrors concepts from the transition of the principles-based bond definition.

69. Stapling of Investments: The original exposure of the principles-based bond definition (May 2021) included an initial example detailing a situation where "equity interests" from a tranche (such as residuals) were required to be held by a reporting entity when holding debt tranches. That language identified situations where the reporting entity would be restricted from selling, assigning, or transferring the unsecured debt investment without also selling, assigning or transferring the equity interest to the same party. This restriction is often referred to as the "stapling" of investments. Pursuant to the guidance in the initial example, although the debt instrument would separately qualify as a creditor relationship for bond reporting, when considering the entirety of the holdings (both the residual/equity interests and debt tranches combined), the investment would be considered an equity instrument in substance. Although the debt instrument would appear to have a higher priority of payment, that priority would be supported by the residual/equity interest the reporting entity has to hold. Ultimately, the reporting entity would be subordinate to themselves as they would recognize a loss on the residual/equity tranche to safeguard payment under the debt tranche. Under that initial proposed example, all holdings under such situations, including the debt tranches, would not qualify as creditor relationships and would not qualify for bond reporting.

70. After considering comments from the first exposure period, as well as discussing within the small group of industry and regulators, this example was eliminated from the principles-based bond definition. These discussions ultimately concluded that tranches that separately qualify as bonds should be reported as bonds even if other tranches from a structure that do not qualify as bonds are also held by the reporting entity. Elements noted as part of the decision to remove the stapling restriction include:

 

a. A key element in the initial proposal to require all of the holdings as equity was to ensure that the risk of the holdings was properly captured. It was noted that recent developments to tranche investments that were previously reported as investments in LLCs or joint ventures could result in RBC arbitrage. This is because the risk of the investment would be concentrated in a specific tranche intended to absorb losses, and only that limited tranche would be reported on Schedule BA with higher RBC charges. This would allow the debt tranches (as they are subordinated by the equity tranche) to likely qualify as bonds with Schedule D-1 reporting and lower RBC charges. However, because risk has been concentrated into the smaller equity tranche as a result of leverage, and because Schedule BA RBC charges are fixed and insensitive to leverage, there is a lowering of risk-based capital in total despite no change in risk. The subsequent discussions highlighted that this is an RBC issue for the equity tranche and is not an accounting classification issue. As consideration on appropriate risk charges for residual tranches has been requested to the Financial Condition (E) Committee and is a discussion item for the RBC Investment Risk and Evaluation (E) Working Group, this issue is not within the focus of the Statutory Accounting Principles (E) Working Group. It was also noted that consideration of statutory accounting provisions (such as nonadmittance) to achieve a desired risk assessment would be an inappropriate use of the accounting guidance. It was also noted that the investments within scope of these discussions are likely permitted for admittance under state law and incorporating statutory guidance different from state law would only result with identification of prescribed practices as domiciliary state laws and statutes are the ultimate authority for the application of SAP.

b. It was also identified that the initial exposed example was specific to investments that were "stapled" under contractual terms. This guidance would have only been applicable to dynamics in which there was an explicit restriction in the sale, assignment, or transfer of the residual/equity tranche separately from a debt tranche. It was identified that without an active market for residual/equity tranches (which is common) the explicit restrictions would not be necessary to achieve a similar result. Structures would only need to be designed to require initial acquisition of residual/equity tranches when acquiring debt tranches (with removal of the explicit disposal restrictions) to avoid the proposed stapling guidance. Since the proposed guidance could be easily avoided, the guidance would not address the underlying concern.

c. This discussion noted that it is quite common for acquisitions to require purchases of a vertical slice of a structure and for investments to be stapled for a short duration of time. These provisions are generally made for easier marketing and for easier compliance with conflict-of interest provisions. The short-term aspect of some stapled investments raised concerns as to how bond-qualifying debt tranches would be reported if stapling provisions to a residual/equity tranche were subsequently eliminated. This was identified as likely requiring a schedule move (from BA to D-1) with potential other accounting and reporting impacts (such as with NAIC designations and measurement method). This discussion noted that an issuer's stapling of investments may reflect a legitimate business purpose, and not intend for RBC arbitrage, and the elimination of such components after the stated timeframe could cause confusion or unnecessary noise in the financial statements from the reclassification of investments. This discussion further supported that the acquisition of different tranches, even if explicitly stapled, should not prevent separate debt (bond) and residual/equity recognition based on the characteristics of the specific tranche.

71. ABS as Short-Term or Cash Equivalent: With the required assessments and requirements for a security to qualify as ABS, as well as dedicated reporting based on the underlying collateral assets, ABS will no longer be permitted to be reported as short-term or cash equivalents. All qualifying ABS will be required to be reported on Schedule D-1-2, even if acquired within one year or less from the maturity date,

 

to allow for full assessment of ABS held by a reporting entity by regulators. 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 to the short-duration until maturity. As ultimate cash flows from ABS 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.

**Key Discussions / Aspects in Developing the Definition**

72. Refinancing Risk / Residual Risk Exposure: Discussion of refinancing risk (where there is outstanding debt owed at maturity that will need to be refinanced for the remaining principal to be received by the note holder) was a key element discussed in accordance with the meaningful cash flow requirement for non-financial ABS. This discussion highlighted that traditional refinancing risk is accepted in the context of corporate debt but is viewed differently when assessing the cash flows of non-financial assets in an ABS structure. This differentiation was confirmed, with identification that there are concerns unique to non-financial ABS.

73. The requirement for a non-financial ABS to produce meaningful cash flows to service the debt other than through the sale or refinancing of the collateral assets ensures that structures captured as a bond on Schedule D-1 actually reflect bond-like cash flows. Structures that rely on the sale or refinancing at maturity to generate cash flows to repay debt obligations ultimately reflect a point-in-time reliance on the underlying collateral asset values that does not reflect the intent of Schedule D-1 reporting of bond-like cash flows. These structures are more reflective of the underlying collateral risk, ultimately contingent on the market at a future point in time and whether the underlying assets can be sold or refinanced in accordance with original expectations at the time of the structure origination.

74. A key comment raised by industry with regards to the meaningful cash flow requirement, and the restriction against relying on the sale/refinancing at maturity to produce meaningful cash flows, is that consideration should be given to the level of overcollateralization that exists in a structure if the meaningful requirement will not be met without sale or refinancing. These industry comments take the position that as the level of overcollateralization to the debt obligation increases, then there is a greater likelihood that the debt issuer will be successful in refinancing or selling the assets and generate the means to repay the debt obligation. Although overcollateralization is a factor in securities for bond classification, allowing overcollateralization to override the requirement for meaningful cash flows other than the refinancing / sale at maturity is not permitted for the following reasons:

a. The intent of the principles-based bond definition is to clarify what shall be reported as bonds on Schedule D-1. Non-financial ABS that do not generate meaningful cash flows and rely on the refinancing or sale of the underlying assets do not reflect bond-like cash flows and are not characteristic of bond investments. These structures ultimately reflect equity (point-in-time) valuation risks of the assets held as collateral.

b. The industry position that overcollateralization safeguards the asset performance is an argument that supports the quality of the structure, but not the substance of the investment design. The principles-based bond definition does not factor in investment or credit quality within the determination of whether a structure qualifies for reporting as a bond on Schedule D-1. Permitting an assessment based on overcollateralization would introduce a concept that credit quality determines bond / Schedule D-1 reporting, and that is not an accurate conclusion in line with the principle concepts of bond classification.

75. Consistent with prior conclusions, reporting an investment as a bond on Schedule D-1 is not indicative of the quality of the investment, but rather reflects securities expected to generate bond-like cash flows. Securities reported as bonds on Schedule D-1 may be of high-quality or low-quality, but the reporting is based on the substance of the structure, which ultimately requires bond-like cash flows for all

investments. This includes a requirement that non-financial ABS must produce meaningful cash flows through the use of the underlying collateral assets other than through the sale or refinancing of the assets.

76. Additionally, through the small group discussions around the refinancing restriction, it was noted that even if a debt instrument meets all of the criteria to be reported as a bond on Schedule D-1, there will still be a potential for unintentional RBC arbitrage related to securitizations, because the residual tranches absorb all of the redistributed risk of the underlying collateral, but receives a fixed RBC charge that is not in any way risk-rated. While this could be the case in any type of securitization, it is particularly pronounced if the underlying collateral is equity investments. Equity investments generally receive a base 30% RBC charge for life companies. If equity investments are securitized, the bond tranches will get low bond charges (<2%), while the residual tranche will continue to receive a flat 30% base charge. This will have the effect of bringing the overall weighted-average capital charge on the underlying investments from 30% to approximately 10-15%. This will occur even if the bond tranches have all of the substance associated with a bond. Following these discussions, it was identified that this regulatory concern may not be appropriate to address through the accounting standards but may warrant discussion under the Capital Adequacy (E) Task Force. Subsequent discussions from the Financial Condition (E) Committee directed the new RBC working group (the RBC Investment Risk and Evaluation (E) Working Group) to evaluate this and any other investment-related RBC items. Subsequent to these discussions, the RBC Investment Risk and Evaluation (E) Working Group assumed a project to assess RBC factors for residual interests. An interim approach was adopted to include a 30% base RBC factor with a 15% sensitivity test for year-end 2023, with a 45% base RBC factor and 0% sensitivity for year-end 2024. Continued discussion is expected under a long-term project.

77. <u>Use of NAIC Designation / SVO Review in Determining Bond / Schedule D-1 Reporting</u>: The accuracy of the financial statements, and compliance with statutory accounting provisions, is the responsibility of the reporting entity. Assessment and compliance with key concepts, such as the "meaningful cash flow generation" and "substantive credit enhancement" concepts for ABS are also the responsibility of the reporting entity, along with appropriate documentation of these assessments for regulator review when requested. Consistent with the existing *NAIC Policy Statement on Coordination of the Accounting Practices and Procedures Manual and the Purposes and Procedures Manual of the NAIC Investment Analysis Office*, a reporting entity cannot utilize an NAIC designation to conclude on the substance of an investment or the resulting reporting schedule. Pursuant to the policy statement, obtaining an NAIC designation does not change an investment's applicable SSAP, annual or quarterly statement reporting schedule, or override SSAP guidance required for an investment to be an admitted asset.

78. Questions have been received whether an NAIC designation in the AVS+ product or an assessment of an investment from a "Regulatory Treatment Analysis Service" (RTAS) submission from the SVO can be utilized as support that an investment qualifies as a bond for Schedule D-1 reporting. These are inaccurate interpretations on the use of NAIC designations within those products. The assignment of an NAIC designation (either from the SVO or CRP) reflects the credit quality of an investment. An assessment of credit quality does not provide assurances that the investment qualifies for reporting as a bond on Schedule D-1 as an ICO or an ABS. As part of this principles-based bond project, consideration is planned to expand the ability to report and use NAIC designations on Schedule BA so that investments that do not qualify as bonds can have appropriate risk assessments that factor in the credit quality of the investment. This capability would ultimately depend on action by the Capital Adequacy (E) Task Force.

79. Although the NAIC designation and RTAS processes cannot be used in determining Schedule D-1 compliance, it is envisioned that a small group of regulators and NAIC staff could be formed to review specific investment structures under the principle-based concepts to assist in assessments of complex new investment designs. If formed, it is anticipated that NAIC staff on the statutory accounting side and within the SVO would assist this small group.

80. <u>Interest Only / Principal Only Strips</u>: Discussion occurred on whether specific guidance should direct the reporting of interest only (IO) and principal only (PO) strips. The resulting conclusion from this

 

discussion was that the principle concepts from the bond definition should continue to be applied to these investments. If the strips qualify within the definition as ICO, they would be captured in scope of that guidance. If the strips qualified as ABS, they would be captured in scope of that guidance. It was noted that interest-only strips shall also be assessed in accordance with the residual guidance. If the interest-only strip reflects excess interest (e.g., remaining differential spread from interest collected from interest paid), these investments would be akin to a residual investment without contractual interest or principal payments and shall be captured in scope of that guidance. (Residuals are in scope of SSAP No. 21 and required to be reported on Schedule BA. Residuals are not permitted to be reported on Schedule D-1.)

81. The discussion of IO/PO strips with industry representatives identified that they are not overly prevalent investments with insurance reporting entities. It was also noted that IO/PO based on RMBS are relatively rare due to the prepayment risk, however those based on CMBS generally have contractual provisions that prohibit prepayments, thus ensuring that they act more akin to typical bonds. This discussion further highlighted that changes to the principal-based bond definition are not justified for IO/PO investments, and insurers should document their accounting policies for these investments to demonstrate compliance with the bond definition.

82. The discussion of IO/PO strips focused on U.S. Treasury strips and mortgage-backed securities as likely investments, but it was noted that the application of the overall bond definition concepts should be applied to any future design of these investments. Specific elements noted for the two general designs:

a. U.S. Treasury Strips: Treasury Strips are created when a bond’s coupons are separated from the bond. The coupons separated from the bond are sold individually (IO), becoming separate securities from the principal payments due at maturity (PO). U.S. Treasury Strips are backed by the U.S. government. U.S. Treasury strips (IO and PO) are considered U.S. government issues and would be captured with other securities backed by the U.S. government as ICO. Specific identification of U.S. Treasury strips as a separate reporting line of ICO investments, captured within the U.S. government category, was noted to be repetitive and not necessary.

b. Mortgage-Backed Securities and Other Non-Treasury Strips: Other IO and PO strips are required to be assessed in accordance with the principle concepts of the bond definition. It is anticipated that non-U.S. strips (including mortgage-backed security strips) would not qualify as ICO and shall be reviewed in accordance with the ABS concepts to determine whether the strip qualifies for reporting as a bond on Schedule D-1. The separation of the principal and interest components into separate securities does not change the application of the principle concepts for determining whether a security qualifies as a bond. It was noted that IO strips could be high in the capital structure (supported by subordination) or could represent residual interests (reflecting the spread between proceeds collected and contractual interest). The specific details of the individual IO/PO security shall determine the appropriate accounting and reporting.

83. The discussion of IO/PO strips identified that there is no current need to have separate reporting lines to identify these items within the investment schedules. However, it was identified that the ability to identify these investments with a code (or other feature) would allow for future aggregation and assessment. This was requested to be considered as part of the reporting revisions.

84. <u>Embedded Derivatives / Underlying Variables</u>: Discussion occurred on the language that precludes bond reporting based on the appreciation or depreciation of an underlying collateral value or other variable. Although industry comments noted that the intent of the language was understood, it was identified that the language could be interpreted to mean that amounts in both the magnitude and timing of principal and interest payments must be known in advance, and 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 or depreciation of an asset or variable. It was also noted that the reference to “other variable” could be

interpreted to mean interest is not allowed to vary based on any variable or just the appreciation or depreciation of the variable. After discussing these comments, revisions were drafted to clarify that the exclusion is not intended to restrict variables that are commonly related to debt instruments, such as but not limited to, plain vanilla inflation or benchmark interest rate adjustments (such as with U.S. TIPs or SOFR-Linked coupons), scheduled interest rate step-ups, or credit-quality related interest rate adjustments. Furthermore, as detailed in footnote 3, this exclusion is not intended to encompass nominal interest rate adjustments. This guidance has also been incorporated within the provisions for determining whether a debt instrument represents a creditor relationship and is applicable for debt instruments structured as ICO and ABS.

**<u>Accounting for Debt Securities That Do Not Qualify as Bonds</u>**

85. Securities that reflect debt instruments that do not qualify for bond reporting as an ICO or an ABS shall follow specific guidance captured in SSAP No. 21 and be reported on Schedule BA. Investments in scope of this guidance are limited to items that would be in scope of SSAP No. 26, but that do not qualify for bond reporting as they reflect:

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.

86. The debt securities captured in the SSAP No. 21 guidance meet the definition of assets as defined in SSAP No. 4 and are admitted assets to the extent they conform to the requirements within SSAP No. 21. The provisions are specific that the guidance for non-bond debt securities in SSAP No. 21 shall not be inferred to other securities or investment structures.

87. Debt securities in scope of SSAP No. 21 that do not qualify as bonds under SSAP No. 26 and for which the primary source of repayment is derived through rights to underlying collateral, qualify as admitted assets if the underlying collateral primarily qualify as admitted invested assets. As detailed in the SSAP No. 21 guidance pertaining to residual tranches, any residual tranches or first loss positions held from the same securitization that did not qualify as a bond under SSAP No. 26 also only qualify as admitted assets to the extent the underlying collateral primarily qualifies as admitted invested assets.

88. Debt securities in scope of the SSAP No. 21 guidance shall be reported at acquisition at cost, including brokerage and other related fees on Schedule BA. Subsequent measurement shall reflect 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. Debt securities in scope of SSAP No. 21 shall then follow the guidance in SSAP No. 43 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 the interest maintenance reserve (IMR).

89. During the SSAP No. 21 discussion, industry inquired on the direction to utilize SSAP No. 43 for the components detailed in paragraph 88, and not separately assess securities to determine if they are more akin to ICO or ABS and using either SSAP No. 26 or SSAP No. 43 based on those assessments for the calculation of amortized cost, OTTI and allocating AVR/IMR. With this discussion, it was noted that investments that fail the creditor relationship test are identified before determining whether the security would be an ICO or ABS, and as the components of SSAP No. 43 are more relevant for debt securities that do not qualify as bonds, and to ensure consistency for all non-bond debt securities in scope of SSAP No. 21, the decision to utilize SSAP No. 43 for all debt securities that do not qualify as bonds was retained.

**Transition Guidance**

90. At the time of transition to apply the guidance adopted to reflect the principles-based bond definition, 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 (as of the origination date), 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 origination, reporting entities may utilize current or acquisition information in concluding that a security qualifies for reporting as a bond as either an ICO or ABS.

91. 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 definition 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 guidance in SSAP No. 21 for non-bond debt securities, 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—Accounting Changes and Corrections of Errors*, 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, BACV 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 January 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 BACV. 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 applicable SSAP guidance 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.

c. After application of the transition guidance 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 BACV that exceeds amortized cost.

92. 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 BACV for all securities reclassified off Schedule D-1.

b. Aggregate BACV after transition for all securities reclassified off Schedule D-1 that resulted with a change in measurement basis. (This shall be a subset of the aggregate BACV reclassified off Schedule D-1 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 BACV as of December 31, 2024 and BACV 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.

93. ABS 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 January 1, 2025. Similar to the process detailed above, the securities shall be removed from Schedule 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. Immediately 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.

94. The transition guidance shall be applied prospectively beginning with the first year of adoption (January 1, 2025). For disclosures that provide comparative information, reporting entities shall not restate the prior year’s information in the 2025 disclosure.

**Investment Examples – Securities That Do Not Represent Creditor Relationship Despite Legal Form**

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

96. 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.

97. 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, or an equity-based derivative, is a bond under the principles-based bond definition as such security would contain equity-like characteristics.

98. 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 ICO.

99. Example 2 Rationale: Determining whether debt instruments collateralized by equity interests qualify as bonds under the principles-based bond definition inherently requires significant judgment and analysis. Unlike debt instruments collateralized by assets with contractual cash flows, or debt instruments collateralized by cash-generating non-financial assets, debt instruments collateralized by equity interests may be dependent on cash flow distributions that are not contractually required to be made and/or may not be controlled by the issuer of the debt. In some instances, sale or refinancing of the underlying equity interests may be the only means of generating cash flows to service the debt instruments. As a result, there is a rebuttable presumption that a debt instrument collateralized by equity interests does not qualify as a bond. Notwithstanding this rebuttable presumption, it is possible for such debt instruments to qualify as bonds, 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

i. Source(s) of expected cash flows to service the debt (i.e., dividend distributions from the underlying collateral vs. sale or refinancing of the underlying collateral)

100. While reliance on the sale of underlying equity interests or refinancing at maturity does not preclude the rebuttable presumption from being overcome, it does require that 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.

101. The analysis of the underlying structure 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 large and 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.

**Investment Examples – Analysis of ABS Under the Meaningful Cash Flows and Substantive Credit Enhancement Concepts**

102. All ABS structures are required to provide substantive credit enhancement to qualify for bond reporting on Schedule D-1. Furthermore, ABS structures that are backed by non-financial assets must generate meaningful cash flows to service the debt without reliance on the sale or refinancing at the maturity of the investment. The following provides examples of analysis under these criteria:

103. Example 3 – Agency Mortgage-Backed Securities: 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.

104. Example 3 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., knowledgeable investor transacting at arm's length) would conclude the Agency guarantee is expected to absorb all losses from the debt instrument. 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. 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 of the principles-based bond definition to determine if the holder is in a substantively different economic position than if the holder held the underlying assets directly.

105. Example 4 – Debt Instrument Issued by an SPV: 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 and 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. While the debt is outstanding, the lease, the lease payment, and the mortgage all serve as security for the debtholders. Should a default occur, the debtholders can foreclose on and liquidate the real property as well as submit an unsecured lease claim in the lessee's bankruptcy for any defaulted lease payments. The loan-to-value (LTV) (as a percentage of property value) at origination is 100%.

106. 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 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 real property 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 property could be liquidated over a reasonable period of time, if necessary.

107. Example 4 Rationale: The reporting entity determined that as a debtholder, they are in a fundamentally different position than if the real estate was owned directly. The 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 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 (greater than 50%), so a full analysis is required. In reaching 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 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 (50% loan-to-value) that would be able to be recovered by sale or refinancing at the maturity of the loan.

108. 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 real property directly, in accordance with the requirements of the principles-based bond definition. In reaching this conclusion, the reporting entity noted that although the debt instrument starts with a 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. 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., a knowledgeable investor transacting at arm's length) would consider this level of overcollateralization to put the investor in a substantially different economic position than owning the underlying property directly.

109. For the purpose 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 LTV that is expected to decrease over time is not necessarily deemed to have substantive overcollateralization.

110. Example 5 – Debt Instrument Issued by an SPV With Lease Term Less than Debt Instrument: A reporting entity invested in a debt instrument with the same characteristics as described in Example 4, except that the existing 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 property cannot be re-leased, there would not be enough cash flows to service the scheduled principal and interest payments, and the property would have to be liquidated to pay off the debt upon default.

111. Example 5 – Rationale: All details of this example, including the expected collateral cash flows, are consistent with those in Example 4, except that the cash flows in Example 4 are contractually fixed for the duration of the debt while the cash flows in this example are subject to re-leasing risk. Notwithstanding the involvement of re-leasing risk, the reporting entity concluded that the ability to re-lease the property was highly predictable and supported the conclusion that the underlying collateral was expected to produce meaningful cash flows to service the debt.

112. 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.

113. Example 6 – Lease in SPV with 80% Balloon Payment: 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 LTV at origination is 70%.

114. 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 LTV 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.

115. Example 6 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 issued debt 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.

116. The reporting entity also determined that the structure lacks a substantive credit enhancement to conclude that investors are in a different economic position than holding the equipment directly, in accordance with the requirements of the principles-based bond definition. In reaching this conclusion, the reporting entity noted that the debt starts with a 70% LTV, 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 LTV (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.

117. 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 LTV that is expected to increase over time is not necessarily deemed to have nominal overcollateralization.

**Reflecting the Principles-Based Bond Proposal in SAP**

118. The principles-based bond definition and the specific accounting guidance for bonds, including ICO and ABS, and the guidance for debt securities that do not qualify as bond be captured as new SAP concepts to existing SSAPs:

a. *SSAP No. 26—Bonds (Exhibit 1)*

b. *SSAP No. 43—Asset-Backed Securities* (renamed from Loan-Backed and Structured Securities) (Exhibit 2)

c. *SSAP No. 21—Other Admitted Assets (Exhibit 3)*

119. For SSAP No. 26, the revisions capture the full bond definition, and the guidance for determining whether a security qualifies as either an ICO or an ABS. The accounting guidance for ICO is retained within SSAP No. 26 and is not changed with the inclusion of the bond definition. Other key revisions include transition guidance to reclassify debt securities that do not qualify as bonds from Schedule D-1 to the subsequent schedule and to delete the glossary as no longer necessary.

120. For SSAP No. 43, in addition to revising the name to "Asset-Backed Securities," revisions reorder and streamline the existing guidance. Although the broad measurement concepts and requirements to assess cash flows have not changed, the guidance specific to whether collection of cash flows is probable, not probable, and pertains to beneficial interests has been eliminated. The guidance has been rewritten to provide consistent guidance for the assessment of cash flows and considering the impact of prepayments. These revisions are not expected to result in significant deviations from past practice as the resulting guidance is believed to be reflective of prominent past industry interpretations. Clarifications have been included to ensure recognition of an other-than-temporary impairment whenever a security is in an impaired state (fair value is less than amortized cost, regardless of if an unrealized loss has been recognized) and there is an adverse change in cash flows expected to be collected. Other key revisions include transition guidance to reclassify debt securities that do not qualify as bonds from Schedule D-1 to the subsequent schedule as well as to incorporate guidance that prohibits reporting ABS as cash equivalents or short-term investments and the process to reclassify any securities reported as such as of the effective date.

121. For SSAP No. 21, revisions incorporate new guidance for the accounting and reporting for debt securities that do not qualify as bonds as well as residual interests. For both sections, the revisions specify new measurement and admittance concepts for these securities and specify reporting on Schedule BA in designated reporting lines. For residuals, guidance is included for the recognition of other-than-temporary impairments and transition guidance for situations where the residual had a different measurement method prior to the effective date.

122. In addition, Exhibit 4, details "revisions to other SSAPs" adopted in accordance with the principles-based bond definition. This section identifies all SSAPs that have modified guidance, which predominantly

reflects updated terms and references, but includes the revisions to SSAP No. 2R to restrict ABS from being in scope.

**<u>Discussion of Comments Received and Exposures</u>**

123. This section details key comments received from exposures of the principles-based bond definition revisions and the Working Group's consideration for potential edits.

a. Per the exposure of the issue paper and principles-based bond definition on March 2, 2022, with comments due May 6, 2022. The Working Group heard comments on July 18, 2022, and directed limited edits to be reflected as followed:

i. Revise the guidance related to U.S. Treasury Inflation Protected Securities (TIPs) and to clarify the guidance regarding variable contractual principal and interest payments. These revisions clarified that securities with plain-vanilla inflation adjustment mechanisms are not intended to be captured within the provisions that restrict bond classification due to varying principal or interest payments, as well as clarified that other variances in contractual amounts due to reference variables (and not just equity interests) are intended to be precluded from bond treatment.

ii. Revise guidance describing substantive credit enhancements, particularly to revise reference to the first loss "tranche" as the first loss "position" and clarify that securitization tranches that do not have contractual principal and interest payments along with substantive credit enhancement do not qualify as a Schedule D Bond and shall be reported on Schedule BA. (Tranches without contractual principal and interest payments are considered residual tranches shall be on Schedule BA.) (Subsequent to these edits further discussion and updates to the residual guidance were adopted. These revisions improve the guidance and remove specific references to contractual principal and interest payments.)

iii. Document the outcome of small group discussions around the application of the bond principles, particularly the equity-backed example, to feeder fund structures. Feeder fund structures shall not automatically be assumed to qualify for bond classification (even if the ultimate collateral is fixed income), nor be automatically precluded bond classification. The substance of the investment should be the determining factor in these and other similar situations. In particular, the assessment of feeder fund structures should evaluate whether the structure ensures the pass through of the underlying cash flows, or whether uncertainty as to the timing or amount of cash flows is introduced by the structure.

iv. Requested interested parties to work with NAIC staff in proposing revisions to capture the elements that may introduce equity-like characteristics into the main components of the bond definition.

b. In addition to the revisions incorporated from the July 18, 2022, call, the Working Group also heard comments and elected not to incorporate revisions for the following items:

i. The Working Group identified that non-bond items that are specifically scoped into SSAP No. 26 will not be identified in the bond definition. The Working Group was explicit that the inclusion of an investment in-scope of SSAP No. 26 did not make the investment a "bond" and such a distinction is necessary to prevent scope-creep or inference of other investments into the bond definition. For example, although SVO-Identified Bond ETFs, SVO-Identified CTLs and certificates of deposit that exceed one year are explicit inclusions to SSAP No. 26 and reported on Schedule D-1, these investments are not bonds.

ii. The Working Group did not incorporate industry-proposed edits to limit guidance that requires the consideration of all returns to equity-backed ABS. Rather, the Working Group clarified that all investments that have contractual principal and interest that can fluctuate due to a referenced variable shall consider all returns in excess of principal repayment as interest when determining whether the investment qualifies for bond reporting under the principles-based definition.

iii. The Working Group did not agree with comments supporting ABS to be reported as cash equivalents or short-term investments even if acquired with a maturity date that is less than 90-days or 1-year away. To ensure proper assessment under the bond definition, and reporting based on the underlying components of the investments, the Working Group retained the provisions that all ABS shall be captured within SSAP No. 43 and be reported on Schedule D-1-2.

iv. The Working Group did not direct changes to the bond definition or issue paper after considering the industry "Lease-Backed Securities Working Group" May 5, 2022, comment letter. That letter, which is consistent with their prior comments, proposes to capture securities as ICO if they pass-through cash flows unaltered (such as with certain lease-backed structures) and are supported primarily by a single rated credit payor, though principal repayment is not fully supported by the obligation of that payor. The discussion noted that these securities shall follow the guidance for ABS if they are not fully supported by an underlying contractual obligation of a single operating entity, including the criteria for substantive credit enhancement and meaningful cash flows. The Working Group identified that these structures are not based on the credit worthiness of a single operating entity and rely on the underlying collateral for repayment, which is why they should be considered ABS rather than ICO. The comment letter also raised concerns around the guidance for evaluating project finance debt noting a perception that inconsistent classification may occur for investments with similar characteristics. As a result of the discussion, there were no changes to the exposed bond definition. Working Group members and other interested parties noted during the discussion that the guidance pertaining to project finance is intended to provide guidance for evaluating issuers that share characteristics of both operating entities and ABS Issuers (i.e., the middle of the spectrum). Nevertheless, the guidance is clear that issuers of project finance debt must themselves have the characteristics of operating entities in order for the debt instrument to qualify as an ICO. As such, project finance bonds issued by operating entities and other municipal revenue bonds will be retained as ICO as the design of these structures are supported by the credit worthiness of a single operating entity and are therefore different than the investment structures presented by the industry Lease-Backed Securities Working Group.

c. Per the exposure of the principles-based bond definition, and proposed revisions to SSAP No. 26 and SSAP No. 43 on August 10, 2022, with comments due October 7, 2022, comments were received from Fermat Capital, the industry Lease-Backed Securities Working Group and Interested Parties. After considering the comments, the following key revisions were incorporated:

i. Revisions to incorporate the entire bond definition within SSAP No. 26, with a deletion of bond definition guidance from SSAP No. 43. With this change, securities that qualify as ABS after application of the bond definition will follow the measurement and reporting guidance within SSAP No. 43. This edit prevents unintended inconsistencies in the guidance that could occur if aspects of the bond definition are in both SSAPs.

ii. Revisions to incorporate the guidance for determining a creditor relationship, which was in an exhibit, into the body of guidance within SSAP No. 26.

iii. Revisions to the examples for ABS analysis, which were moved to SSAP No. 26, to reflect a scenario in which payments under the instrument are secured by a note, a legal assignment from the borrower of a lease for real property and the assignment of the lease payments from an operating entity tenant. This revision was in response to comments from the industry Lease-Backed Security Working Group and detail that the SPV does not need to have ownership interest in the underlying collateral for the security to qualify as an ABS.

iv. Revisions to SSAP No. 26 to clarify that investments with specific guidance and reporting lines (such as surplus notes, working capital finance investments (WCFI) and structured settlements) shall follow the guidance in their specific SSAP and be reported on designated reporting lines. This edit was made in response to the comments from Fermat Capital, who identified that WCFI meet the definition of ICO. These investments shall follow the guidance *in SSAP No. 105R—Working Capital Finance Investments* and be reported on their specific reporting lines on Schedule BA.

v. Revisions to SSAP No. 26, and the addition of a new footnote, to clarify that the general creditworthiness of an entity can be direct or indirect recourse and is the primary source of repayment for issuer credit obligations.

vi. Revisions to SSAP No. 26 to clarify application when interest and principal vary based on the performance of an underlying value or variable. The revised guidance adds language to clarify that the exclusion is not intended to restrict variables that are commonly linked to debt instruments, such as plain-vanilla inflation or benchmark interest rates.

vii. Revisions to SSAP No. 26 to delete the proposed glossary, with the inclusion of the bank loan definition into a footnote. Other definitions were identified as not being necessary for retained inclusion in the statement.

viii. Revisions to SSAP No. 43 to identify Freddie-Mac When Issued Trust Certificates, pursuant to *INT 22-01: Freddie Mac When Issued K-Deal (WI Trust) Certificates*, as an explicit scope inclusion.

ix. Revisions to SSAP No. 43 to clarify the guidance for prospective adjustment method for high-credit quality investments, and on the assessment of cash flows. This guidance clarifies that if a security is in an unrealized loss position, and there is an adverse change in cash flow, the entity shall recognize an other-than-temporary impairment.

x. Revisions to both SSAP No. 26 and SSAP No. 43 to provide specialized transition and disclosure guidance for the reclassification of securities previously reported that will no longer qualify for reporting as bonds.

xi. Revision to the issue paper to clarify the application of the principles-based bond definition to feeder funds.

 

d. Per an exposure on November 16, 2022 of SSAP No. 26, SSAP No. 43 and other SSAPs that will be impacted under the bond project, until February 10, 2023, revisions were incorporated to reflect most of the interested party comments. The revised documents were discussed and exposed at the 2023 Spring National Meeting. Most of the edits were minor, but the following elements are specifically noted:

i. Revisions to SSAP No. 26 incorporated an exception for nominal interest rate adjustments. The guidance defines the exception as being too small to be taken into consideration when assessing an investment's substance as a bond. This revision was added based on industry's comments on inadvertent impact to sustainability-linked bonds, but the exception guidance is not limited to those specific bonds.

ii. Revisions clarify that replication (synthetic asset) transactions are addressed in *SSAP No. 86—Derivatives* and are not impacted by the principles-based bond definition.

iii. Revisions to SSAP No. 26 to explicitly identity that residuals, including first loss positions, do not qualify as bonds and shall be captured in *SSAP No. 21—Other Admitted Assets*.

iv. Revisions specific to transition that clarify that investment assessments are required as of origination and to permit current or acquisition information in determining whether investments qualify as bonds at the time of transition. The guidance was also clarified that the transition guidance shall be applied prospectively beginning with the first year of adoption. For disclosures that provide comparable information, reporting entities shall not restate the prior year's information in the 2025 disclosure.

v. With an exposure of the revised documents, an updated SSAP No. 21 was also exposed to update guidance for the measurement of debt securities at the lower of amortized cost or fair value and to incorporate proposed accounting and reporting guidance for residuals.

e. The Statutory Accounting Principles (E) Working Group received comments on June 9, 2023, from the 2023 Spring National Meeting exposure. No comments were received on SSAP No. 26, SSAP No. 43 or the document that detailed revisions to other SSAPs. The Working Group adopted the SSAP revisions reflected in these documents on August 12, 2023, during the 2023 Summer National Meeting, effective January 1, 2025.

f. During the 2023 Summer National Meeting, the Working Group considered comments on SSAP No. 21 pertaining to the guidance for debt securities that do not qualify as bonds and for residual interests and exposed a revised SSAP No. 21 until September 29, 2023. The revisions for debt securities that do not qualify as bonds reflect a majority of interested parties' comments.

i. For debt securities that do not qualify as bonds, revisions clarify that if the primary source of repayment is derived through underlying collateral, the investment shall only be admitted if the underlying collateral qualifies as admitted invested assets. For residuals, revisions clarify that if the reporting entity holds a debt tranche from the same securitization, and the debt tranche does not qualify as a bond (either an ICO or ABS), and the debt security does not qualify as an admitted asset under SSAP No. 21, then the residual does not qualify as an admitted asset.

ii. Revisions proposed new measurement methods for residuals. This guidance is different from what was proposed by interested parties but intends to reflect the highly uncertain amount and timing of residual cashflows. This proposed guidance will require all cash flows received to be treated as a return of principal until the BACV is zero. At that point, all cashflows received would be treated as interest income. This proposed guidance was noted to best suit how residuals work conceptually. The reporting BACV will reflect the potential risk of loss prior to recovering the initial investment, rather than requiring an assessment of potential loss over the entire life of the securitization.

g. During the 2023 Fall National Meeting, the Working Group considered comments and exposed an updated SSAP No. 21 until January 22, 2024. No comments were received on the section for non-bond debt securities, but comments focused on the guidance for residual interests. Revisions reflected in the 2023 Fall National Meeting exposure:

i. Revisions capture an Allowable Earned Yield method for the measurement of residuals. This guidance will limit the extent interest income can be recognized without recognizing cash flows as return of principal. Provisions were also included to permit a practical expedient to allow all cash flows received to be taken as a reduction of BACV. Under the practical expedient, interest income would not be recognized until BACV was zero.

ii. Revisions clarified the treatment of reductions in fair value as unrealized losses and updated OTTI guidance to be consistent with SSAP No. 43 and the assessment of the present value of expected cash flow to the BACV.

h. On February 22, 2024, an updated SSAP No. 21 reflecting a variety of edits from working with industry throughout the interim was exposed until March 7, 2024. The shortened comment period was proposed to allow for adoption consideration during the 2023 Spring National Meeting.

i. Revisions for residual incorporate the definition and characteristics captured in other SSAPs to make SSAP No. 21 the location for all residual guidance. All residuals shall follow the accounting, admittance and reporting guidance detailed in SSAP No. 21.

ii. Revisions clarified that residuals shall be accounted for at the lower of Allowable Earned Yield method or fair value, or under the practical expedient.

iii. Revisions eliminated the guidance that directed reclassification of residuals to other SSAPs and reporting schedules in situations when the residual tranches cease to meet the definition of residual tranches. With the deletion, once classified as a residual, an investment would retain that classification and reporting until it is disposed by the reporting entity.

iv. Revisions separate the OTTI calculation between items measured at the Allowable Earned Yield method and those that follow the practical expedient.

v. Revisions incorporate transition guidance for residuals that were accounted for under a different SSAP prior to the effective date.

vi. Revisions prescribe a January 1, 2025, effective date, but permit early adoption of the residual guidance.

**History of Definition / Scope Development of SSAP No. 43 – Before the Principles-Based Definition**

*The following section details the historical development of SSAP No. 43 along with the prior benefits for reporting investments in scope of SSAP No. 43 and key issues from the prior guidance. Due to various revisions that have been reflected since its original adoption, this information is retained for historical reference on the SSAP No. 43 guidance prior to the reflection of the principles-based bond proposal.*

124. *SSAP No. 43—Loan-backed and Structured Securities* was originally effective with the SAP codification and resulted with separate guidance for "bonds" (in SSAP No. 26) and "loan-backed and structured securities" (in SSAP No. 43). (The initial guidance indicated that investments in scope of SSAP No. 43 met the definition of a bond in *SSAP No. 26—Bonds, excluding Loan-backed and Structured Securities*.) Although most of the guidance between the original SSAP No. 26 and SSAP No. 43 was the same, the guidance in SSAP No. 43 recognized the need to review (at least quarterly) the assumptions and resulting cash flows of the underlying loans, as changes in assumptions could necessitate a recalculation of the effective yield or other-than-temporary impairment.

125. The original issue paper to SSAP No. 43 (Issue Paper No. 43) cited guidance originally contained in Chapter 1, *Bonds and Loaned Backed and Structured Securities*, from the *Accounting Practices and Procedures Manual of the Life and Accident and Health Insurance Companies*. The issue paper identified that the *Accounting Practices and Procedures Manual for Property and Casualty Insurance Companies* contained similar guidance. In this Issue Paper No. 43, and the original SSAP No. 43, loan-backed securities were defined as "pass-through certificates, collateralized mortgage obligations (CMOs) and other securitized loans…" The reference to "securitized loans" was a key aspect of this original definition.

126. Original definition / scope guidance for SSAP No. 43:

> 2. Loan-backed securities are defined as pass-through certificates, collateralized mortgage obligations (CMOs), and other securitized loans not included in structured securities, as defined below, for which the payment of interest and/or principal is directly proportional to the interest and/or principal received by the issuer from the mortgage pool or other underlying securities.
>
> 3. Structured securities are defined as loan-backed securities which have been divided into two or more classes for which the payment of interest and/or principal of any class of securities has been allocated in a manner which is not proportional to interest and/or principal received by the issuer from the mortgage pool or other underlying securities.
>
> 4. Loan-backed securities are issued by special-purpose trusts (issuer) established by a sponsoring parent organization. Mortgage loans or other securities securing the loan-backed obligation are acquired by the issuer and pledged to an independent trustee under the issuer's obligation has been fully satisfied. The investor can only look to the issuer's assets (primarily the trusteed assets or third parties such as insurers or guarantors) for repayment of the obligation. As a result, the sponsor and its other affiliates may have no financial obligation under the instrument, although one of those entities may retain the responsibility for servicing the underlying mortgage loans. Some sponsors do guarantee the performance of the underlying loans.
>
> 5. Loan-backed securities meet the definition of assets as defined in *SSAP No. 4—Assets and Nonadmitted Assets* and are admitted asset to the extent they conform to the requirements of this statement.

127. In agenda item 2007-26, *FAS 156: Accounting for Servicing of Financial Assets an amendment of FASB Statement No. 140,* the Working Group adopted with modification FAS 156 in *SSAP No. 91R—Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, revising the terminology for "retained interests" to "interests that continue to be held by the transferor." This action also clarified that beneficial interests from the sale of loan-backed and structured securities shall be accounted for in accordance with SSAP No. 43. This initial adoption identified that the holder of a beneficial interest in securitized financial assets should recognize the excess of all cash flows attributed to the beneficial

interest estimated at the acquisition date over the initial investment as interest income over the life of the beneficial interest using the effective yield method.

128. In 2009, the Working Group adopted a substantively-revised SSAP No. 43 (effective September 30, 2009). The focus of the substantive revisions was to revise the valuation and impairment requirements based on the cash flows expected to be collected for the securities, rather than fair value. Although the focus of the revisions was inclusion of impairment guidance based on whether an entity has an intent to sell, whether an entity does not have the intent and ability to hold a security, and when there is a non-interest related decline if there is no intent to sell and the entity has the intent and ability to hold, the revisions resulted in a significant rewrite of the guidance in SSAP No. 43, including the guidance for beneficial interests. This guidance expanded the prior scope inclusion from "beneficial interests from the sale of LBSS," to include "purchased beneficial interests in securitized financial assets."

129. In agenda item 2010-12, Clarify Definitions of Loan-Backed and Structured Securities, the Working Group received a regulator-sponsored, nonsubstantive Form A with a proposal to revise the definitions of a loan-backed and structured security (LBSS). As a result of this proposal, the definition was revised to eliminate the reference to "securitized loans" and instead refer to "securitized assets." These revisions were adopted with an effective date of January 1, 2011.

a. Although the agenda item simply identifies that this item was exposed in August 2010, and then adopted after a single exposure in October 2010, with an effective date of January 1, 2011, there were significant comments received during the exposure period. In short summary, these comments highlighted that the scope of the changes were intended to move fixed-income assets that had been accounted for as bonds under SSAP No. 26 to SSAP No. 43 as LBSS. Particularly, the comments noted concerns with the movement of equipment trust certificates and credit tenant loans from the accounting provisions of SSAP No. 26 to the accounting rules of SSAP No. 43. These comments stated that "instruments with radically different sources of cash flows and risk characteristics utilize trust structures, and not all should be classified as loan-backed." There were no changes incorporated to the proposed guidance as a result of these comments, and the revisions were adopted as exposed.

130. In 2019, revisions to the definition and scope section were also adopted to clarify the identification of affiliate/related party transactions (agenda item 2019-03) as well as to explicitly capture mortgage-referenced securities issued from a government sponsored enterprise in scope of SSAP No. 43 (agenda item 2018-17). The inclusion of mortgage-referenced securities was a distinct departure from the "trust" structure required in determining inclusion within scope of SSAP No. 43, but was incorporated as the securities (with the referenced pool of assets), functions similarly to the securities held in trust and the referenced pool of assets can be assessed for the underlying credit risk

131. Between the adoption of agenda item 2010-12 and the items adopted in 2019, there were several revisions to SSAP No. 43, but those revisions did not impact the definition / scope of the statement. Those revisions included changes to incorporate price-point NAIC designations, guidance for interim financials for RMBC/CMBS, clarification of disclosures, updating Q/A guidance, and guidance for prepayment fees.

132. Definition of loan-backed and structured securities in the "As of March 2020" AP&P Manual:

> 2. Loan-backed securities are defined as securitized assets not included in structured securities, as defined below, for which the payment of interest and/or principal is directly proportional to the payments received by the issuer from the underlying assets, including but not limited to pass-through securities, lease-backed securities, and equipment trust certificates.
>
> 3. Structured securities are defined as loan-backed securities which have been divided into two or more classes for which the payment of interest and/or principal of any class of securities has

been allocated in a manner which is not proportional to payments received by the issuer from the underlying assets.

4. Loan-backed securities are issued by special-purpose corporations or trusts (issuer) established by a sponsoring organization. The assets securing the loan-backed obligation are acquired by the issuer and pledged to an independent trustee until the issuer's obligation has been fully satisfied. The investor only has direct recourse to the issuer's assets, but may have secondary recourse to third parties through insurance or guarantee for repayment of the obligation. As a result, the sponsor and its other affiliates may have no financial obligation under the instrument, although one of those entities may retain the responsibility for servicing the underlying assets. Some sponsors do guarantee the performance of the underlying assets.

a. In determining whether a loan-backed structure is a related party investment, consideration shall be given to the substance of the transaction, and the parties whose action or performance materially impacts the insurance reporting entity holding the security. For example, although a loan-backed security may be acquired from a non-related issuer, if the assets held in trust predominantly[4] 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, and the transaction shall also subject to the accounting and reporting provisions in *SSAP No. 25—Affiliates and Other Related Parties*.

5. Mortgage-referenced securities do not meet the definition of a loan-backed or structured security but are explicitly captured in scope of this statement. In order to qualify as a mortgage-referenced security, the security must be issued by a government sponsored enterprise[5] in the form of a "credit risk transfer" in which the issued security is tied to a referenced pool of mortgages. These securities do not qualify as "loan-backed securities" as the pool of mortgages are not held in trust and the amounts due under the investment are not backed or secured by the mortgage loans. Rather, these items reflect instruments in which 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 for loan-backed securities within this standard apply to mortgage-referenced securities.

6. Investments within the scope of this statement are also subject to the provisions and disclosure requirements of SSAP No. 25 if the SSAP No. 43 transaction is a related party arrangement[6]. Loan-backed and structured 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.

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[4] 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. 43 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. 43 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.

[5] Currently, only Fannie Mae and Freddie Mac are the government sponsored entities that issue qualifying mortgage-referenced securities. However, this guidance would apply to mortgage-referenced securities issued by any other government sponsored entity that subsequently engages in the transfer of residential mortgage credit risk.

[6] As discussed in paragraph 4.a. of this statement, a SSAP No. 43 security may still be considered a related party transaction even if the asset trustee or security issuer is a non-related party.

7. The scope of this statement encompasses all types of loan-backed and structured securities, including, but not limited to, the following:

a. Loan-backed and structured securities acquired at origination,

b. Loan-backed and structured securities acquired subsequent to origination for which it is probable, at acquisition, that the reporting entity will be able to collect all contractually required payments receivable, and are accounted for at acquisition under SSAP No. 103R,

c. Loan-backed and structured securities for which it is probable, either known at acquisition or identified during the holding period[7], that the reporting entity will be unable to collect all contractually required payments receivable, and

d. Transferor's beneficial interests in securitization transactions that are accounted for as sales under SSAP No. 103R and purchased beneficial interests in securitized financial assets[8].

Benefits of Reporting in Scope of SSAP No. 43 – Before the Principles-Based Definition

133. There are a variety of benefits for reporting investments as bonds on Schedule D-1. Also, with regards to bifurcated impairment, capturing an investment in scope of SSAP No. 43 may be more advantageous than capturing in scope of *SSAP No. 26—Bonds*. These benefits include:

a. Capturing an investment in scope of SSAP No. 26 or SSAP No. 43 results with reporting the investment on Schedule D-1, Long-Term Bonds. By reporting on this bond schedule, the investment is generally not subject to investment limitations, the asset is admitted and the investment has the benefit of lower risk-based capital (RBC) charges based on NAIC designation. (Moving held equity instruments from Schedule BA into a SSAP No. 43 trust has been particularly noted as providing "regulatory capital relief.")

b. Capturing an investment in scope of SSAP No. 26 or SSAP No. 43 may result in amortized cost reporting and a delay in recognizing decreases in value or other-than-temporary impairments than if the assets held in trust were reported separately on the statutory financial statements.

i. Under the SSAP No. 43 bifurcated impairment model, an entity is not required to recognize an OTTI or deviate from an amortized cost measurement as long as the entity can assert that they have the intent and ability to hold the SSAP No. 43 security to recover the amortized cost basis and there is no non-interest related decline. (This has been a key factor in the PPN design, as a high-quality bond is placed in trust (along with other assets), and the bond – over several years – will single-handedly satisfy the contractual requirements of the 43 issued security, preventing any recognition of OTTI or a reduction of NAIC designation even when the other securities held in trust could completely default to zero.)

ii. The SSAP No. 43 bifurcated impairment can be considered an advantage over SSAP No. 26 as under SSAP No. 43, if there is an intent and ability to hold the asset, a reporting entity only has to recognize an OTTI for the portion of the non-

[7] Securities classified within the type of paragraph 7.a. or 7.b. may be required to change classification to type 6.c. when it becomes probable that the reporting entity will be unable to collect all contractually required payments receivable.

[8] The accounting requirements related to these types of securities included in paragraphs 22-25 shall be determined at acquisition or initial transfer.

interest related loss. Under SSAP No. 26, if there is any assessed OTTI (despite if interest or credit related), a reporting entity must recognize an OTTI down to the then-current fair value for the security.

iii. Prior to the principles-based bond project, guidance in SSAP No. 43 did not differentiate between different types of tranches or payment streams for the issued securities. This is easiest to illustrate through the "equity" tranche of a SSAP No. 43 investment but could be a factor if payments are provided sequentially. (Sequential payments are used to pay the senior notes first, until paid in full, before payments are allocated to junior notes.) For the "equity" tranche, which is a term that refers to the junior-most layer of issued SSAP No. 43 securities, this tranche is the first-loss position and only receives payment after all other layers have been satisfied. Without prior guidance in SSAP No. 43 for this layer, entities were able to classify these residual tranches as "bonds" on Schedule D-1, which did not properly reflect the nature of those investments.

c. SSAP No. 43 permits admittance of the security without any verification to the assets held in trust. As such, if a reporting entity was to derecognize a joint venture or LLC from Schedule BA and reacquire through the ownership of a SSAP No. 43 security, the reporting entity would be permitted to admit the security without any verification of the joint venture or LLC held in trust. Under *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*, assets must have audited support (audited U.S. GAAP financials, audited reconciliation to U.S. GAAP, audited IFRS financials or audited U.S. tax basis equity) in order to be admitted in the statutory financial statements.

Key Issues with Scope / Definition Application of SSAP No. 43 – Before the Principles-Based Definition

134. With the existing guidance in SSAP No. 43, there are no restrictions to the assets that can be placed in trust and used to support securities issued from the trust structure. Although these structural designs are referred to as "securitizations" and reported as debt instruments, these investment structures may not reflect actual securitizations in which cash flows from multiple contractual debt obligations held in trust are used to pay principal and interest payments on the trust-issued security. The assets being securitized may include assets that are not cash flow producing, creating reliance on an underlying collateral valuation risk. Or, there may be no economic substance to the use of the securitization structure, such that the insurer is in the same economic position as owning the underlying assets directly. As a result, there is a regulatory concern that assets being represented as bonds may contain unidentifiable risks that regulators would not traditionally associate with bond risk.

135. As an additional issue of the existing guidance, questions have been raised on whether securities captured in scope of SSAP No. 43 would be "asset-backed securities" as defined by the Code of Federal Regulations (17 CFR 229.1101(c)). These questions have arisen as an SEC identified nationally recognized statistical rating organization (NRSRO) must be specifically approved to provide ratings of "asset-backed securities." Since the CFR definition is different than what is permitted in scope of SSAP No. 43, a rating from an NRSRO approved as a credit rating provider (CRP) that may not be approved by the SEC for "asset-backed securities" could provide a valid rating for a SSAP No. 43 instrument permitted as "filing exempt" if that asset was not an "asset-backed security." This has caused questions as regulators have identified designations given by CRPs not SEC approved to provide "ABS" designations and have questioned the use of these CRP ratings in determining the NAIC designation.

**Issue Paper Exhibits:**

*Staff Note: Although not captured, the final issue paper retained for historical purposes will include the following Exhibits reflecting the adopted guidance to initially reflect the principles-based bond definition.*

*Exhibit 1 – SSAP No. 26—Bonds*

*Exhibit 2 – SSAP No. 43—Asset-Backed Securities*

*Exhibit 3 – SSAP No. 21—Other Admitted Assets*

*Exhibit 4 – Revisions to Other SSAPs*

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2024/08-13-24 Summer National Meeting/Adoptions/Bond IP - Adopted 2024 Summer.docx

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

**Issue:** Review of *INT 03-02: Modification to an Existing Intercompany Pooling Arrangement*

**Check (applicable entity):**

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

**Description of Issue:**
This agenda item provides a review of Interpretation (INT) 03-02*: Modification to an Existing Intercompany Pooling Arrangement*, because of conflicts between INT 03-02 and *SSAP No. 25—Affiliates and Other Related Parties.* This agenda item was prompted by the recent focus of Statutory Accounting Principles (E) Working Group on related party transactions, recent queries to NAIC about how broadly to apply the guidance in INT 03-02 and the review of the SSAP No. 62R, paragraph INT 03-02 addresses the valuation of bonds in instances when bonds are used instead of cash for the payment among affiliates for amounts due on modifications to existing intercompany reinsurance pooling contracts. The discrepancy between the INT 03-02 and SSAP No. 25 has been identified through recent discussions evaluating related party transactions. Key excerpts of INT 03-02 are in the Authoritative Literature section below.

The primary accounting question that is a concern for this agenda item is INT 03-02, paragraph 11b which asks, "What is the appropriate valuation basis to be used for assets and liabilities that are transferred among affiliates in conjunction with the execution of a new reinsurance agreement(s) that serves to substantively modify an existing intercompany pooling arrangement?" The response provided in INT 03-02, paragraph 13 is, "The appropriate valuation basis to be used for assets and liabilities that are transferred among affiliates in conjunction with the execution of a new reinsurance agreement(s) that serves to substantively modify an existing intercompany pooling arrangement is statutory book value for assets and statutory value for liabilities. Book value is defined in the glossary of the *Accounting Practices and Procedure Manual*."

INT 03-02 states that it is an interpretation of the following three reinsurance statements: *SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance*, *SSAP No. 62R—Property and Casualty Reinsurance* and *SSAP No. 63—Underwriting Pools. SSAP No. 25—Affiliates and Other Related Parties* is not listed as an interpreted statement. However, as described below, the consensus in INT 03-02, paragraph 13 is not consistent with the guidance in SSAP No. 25 regarding economic transactions between related parties.

The result of the consensus in INT 03-02, paragraph 13 allows assets used in affiliated payments for reinsurance contracts, which modify existing intercompany reinsurance pooling agreements, to be transferred using statutory book value. Note that in most cases, this means that bonds, which are likely the primary assets that would be used, would typically have a statutory book value that reflects amortized cost. The valuation of assets using statutory book value on transfer to an affiliate can result in substantial differences from the cash equivalent (fair value) for the payment due. For example, bonds reported at amortized cost book value could have a corresponding fair value that is materially higher or lower. This difference in valuation can result in an unacknowledged dividend or with the passing on of an investment loss.

SSAP No. 25 describes economic transactions and non-economic transactions (See Authoritative Literature). Economic transactions are defined as arm's-length transactions which results in the transfer of the risks and rewards of ownership and represents a consummated act thereof, i.e., "permanence." SSAP No. 25, paragraph 18 indicates that economic transactions between related parties shall be recorded at fair value at the date of the transaction and also notes that to the extent that the related parties are affiliates under common control, the controlling reporting entity shall defer the effects of such transactions that result in gains or increases in surplus until such time that the asset is sold outside the group.

It is quite possible, by using transfers at book value instead of fair value, to design a transaction with a very significant economic effect. The following example illustrates the concern with the results of the guidance in INT 03-02. For this example, $100 million is due on an existing intercompany reinsurance pooling agreement. INT 03-02 would allow bonds to be settled using statutory book value which may not be reflective of the fair value equivalent of a cash settlement.

| **Asset Used to Settle** | **Book Value (millions) Measurement for Settlement** | **Fair Value (millions)** | **Result** | **Consistent with SSAP No. 25 for an Economic Transaction?** |
|---|---|---|---|---|
| Cash | $100 | $100 | No difference in basis | Yes |
| Bonds | $100 | $ 85 | $15 difference in fair value means the paid party received an amount less than what is actually owed. This approach could allow reporting entities to transfer impaired assets to affiliates in lieu of assessing OTTI. | No |
| Bonds | $100 | $110 | $10 difference in fair value means the paid party has received an asset greater than what was owed. This dynamic could result in an unrecognized gain or dividend. | No |

The INT 03-02 direction to use statutory book value for the transfer of bonds between affiliated entities in most instances would conflict with the primary guidance on affiliated transactions contained in *SSAP No. 25—Affiliates and Other Related Parties.* For example, economic transactions between related parties are valued using fair value. (There are more nuances in SSAP No. 25 when payments have the possibility of being economic for one entity and noneconomic for an upper-level parent). NAIC staff recommends that the treatment of transfers of assets between affiliates should be consistent for all intercompany transactions and there is not a compelling need to be different if assets are transferred instead of cash for intercompany reinsurance.

Under INT 03-02, for intercompany reinsurance transactions, takes an approach that either SSAP No. 25 or SSAP No. 62R may apply, but multiple Working Group discussions have noted that SSAP No. 25 provides the overarching guidance that is relevant in evaluating all related party transactions. INT 03-02, paragraph 8 indicates that the statutory accounting intention is to avoid surplus gains for the ceding entity as a result of implementing a modification to an intercompany pooling arrangement. However, the guidance in SSAP No, 62R, paragraph 37 uses a more punitive method of accounting if there is a gain in surplus to the ceding entity as a result of the intercompany reinsurance transaction. Therefore, NAIC staff would characterize the SSAP No. 62R guidance as imposing an accounting penalty if there is a gain, rather than seeking to avoid recognizing such a gain. The INT also characterizes SSAP No. 25 as being for isolated transactions, which is inconsistent with discussions of the Working Group on the applicability of SSAP No. 25.

SSAP No. 62R, paragraph 36d (see Authoritative Literature) includes an exception to retroactive reinsurance accounting which allows prospective accounting treatment for intercompany reinsurance agreements and any amendments thereto, among companies 100% owned by a common parent or ultimate controlling person <u>provided there is no gain in surplus as a result of the transaction.</u> Paragraph 37 provides that if there is a gain to the ceding entity that a more restrictive method of accounting is required which is less beneficial to the financial statements. Whereas the INT tries to argue that statutory intent is to avoid surplus gain, NAIC staff would note that the goal is not to avoid gain as a result of the reinsurance transaction, but to impose a different accounting if there is a gain. NAIC staff would characterize evaluating reinsurance agreements for SSAP No. 62R, paragraph 36d or paragraph

37 as using the cash flows or corresponding equivalent fair value (cash equivalent) of the amounts payable or receivable in the reinsurance transactions to determine if there is a gain or loss to the ceding entity. The reinsurance cash flows evaluated should be the same as if the bond was sold for fair value and resulting cash equivalent obligation was paid. The fact that the bond sold has a gain or loss is not part of the reinsurance contract evaluation, the reinsurance contract that is an economic transaction evaluation is based on the cash equivalent value of the assets transferred less the liabilities transferred. The evaluation of gain or loss on the intercompany reinsurance transaction should give the same answer if either cash or assets were transferred.

**Existing Authoritative Literature:**

03-02*: Modification to an Existing Intercompany Pooling Arrangement* is attached in full. The following excerpts are from INT 03-02:

> 8. Therefore, based on the foregoing guidance and background, the statutory accounting intent is to avoid surplus gains for the ceding entity as a result of implementing a modification to an intercompany pooling arrangement. On that basis, such a modification does not represent an economic transaction to the insurance group or to the impacted companies. As such, the transfer of both the assets and the liabilities valued at statutory book value ensures that there is no impact to surplus as a result of implementing a modification to an existing pooling arrangement.

11. The accounting issues are:

   a. What is the relevant guidance for modifications to intercompany pooling arrangements?

   b. What is the appropriate valuation basis to be used for assets and liabilities that are transferred among affiliates in conjunction with the execution of a new reinsurance agreement(s) that serves to substantively modify an existing intercompany pooling arrangement?

The Working Group reached a consensus as follows:

12. SSAP No. 62R provides accounting for property and casualty reinsurance agreements including specific guidance on intercompany pooling agreements. SSAP No. 62R provides two methods of accounting for changes in intercompany pooling agreements, depending on whether or not the pooling results in a gain in surplus.

13. The appropriate valuation basis to be used for assets and liabilities that are transferred among affiliates in conjunction with the execution of a new reinsurance agreement(s) that serves to substantively modify an existing intercompany pooling arrangement is statutory book value for assets and statutory value for liabilities. Book value is defined in the glossary of the *Accounting Practices and Procedure Manual*.

*SSAP No. 25—Affiliates and Other Related Parties*

**Transactions Involving the Exchange of Assets or Liabilities**

14. An arm's-length transaction is defined as a transaction in which willing parties, each being reasonably aware of all relevant facts and neither under compulsion to buy, sell, or loan, would be willing to participate. A transaction between related parties involving the exchange of assets or liabilities shall be designated as either an economic transaction or non-economic transaction. An economic transaction is defined as an arm's-length transaction which results in the transfer of the risks and rewards of ownership and represents a consummated act thereof, i.e., "permanence." The appearance of permanence is also an important criterion in assessing the economic substance of a transaction. In order for a transaction to have economic substance and thus warrant revenue (loss) recognition, it must appear unlikely to be reversed. If subsequent events or transactions reverse the effect of an earlier transaction prior to the issuance of the financial statements, the reversal shall be considered in determining whether economic substance existed in the case of the original transaction. Subsequent events are addressed in SSAP No. 9—Subsequent Events. An economic transaction must represent a bonafide business purpose demonstrable in measurable

terms. A transaction which results in the mere inflation of surplus without any other demonstrable and measurable betterment is not an economic transaction. The statutory accounting shall follow the substance, not the form of the transaction.

15. In determining whether there has been a transfer of the risks and rewards of ownership in the transfer of assets or liabilities between related parties, the following—and any other relevant facts and circumstances related to the transaction—shall be considered:

a. Whether the seller has a continuing involvement in the transaction or in the financial interest transferred, such as through the exercise of managerial authority to a degree usually associated with ownership;

b. Whether there is an absence of significant financial investment by the buyer in the financial interest transferred, as evidenced, for example, by a token down payment or by a concurrent loan to the buyer;

c. Whether repayment of debt that constitutes the principal consideration in the transaction is dependent on the generation of sufficient funds from the asset transferred;

d. Whether limitations or restrictions exist on the buyer's use of the financial interest transferred or on the profits arising from it;

e. Whether there is retention of effective control of the financial interest by the seller.

16. A transaction between related parties may meet the criteria for treatment as an economic transaction at one level of financial reporting but may not meet such criteria at another level of financial reporting. An example of such a transaction is a reporting entity purchasing securities at fair value from an affiliated reporting entity that carried the securities at amortized cost. This transaction meets the criteria of an economic transaction at this level of financial reporting, and therefore, the selling reporting entity would record a gain and the acquiring reporting entity would record the securities at their cost (fair value on the transaction date). At the common parent level of reporting, this transaction has resulted in the mere inflation of surplus, and therefore, is a non-economic transaction. The parent reporting entity shall defer the net effects of any gain or increase in surplus resulting from such transactions by recording a deferred gain and an unrealized loss. The deferred gain shall not be recognized by the parent reporting entity unless and until arms-length transaction(s) with independent third parties give rise to appropriate recognition of the gain.

17. A non-economic transaction is defined as any transaction that does not meet the criteria of an economic transaction. Similar to the situation described in paragraph 16, transfers of assets from a parent reporting entity to a subsidiary, controlled or affiliated entity shall be treated as non-economic transactions at the parent reporting level because the parent has continuing indirect involvement in the assets.

18. When accounting for a specific transaction, reporting entities shall use the following valuation methods:

a. Economic transactions between related parties shall be recorded at fair value at the date of the transaction. To the extent that the related parties are affiliates under common control, the controlling reporting entity shall defer the effects of such transactions that result in gains or increases in surplus (see paragraph 16);

b. Non-economic transactions between reporting entities, which meet the definition of related parties above, shall be recorded at the lower of existing book values or fair values at the date of the transaction;

c. Non-economic transactions between a reporting entity and an entity that has no significant ongoing operations other than to hold assets that are primarily for the direct or indirect benefit or use of the reporting entity or its affiliates, shall be recorded at the fair value at the date of the transaction; however, to the extent that the transaction results in a gain, that gain shall be deferred until such time as permanence can be verified;

d. Transactions which are designed to avoid statutory accounting practices shall be reported as if the reporting entity continued to own the assets or to be obligated for a liability directly instead of through a subsidiary.

Examples of transactions deemed to be non-economic include security swaps of similar issues between or among affiliated companies, and swaps of dissimilar issues accompanied by exchanges of liabilities between or among affiliates.

**Transactions Involving Services**

19. Transactions involving services between related parties can take a variety of different forms. One of the significant factors as to whether these transactions will be deemed to be arm's length is the amount charged for such services. In general, amounts charged for services are based either on current market rates or on allocations of costs. Determining market rates for services is difficult because the circumstances surrounding each transaction are unique. Unlike transactions involving the exchange of assets and liabilities between related parties, transactions for services create income on one party's books and expense on the second party's books, and therefore, do not lend themselves to the mere inflation of surplus. These arrangements are generally subject to regulatory approval.

20. Transactions involving services provided between related parties shall be recorded at the amount charged[1]. Regulatory scrutiny of related party transactions where amounts charged for services do not meet the fair and reasonable standard established by Appendix A-440, may result in (a) amounts charged being recharacterized as dividends or capital contributions, (b) transactions being reversed, (c) receivable balances being nonadmitted, or (d) other regulatory action. Expenses that result from cost allocations shall be allocated subject to the same fair and reasonable standards, and the books and records of each party shall disclose clearly and accurately the precise nature and details of the transaction. See *SSAP No 70—Allocation of Expenses* for additional discussion regarding the allocation of expenses.

***SSAP No. 62R—Property and Casualty Reinsurance*** provides the following (**bolding added for emphasis**):

36. The accounting principles for retroactive reinsurance agreements in paragraph 34 shall not apply to the following types of agreements (which shall be accounted for as prospective reinsurance agreements unless otherwise provided in this statement):

a. Structured settlement annuities for individual claims purchased to implement settlements of policy obligations;

b. Novations (i.e., (i) transactions in which the original direct insurer's obligations are completely extinguished, resulting in no further exposure to loss arising on the business novated or (ii) transactions in which the original assuming entity's obligations are completely extinguished) resulting in no further exposure to loss arising on the business novated, provided that (1) the parties to the transaction are not affiliates (or if affiliates, that the transaction has the prior approval of the domiciliary regulators of the parties) and (2) the accounting for the original reinsurance agreement will not be altered from retroactive to prospective;

c. The termination of, or reduction in participation in, reinsurance treaties entered into in the ordinary course of business;

[1] The amount charged shall be reviewed when there are any modifications or waivers subsequent to the establishment of the contract terms. If waivers or modifications to amounts charged occur, the related party transaction shall be reassessed to determine whether the contract continues to reflect fair and reasonable standards. If the transaction was with a parent or other stockholder and the charge for services has been fully waived, then the guidance in SSAP No. 72 for recognition as contributed capital (forgiveness of reporting entity obligation) or as a dividend (forgiveness of amount owed to the reporting entity) shall apply.

d. **Intercompany reinsurance agreements, and any amendments thereto, among companies 100% owned by a common parent or ultimate controlling person provided there is no gain in surplus as a result of the transaction; or**

e. Reinsurance/retrocession agreements that meet the criteria of property/casualty run-off agreements described in paragraphs 102-105.

37. **Retroactive reinsurance agreements resulting in surplus gain to the ceding entity (with or without risk transfer)** entered into between affiliates or between insurers under common control (as those terms are defined in Appendix A-440) shall be reported as follows:

a. The consideration paid by the ceding entity shall be recorded as a deposit and reported as a nonadmitted asset; and

b. No deduction shall be made from loss and loss adjustment expense reserves on the ceding entity's balance sheet, schedules, and exhibits.

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

INT 03-02 was exposed in March of 2003 and adopted in June 2003. The interpretation was not subsequently amended. The final vote on this consensus had three members opposed. The March 2003 exposure received six different comment letters to the Emerging Accounting Issues (E) Working Group from: 1) Ohio (EAIWG member); 2) New Hampshire (EAIWG member); 3) Interested parties, 4) Liberty Mutual and 5) PricewaterhouseCoopers (one of the very few letters ever submitted directly by the firm.) and 6) CNA. Five out of the six commenters noted concerns that the proposed guidance (which was ultimately adopted) would conflict with SSAP No. 25 guidance regarding economic transactions. While the interested parties' comment letter was more neutral, the verbal comments provided supported the use of SSAP No. 25.

Several commenters recommended not adopting the guidance regarding the use of book value and instead following SSAP No. 25 guidance for economic and non-economic transactions. The commenters noted that SSAP No. 25 directs the use of fair value when such transactions meet the definition of an economic transaction and that tax regulations would provide a result similar to SSAP No. 25. Multiple comments noted concerns similar to those highlighted in the illustration above. Commenters also noted that intercompany pooling reinsurance transactions are economic transactions. They noted that when assets (such as bonds valued at amortized cost) are transferred, if the assets have a different fair value than book value, that difference should be recognized since the transferor no longer controls the assets. Commenters also noted that treatment for reinsurance transactions for asset transfers should not be different than the treatment for other intercompany transactions.

CNA comments were supportive of adopting the exposed consensus, the comment letter provided illustrations and noted that intercompany reinsurance agreements were subject to regulatory approval. The comments tried to illustrate concerns possibly having premature gain / surplus recognition.

The June 2003 minutes Emerging Accounting Issues (E) Working Group discussion on the INT 03-02 are excerpted below.

> The working group was referred to INT 03-02: *Modification to an existing intercompany pooling arrangement* (Attachment D). Written comments were received from Ohio, New Hampshire and interested parties. Ohio and New Hampshire believe that the transfer of assets and liabilities in an intercompany pooling arrangement constitute an economic transaction and the accounting guidance in SSAP No. 25—*Accounting for and Disclosures about Transactions with Affiliates and Other Related Parties* (SSAP No. 25), should be followed. As such, the assets should be transferred at fair value and the ceding entity should record a realized gain or loss. Keith Bell (Travelers) spoke on behalf of interested parties. Interested parties commented that if the transaction was considered to be an economic transaction, SSAP No. 25 should be followed. If the modification of an intercompany pooling arrangement is considered a noneconomic transaction, the guidance in SSAP No.62—*Property and Casualty Reinsurance*(SSAP No. 62) is applied,

as such, statutory book value should be used for assets and statutory value should be used for liabilities. Jeff Alton (CNA) presented his comments by summarizing the statements made in his comment letter. Mr. Alton stated that no revenue recognition should occur and suggested using a modified statutory book value for transferring assets and liabilities. Mr. Clark stated that the Statutory Accounting Principles Working Group must address the recommended transfer at modified statutory book value as this recommendation would require substantive adjustments to statutory accounting principles. Shelly Zimmerman (Liberty Mutual) provided comments which supported that intercompany pooling changes should follow the accounting guidance in SSAP No. 25 as these are economic transactions between affiliates. Jean Connelly (PriceWaterhouseCoopers) provided comments that summarize those outlined in the comment letter. Ms. Connelly stated that intercompany pooling arrangements are economic transactions and that INT 03-01 provides a substantive change to SSAP No. 25.

Mr. Johnson then stated that he believes there is a stronger case for non-economic transaction treatment and as such, statutory book value is appropriate for valuation purposes. Additionally, all these transactions are subject to regulatory review under the Insurance Holding Company Act, affording regulators some control over the approval of these transactions. Mr. Fritsch commented that if this guidance is not adopted in the form of a new interpretation, SSAP No. 25 should be followed. Mr. Alton stated that he believes the current guidance in effect for intercompany pooling arrangements exists in SSAP No. 62, paragraph 30d which supports surplus neutrality: hence, the need is for an interpretation of paragraph 30d. Mr. Johnson stated that language clarification in SSAP No.61—*Life, Deposit-Type and Accident and Health Reinsurance*(SSAP No. 61) and SSAP No. 62 should be addressed as a project of the reinsurance subgroup of the SAPWG. Mr. Johnson made a motion to adopt Interpretation 03-02 with deletion of the first two sentences in paragraph 11. Mr. Stolte seconded the motion. Mr. Johnson requested a roll call vote. There were 9 yeas from Alabama, Connecticut, Florida, Illinois, Louisiana, Michigan, Texas, Pennsylvania and Virginia. There were 3 nays from New York, Ohio, and Wisconsin. Therefore, the working group adopted Interpretation 03-02 by consensus. Mr. Johnson also made a motion to refer to the Reinsurance Subgroup of the SAPWG, review of the current guidance in SSAP No. 61, SSAP No. 62 and SSAP No. 63—*Underwriting Pools and Associations Including Intercompany Pools.* Mr. Ford seconded the motion. The working group unanimously adopted the referral.

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

**Convergence with International Financial Reporting Standards (IFRS):** Not Applicable

**Staff Review Completed by:** Robin Marcotte – NAIC Staff, July - 2022

**Staff Recommendation: NAIC staff recommends that the Working Group move this item to the active listing, categorized as a SAP clarification, and expose the intent to nullify INT 03-02, as it is inconsistent with SSAP No. 25 guidance regarding economic and non-economic transactions between related parties. The guidance in INT 03-02 can result with in essence, unrecognized gains (dividends) or losses through the using the statutory book valuation when using assets (bonds) to make payments to affiliates for modifications to existing intercompany reinsurance pooling agreements. Treatment of transfers of assets between affiliates should be consistent for all intercompany transactions and there is not a compelling need to be different when valuing assets for intercompany reinsurance transactions.**

**Status:**
On August 10, 2022, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a SAP clarification, and exposed the intent to nullify INT 03-02.

On December 13, 2022, the Working Group moved this agenda item to the active listing, categorized as a SAP clarification, and re-exposed the intent to nullify INT 03-02. This re-exposure requested industry to provide comments on specific instances in which the interpretation was being applied. In addition, the following key points were noted for consideration during the exposure in response to some of the comments received.

1. In the current interest rate environment, the fair value of many bonds is below book value. For example, a bond with an amortized cost of 100 with a fair value of 85. The way INT 03-02 is written a bond with a fair value of 85 could be used to settle an intercompany reinsurance pooling obligation of 100. If the reporting entity paid with cash, they would be required to pay $100. The actual cash value of obligations when they are extinguished is a relevant measure of the transaction.

2. Using book value for measurement of payments between affiliates can result in either unrecognized or in effect dividend or losses. SSAP No. 25 requires such transfers of assets between affiliates to use fair value. If a subsidiary can pay the parent with assets that have a lower fair value than book value (ex, owes $100 but pays with a bond of 85), this has a similar effect as an unrecognized capital contribution to the subsidiary. SSAP No. 72 requires a capital contribution to be valued using fair value.

3. At the ultimate parent level such transfer of assets (in accordance with SSAP No. 25 guidance) may be noneconomic in that the parent continues to hold an interest in the same assets. Therefore, at the parent level, such transfers of assets may result in the deferral of gains. Staff believes that losses would not be deferred at the ultimate parent level.

4. While it may be more expedient to pay intercompany reinsurance pooling transactions with assets, the valuation used should be similar to if the obligation was extinguished with cash. Therefore, an entity can still choose to pay with assets, they just need to be valued consistently with SSAP No. 25 guidance.

5. SSAP No. 62R, paragraph 36d provides an exception to retroactive reinsurance accounting guidance which allows for prospective accounting treatment for intercompany reinsurance among 100% owned affiliated provided there is no gain to the ceding entity. If there is again to the ceding entity, there is guidance in SSAP No. 62R, paragraph 37 which requires a more punitive method of accounting than either prospective or retroactive reinsurance accounting. Therefore, NAIC staff comment is that the statutory accounting objective is to provide different treatment for retroactive reinsurance contracts if there is a gain to the ceding entity. This is another reason that the guidance in INT 03-02 is problematic. The object is to correctly measure the effects of the contract, which drives the accounting. The objective is not to obscure whether there is a gain to the ceding entity, which can happen in the event that the assets used in payment are not measured correctly.

6. Interested parties noted that modifications to intercompany pooling arrangements are typically effective retroactive to the beginning of the year. Staff notes that the payment value when the transaction is settled should be equivalent to the cash value of what is owed on the date of extinguishment of the liability.

7. Many of the interested parties' comments regarding GAAP use of book value are more relevant to consolidated basis accounting which is not consistent with the legal entity basis of statutory accounting.

8. Interested parties' comments noted that there is a difference in treatment for intercompany pooling participants who are not 100% owned by a common parent. NAIC staff notes that retroactive pooling agreement changes with participants that are not 100% under common control do not meet the exception to retroactive accounting provided in SSAP No. 62R, paragraph 36d. NAIC staff notes that SSAP No. 62R, paragraph 37 provides guidance for retroactive reinsurance agreements among affiliates where there is a gain to the ceding entity. Therefore, the regulatory objective is not to avoid gain but to properly account for intercompany retroactive contracts that include gains.

On March 22, 2023, the Working Group re-exposed the intent to nullify INT 03-02, effective December 31, 2023. The nullification is proposed as INT 03-02 is inconsistent with SSAP No. 25 guidance regarding economic and non-economic transactions between related parties. The guidance in INT 03-02 can result with, in essence, unrecognized gains (dividends) or losses through the using the statutory book valuation when using assets (bonds) to make payments to affiliates for modifications to existing intercompany reinsurance pooling agreements.

Treatment of transfers of assets between affiliates should be consistent for all intercompany transactions and there is not a compelling need to be different when valuing assets for intercompany reinsurance transactions.

On August 13, 2023, the Statutory Accounting Principles (E) Working Group re-exposed the intent to nullify INT 03-02 and directed NAIC staff to work with industry regarding some of their comments and examples to be submitted by industry.

On December 1, 2023, the Statutory Accounting Principles (E) Working Group deferred action on this agenda item and directed NAIC staff to continue working with interested parties on the proposal.

On March 16, 2024, the Statutory Accounting Principles (E) Working Group exposed its intent to nullify INT 03-02, and exposed revisions to *SSAP No. 25—Affiliates and Other Related Parties* and *SSAP No. 63—Underwriting Pools* to address transfers of assets when modifying intercompany pooling agreements. The exposed revisions were based on interested parties' comments with minor edits proposed by NAIC staff.

**Exposed Revisions to SSAP No. 25 and SSAP No. 63 are illustrated below.**

*SSAP No. 25—Affiliates and Other Related Parties*

4. If a company transfers assets or liabilities to effectuate a modification to an existing intercompany pooling arrangement, the transaction, including the transfer of assets, shall be accounted for and valued in accordance with the guidance in *SSAP No. 63—Underwriting Pools.* The guidance in SSAP No. 63 regarding the transfers of assets or liabilities to effectuate a modification of an intercompany pooling arrangements shall not be applied or analogized to other transactions involving transfers of assets and liabilities.

*SSAP No. 63—Underwriting Pools* *(only impacted paragraph are reflected. )*

1. This statement establishes statutory accounting principles for underwriting pools and associations, including intercompany pooling arrangements.

8. Insurance groups that utilize intercompany pooling arrangements often modify these arrangements from time to time for various business reasons. These business reasons commonly include mergers, acquisitions, dispositions, or a restructuring of the group's legal entity structure. In order to effectuate a relatively simple modification, such as changing pooling participation percentages without changing the pool participants, companies often simply amend the existing pooling agreement. Alternatively, in order to effectuate a more complex modification, such as changing (by adding or removing) the number of pool participants, a company may commute the existing pooling agreement and execute a new pooling agreement(s). In conjunction with executing the appropriate intercompany pooling agreements, a transfer of assets and liabilities amongst the impacted affiliates may also be required in order to implement the new pooling agreement(s). The following subparagraphs provide guidance specific to modifications of intercompany pooling arrangements and shall not be applied to an analogous transaction or event.

a. The appropriate valuation basis to be used for assets and liabilities that are transferred among affiliates in conjunction with the execution of a new intercompany pooling agreement(s) that serves to substantively modify an existing intercompany pooling arrangement is statutory book value for assets and statutory value for liabilities.

b. The net amount of the assets and liabilities being moved among entities as a result of a modification to an intercompany pooling shall be used to settle the intercompany payable/receivable (i.e., the assets that are transferred in conjunction with the modification) to minimize the amount of assets transferred in the modification.

12. Note that other applicable reinsurance guidance from *SSAP No. 61R—Life, Deposit Type and Accident and Health Reinsurance* or *SSAP No. 62R—Property and Casualty Reinsurance*, depending on

the type of business, applies to intercompany pooling arrangements and voluntary and involuntary pools. This includes the SSAP No. 62R guidance in paragraphs 33 through 39 regarding retroactive reinsurance.

**New disclosure in paragraph 13**

13.i For modifications to an existing intercompany pooling arrangement that involve the transfer of assets with fair values that differ from cost or amortized cost, the statement value and fair value of assets received or transferred by the reporting entity.

On August 13, 2024, the Statutory Accounting Principles (E) Working Group adopted as final, revisions to *SSAP No. 25—Affiliates and Other Related Parties* and *SSAP No. 63—Underwriting Pools* to address transfers of assets when modifying intercompany pooling agreements. Effective upon adoption, this agenda item also nullifies *INT 03-02: Modification to an Existing Intercompany Pooling Arrangement*. The exposed disclosure to SSAP No. 63, paragraph 13i, was modified from the exposure to incorporate revisions suggested by interested parties.

**Adopted revisions are illustrated below.**
*SSAP No. 25—Affiliates and Other Related Parties*

4. If a company transfers assets or liabilities to effectuate a modification to an existing intercompany pooling arrangement, the transaction, including the transfer of assets, shall be accounted for and valued in accordance with the guidance in *SSAP No. 63—Underwriting Pools.* The guidance in SSAP No. 63 regarding the transfers of assets or liabilities to effectuate a modification of an intercompany pooling arrangements shall not be applied or analogized to other transactions involving transfers of assets and liabilities.

*SSAP No. 63—Underwriting Pools* *(only impacted paragraphs are reflected. )*

1. This statement establishes statutory accounting principles for underwriting pools and associations, including intercompany pooling arrangements.

8. Insurance groups that utilize intercompany pooling arrangements often modify these arrangements from time to time for various business reasons. These business reasons commonly include mergers, acquisitions, dispositions, or a restructuring of the group's legal entity structure. In order to effectuate a relatively simple modification, such as changing pooling participation percentages without changing the pool participants, companies often simply amend the existing pooling agreement. Alternatively, in order to effectuate a more complex modification, such as changing (by adding or removing) the number of pool participants, a company may commute the existing pooling agreement and execute a new pooling agreement(s). In conjunction with executing the appropriate intercompany pooling agreements, a transfer of assets and liabilities amongst the impacted affiliates may also be required in order to implement the new pooling agreement(s). The following subparagraphs provide guidance specific to modifications of intercompany pooling arrangements and shall not be applied to an analogous transaction or event.

a. The appropriate valuation basis to be used for assets and liabilities that are transferred among affiliates in conjunction with the execution of a new intercompany pooling agreement(s) that serves to substantively modify an existing intercompany pooling arrangement is statutory book value for assets and statutory value for liabilities.

b. The net amount of the assets and liabilities being moved among entities as a result of a modification to an intercompany pooling shall be used to settle the intercompany payable/receivable (i.e., the assets that are transferred in conjunction with the modification) to minimize the amount of assets transferred in the modification.

13. Note that other applicable reinsurance guidance from *SSAP No. 61R—Life, Deposit Type and Accident and Health Reinsurance* or *SSAP No. 62R—Property and Casualty Reinsurance*, depending on

the type of business, applies to intercompany pooling arrangements and voluntary and involuntary pools. This includes the SSAP No. 62R guidance in paragraphs 33 through 39 regarding retroactive reinsurance.

**New disclosure in paragraph 13 as modified after exposure:**

13.i The statement value and fair value of assets received or transferred by the reporting entity for modifications to an existing intercompany pooling arrangement that involved the transfer of assets with fair value that differ from statement value.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2024/08-13-24 Summer National Meeting/Adoptions/22-12 - Review INT 03-02.docx

# Interpretation of the Emerging Accounting Issues (E) Working Group

# INT 03-02: Modification to an Existing Intercompany Pooling Arrangement

## NULLIFIED BY AGENDA ITEM 2022-12

**INT 03-02 Dates Discussed**

March 9, 2003; June 22, 2003; August 10, 2022; December 13, 2022; March 22, 2023; August 13, 2023; December 1, 2023; March 16, 2024; August 13, 2024

**INT 03-02 References**

**Current:**
*SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance*
*SSAP No. 62R—Property and Casualty Reinsurance*
*SSAP No. 63—Underwriting Pools*

**INT 03-02 Issue**

1. Insurance groups that utilize intercompany pooling arrangements often modify these arrangements from time to time for various business reasons. These business reasons commonly include mergers, acquisitions, dispositions or a restructuring of the group's legal entity structure. As an insurance group's business objectives and strategies evolve, it may be necessary for the insurance group's legal entity structure to similarly evolve in order to address the insurance group's business needs.

2. SSAP No. 63, paragraphs 5 and 7, defines and describes intercompany pooling as an arrangement among affiliated entities whereby "all of the pooled business is ceded to the lead entity and then retroceded back to the pool participants in accordance with their stipulated shares." This arrangement is established through "a conventional quota share reinsurance agreement…" Arrangements whereby there is one lead company that retains 100% of the pooled business and all or some of the affiliated companies have a 0% net share of the pool may qualify as intercompany pooling."

3. Therefore, in order to effectuate a modification to the existing intercompany pooling arrangement, companies must either 1) amend the existing reinsurance agreement, or 2) execute new agreements. The latter scenario may entail executing at least two agreements: a commutation of the existing agreement, and a new quota share agreement(s) that covers both past and future periods.

4. To illustrate, in order to effectuate a relatively simple modification, such as changing pooling participation percentages without changing the pool participants, companies often simply amend the existing pooling agreement. Alternatively, in order to effectuate a more complex modification, such as changing (by adding or removing) the number of pool participants, a company must commute the existing pooling agreement and execute a new quota share agreement(s). In conjunction with executing the appropriate reinsurance agreements, a transfer of assets and liabilities amongst the impacted affiliates is also required in order to implement the new reinsurance agreement(s). At issue is the appropriate valuation basis to be used for assets and liabilities that are transferred pursuant to the new reinsurance agreement(s).

5. Since SSAP No. 63 does not specifically address modifications to intercompany pooling arrangements, insurance groups that modify their intercompany pooling arrangements must refer elsewhere in Statutory Accounting Principles (SAP) for relevant guidance. The obvious guidance for such transactions is SSAP No. 62R since an intercompany pooling arrangement is, by definition, affiliated reinsurance. There is, however, a minority opinion that *SSAP No. 25—Affiliates and Other Related*

*Parties* appears to apply due to the affiliated nature of these transactions. Since the guidance and intent of SSAP No. 62R and SSAP No. 25 provide for different valuation bases, this interpretation serves to provide definitive guidance as to which SSAP is relevant for these transactions and, therefore, clarify the appropriate valuation basis to be used for assets and liabilities transferred pursuant to a modification to an intercompany pooling arrangement.

SSAP No. 62R Approach:

6. This approach refers to the guidance and statutory accounting intent from SSAP No. 62R since intercompany pooling arrangements are defined and established through reinsurance. Further, since modifications to intercompany pooling agreements typically involve the transfer of net liabilities incurred since the inception of the existing pooling agreement (i.e., prior to the effective date of the new agreement), the retroactive reinsurance accounting guidance in paragraphs 33-39 of SSAP No. 62R is applicable. Paragraph 33 states that this special accounting treatment is warranted "due to the potential abuses involving the creation of surplus to policyholders and the distortion of underwriting results…" However, paragraph 36.d. specifically applies to intercompany reinsurance arrangements, and amendments to intercompany reinsurance agreements, since the reinsurance agreement is among companies 100% owned by a common parent. This paragraph allows prospective accounting treatment for intercompany reinsurance agreements that do not result in a gain in surplus as a result of the transaction.

7. To provide historical perspective, prior to the adoption (with modification) of FASB *Statement No. 113, Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts* (FAS 113) as SAP, paragraph 36.d. was added as one of the SAP modifications. The intent of adding paragraph 36.d. was to specifically exclude intercompany reinsurance agreements among entities 100% owned by a common parent from retroactive reinsurance accounting requirements as a result of amending or modifying these agreements, provided there is no surplus gain. The presumption in this intent was that there would be no gains to the ceding entity resulting from implementing amendments or modifications to these types of reinsurance agreements.

8. Therefore, based on the foregoing guidance and background, the statutory accounting intent is to avoid surplus gains for the ceding entity as a result of implementing a modification to an intercompany pooling arrangement. On that basis, such a modification does not represent an economic transaction to the insurance group or to the impacted companies. As such, the transfer of both the assets and the liabilities valued at statutory book value ensures that there is no impact to surplus as a result of implementing a modification to an existing pooling arrangement.

SSAP No. 25 Approach:

9. An approach different from that which refers to reinsurance accounting guidance is to refer to the guidance in SSAP No. 25 since some may view a modification to an intercompany pooling agreement as a related party transaction involving the exchange of assets or liabilities. In this case, paragraphs 14-18 of SSAP No. 25 would appear applicable. This guidance specifies differing valuation bases, depending on whether the transaction is considered an economic or a non-economic transaction. SSAP No. 25, paragraph 14, states that "…The appearance of permanence is also an important criterion is assessing the economic substance of a transaction. In order for a transaction to have economic substance and thus warrant revenue (loss) recognition, it must appear unlikely to be reversed …" Since insurance groups often modify intercompany pooling arrangements, this type of transaction is not permanent, and may be construed as a non-economic transaction. SSAP No. 25, paragraph 18.b., states that "non-economic transactions … shall be recorded at the lower of existing book value or fair value at the date of the transaction."

10. It appears that this guidance is intended to address matters involving discrete or isolated transfers of assets and/or liabilities between affiliates rather than transfers of assets and liabilities effected in relation to executing reinsurance transactions (the guidance for which is SSAP No. 62R). Additionally,

application of this guidance would result in a change to the surplus of the insurance group as a result of implementing a modification to an existing intercompany pooling arrangement. As previously stated, the statutory accounting intent is to avoid surplus gains for the insurance group as a result of implementing a modification to an intercompany pooling arrangement.

11. The accounting issues are:

    a. What is the relevant guidance for modifications to intercompany pooling arrangements?

    b. What is the appropriate valuation basis to be used for assets and liabilities that are transferred among affiliates in conjunction with the execution of a new reinsurance agreement(s) that serves to substantively modify an existing intercompany pooling arrangement?

**INT 03-02 Discussion**

The Working Group reached a consensus as follows:

12. SSAP No. 62R provides accounting for property and casualty reinsurance agreements including specific guidance on intercompany pooling agreements. SSAP No. 62R provides two methods of accounting for changes in intercompany pooling agreements, depending on whether or not the pooling results in a gain in surplus.

13. The appropriate valuation basis to be used for assets and liabilities that are transferred among affiliates in conjunction with the execution of a new reinsurance agreement(s) that serves to substantively modify an existing intercompany pooling arrangement is statutory book value for assets and statutory value for liabilities. Book value is defined in the glossary of the *Accounting Practices and Procedure Manual*.

**INT 03-02 Status**

14. No further discussion is planned.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2024/08-13-24 Summer National Meeting/Adoptions/22-12a INT 03-02.docx

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

**Issue: ASU 2023-06, Disclosure Improvements**

**Check (applicable entity):**

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

**Description of Issue:** In October 2023, FASB issued *ASU 2023-06, Disclosure Improvements, Codification Amendments in Response to the SEC's Disclosure Update and Simplification Initiative*, in response to a referral from SEC Release No. 33-10532, Disclosure Update and Simplification, issued August 17, 2018. The changes detailed in the ASU seek to clarify or improve disclosure and presentation requirements of a variety of Topics. Many of the amendments allow users to more easily compare entities subject to the SEC's existing disclosures with those entities that were not previously subject to the SEC's requirements, while others represent miscellaneous clarifications or technical corrections of the current disclosure requirements. Two of the more significant items from the SEC referral is the requirement for companies to disclose their the weighted-average interest rate of debt and provide repurchase agreement (repo) counterparty risk disclosures. FASB elected to only require the weighted-average interest rate disclosure for publicly traded companies due to concerns regarding the complexity of the calculation for private companies. It was also noted by Staff that the effective date of ASU 2023-06 is unusual as both its timing, and ultimately its implementation within the Codification, is dependent on whether the SEC removes the related disclosures from Regulation S-X, or Regulation S-K becomes effective, prior to June 30, 2027. For this agenda item, Staff believes that the occurrence, or non-occurrence, of future SEC actions is not relevant to discussion concerning the proposed disclosures' merits for inclusion in the statutory accounting framework. If needed, the Working Group will address the effective date of adoption at a later stage.

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

**Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups)**:
Agenda item 2024-04: Conforming Repurchase Agreements was developed in in response to the American Council of Life Insurers (ACLI) request to modify the treatment of repurchase agreements in the life risk-based capital (RBC) formula to converge with treatment for securities lending programs.

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

**Convergence with International Financial Reporting Standards (IFRS):**
None.

**Staff Recommendation – Spring National Meeting:**
**NAIC staff recommends that the Working Group expose revisions to adopt, with modification, certain disclosures from *ASU 2023-06, Disclosure Improvements, Codification Amendments in Response to the SEC's Disclosure Update and Simplification Initiative,* for statutory accounting within *SSAP No. 15—Debt and Holding Company Obligations* and *SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities.*** The disclosures revisions we have recommended are:

- Certain disclosures for unused commitments and lines of credit, disaggregated by short-term and long-term.

- Disclosure of accrued interest from repos and securities borrowing, separate disclosure of significant (10% of admitted assets) reverse repos, and counterparty disclosures for significant (10% of adjusted capital and surplus) repos and reverse repos.

**NAIC staff also requests regulator and interested party input on whether the accounting policy disclosure for cash flows associated with derivatives, ASC 230-10-50-9, should also be adopted for statutory accounting purposes.** This would require companies to provide an accounting policy disclosure for where cash flows associated with derivative instruments and their related gains and losses are presented in the statement of cash flows.

**Staff Recommendation – Summer National Meeting:**
**NAIC staff recommends that the Working Group adopt, with modification, certain disclosures from *ASU 2023-06, Disclosure Improvements, Codification Amendments in Response to the SEC's Disclosure Update and Simplification Initiative,* for statutory accounting within *SSAP No. 15—Debt and Holding Company Obligations* and *SSAP No. 86—Derivatives*.** The disclosure revisions we have recommended are:

- Certain disclosures for unused commitments and lines of credit, disaggregated by short-term and long-term.
- Disclosure of the derivative cash flow accounting policy

**In addition, NAIC staff recommend that the previously exposed revisions to adopt, with modification, certain disclosures from ASU 2023-06 within *No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*** be combined with agenda item 2024-04: Conforming Repurchase Agreements. These disclosures revisions include:

- Disclosure of accrued interest from repos and securities borrowing, separate disclosure of significant (10% of admitted assets) reverse repos, and counterparty disclosures for significant (10% of adjusted capital and surplus) repos and reverse repos.

Agenda item 2024-04 is intended to review and revise current statutory guidance for repos and secured lending, as such adoption of additional repo disclosures should be considered as a part of that project.

**Staff Review Completed by:**
NAIC Staff – William Oden, February 2024

**Status:**
On December 1, 2023, the Statutory Accounting Principles (E) Working Group deferred exposure of this agenda item as some items were noted which require further consideration.

On March 16, 2024, the Statutory Accounting Principles (E) Working Group exposed revisions to adopt, with modification, certain disclosures from *ASU 2023-06, Disclosure Improvements, Codification Amendments in Response to the SEC's Disclosure Update and Simplification Initiative*, for statutory accounting within *SSAP No. 15—Debt and Holding Company Obligations* and *SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. The Working Group also requested input from regulators and interested parties on whether the derivative cash flow accounting policy disclosure, described in ASC 230-10-50-9, would provide useful information to regulators.

***Exposed Revisions to SSAP No. 15—Debt and Holding Company Obligations – Adopted***

22. For unused commitments and lines of credit, the reporting entity shall separately disclose the following, disaggregated by short-term and long-term, in the notes to financial statements:

    a. The amount and terms of unused commitments for financing arrangements (including commitment fees and the conditions under which commitments may be withdrawn).

~~a.~~b. The amount and terms of unused lines of credit for financing arrangements (including commitment fees and the conditions under which lines may be withdrawn) and the amount of those lines of credit that support commercial paper borrowing arrangements or similar arrangements.

**Relevant Literature**

32. This statement adopts, with modification, *ASU 2023-06, Disclosure Improvements, Codification Amendments in Response to the SEC's Disclosure Update and Simplification Initiative.* Statutory modifications include:

a. Extending the disclosure requirements to both short-term and long-term unused commitments and lines of credit, whereas ASU 2023-06 only required these disclosures for long-term unused commitments and short-term lines of credit.

b. The requirement to disclose the weighted-average interest rate of short-term borrowings was rejected for statutory accounting purposes.

***Exposed revisions to SSAP No. 86—Derivatives – Adopted***

**Disclosure Requirements**

63. Reporting entities shall disclose the following for all derivative contracts used:

a. General disclosures:

i. A description of the reporting entity's objectives for using derivatives, i.e., hedging, income generation or replication;

ii. A description of the context needed to understand those objectives and its strategies for achieving those objectives;

iii. The description for hedging objectives shall identify the category, e.g., fair value hedges, cash flow hedges, or foreign currency hedges, and for all objectives, the type of instrument(s) used;

iv. A description of the accounting policies for derivatives including the policies for recognizing (or reasons for not recognizing) and measuring the derivatives used, and when recognized, where those instruments and related gains and losses are reported;

v. Identification of whether the reporting entity has derivative contracts with financing premiums. (For purposes of this term, this includes scenarios in which the premium cost is paid at the end of the derivative contract or throughout the derivative contract.);

vi. The net gain or loss recognized in unrealized gains or losses during the reporting period representing the component of the derivative instruments' gain or loss, if any, excluded from the assessment of hedge effectiveness;~~ and~~

vii. The net gain or loss recognized in unrealized gains or losses during the reporting period resulting from derivatives that no longer qualify for hedge accounting. For portfolio layer method hedges, disclose circumstances that led to the breach; and

~~vii.~~viii. The reporting entity shall disclose its accounting policy for where cash flows associated with derivative instruments and their related gains and losses are presented in the statement of cash flow.

**Relevant Literature**

74. *This statement adopts, with modification, ASU 2023-06, Disclosure Improvements, Codification Amendments in Response to the SEC's Disclosure Update and Simplification Initiative.* The adopted guidance requires the reporting entity to disclose its accounting policy for where cash flows associated with derivative instruments are presented in the statement of cash flow.

***Not adopted - The following Revisions to were exposed SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities – Are To be Combined with Agenda Item 2024-04 (not adopted in August 2024)***

28. A reporting entity shall disclose the following[fn]:

a. For Repurchase and Reverse Repurchase Agreements:

i. If the entity has entered into repurchase or reverse repurchase agreements, information regarding the company policy or strategies for engaging in repo programs, policy for requiring collateral, as well as whether transactions have been accounted for as secured borrowings or as sale transactions. This disclosure shall include the terms of reverse repurchase agreements whose amounts are included in borrowing money. The following information shall be disclosed by type of agreement:

(a) Whether repo agreements are bilateral and/or tri-party trades;

(b) Maturity time frame divided by the following categories: open or continuous term contracts for which no maturity date is specified, overnight, 2 days to 1 week, from 1 week to 1 month, greater than 1 month to 3 months, greater than 3 months to 1 year, and greater than 1 year[fn];

(c) Aggregate narrative disclosure of the fair value of securities sold and/or acquired that resulted in default. (This disclosure is not intended to capture "failed trades," which are defined as instances in which the trade did not occur as a result of an error and was timely corrected. Rather, this shall capture situations in which the non-defaulting party exercised their right to terminate after the defaulting party failed to execute.)

(d) If as of the date of the most recent balance sheet the aggregate carrying amount of reverse repurchase agreements (securities or other assets purchased under agreements to resell) exceeds 10% of total admitted assets, the assets shall be separately disclosed. The entity shall also disclose whether there are any provisions, beyond the collateral requirements in paragraph 113, to ensure that the market value of the underlying assets remains sufficient to protect the entity in the event that the counterparty defaults and, if so, the nature of those provisions.

***Staff Note 2:*** *The Supplemental Investment Risks Interrogatories (Appendix A-001) does require reporting of the amount and percentage of admitted assets subject to reverse repurchase agreements. Staff is of the opinion that if the assets subject to reverse repurchase agreements exceeded 10% then this fact is significant enough to also be included in the notes the financial statements.*

ii. For repurchase transactions accounted for as secured borrowings[fn], the maximum amount and end balance as of each reporting period (quarterly and annual) for the following:

(a) Fair value of securities sold. (Book adjusted carrying value shall be provided as an end balance only.) This information is required in the aggregate, and by type of security categorized by NAIC designation, with identification of nonadmitted assets. Although legally sold as a secured borrowing, these assets are still reported by the insurer and shall be coded as restricted pursuant to the annual statement instructions, disclosed in accordance with *SSAP No. 1—Accounting Policies, Risks & Uncertainties, and Other Disclosures*, reported in the general interrogatories, and included in any other statutory schedules or disclosure requirements requesting information for restricted assets.

(b) Cash collateral and the fair value of security collateral (if any) received. This information is required in the aggregate and by type of security categorized by NAIC designation with identification of collateral securities received that do not qualify as admitted assets.

(1) For collateral received, aggregate allocation of the collateral by the remaining contractual maturity of the repurchase agreements (gross): overnight and continuous, up to 30 days, 30-90 days, greater than 90 days. This disclosure shall also include a discussion of the potential risks associated with the agreements and related collateral received, including the impact arising changes in the fair value of the collateral received and/or the provided security and how those risks are managed.

(2) For cash collateral received that has been reinvested, the total reinvested cash and the aggregate amortized cost and fair value of the invested asset acquired with the cash collateral. This disclosure shall be reported by the maturity date of the invested asset: under 30 days, 60 days, 90 days, 120 days, 180 days, less than 1 year, 1-2 years, 2-3 years and greater than 3 years. To the extent that the maturity dates of the liability (collateral to be returned) does not match the invested assets, the reporting entity shall explain the additional sources of liquidity to manage those mismatches.

(c) Liability recognized, including accrued interest, to return cash collateral, and the liability recognized to return securities received as collateral as required pursuant to the terms of the secured borrowing transaction.

iii. For reverse repurchase transactions accounted for as secured borrowings[fn], the maximum amount and end balance as of each reporting period (quarterly and annual) for the following:

(a) Fair value of securities acquired. This information shall be reported in the aggregate, and by type of security categorized by NAIC designation, with identification of whether acquired assets would not qualify as admitted assets.

(b) Cash collateral and the fair value of security collateral (if any) provided. (If security collateral was provided, book adjusted carrying value shall be provided as an end balance only.) Disclosure shall identify the book adjusted carrying value of any nonadmitted securities provided as collateral. For collateral pledged, the aggregate allocation of the collateral by the remaining contractual maturity of the reverse-repurchase agreements (gross): overnight and continuous, up to 30 days, 30-90 days, greater than 90 days. This disclosure shall also include a discussion of the potential risks associated with the agreements and related collateral pledged, including obligations arising from a decline in the fair value of the collateral pledged and how those risks are managed.

(c) Recognized receivable for the return of collateral. (Generally cash collateral, but including securities provided as collateral as applicable under the terms of the secured borrowing transaction. Receivables are not recognized for securities provided as collateral if those securities are still reported as assets of the reporting entity.)

(d) Recognized liability, including accrued interest, to return securities acquired under the reverse-repurchase agreement as required pursuant to the secured borrowing transaction. (Generally, a liability is required if the acquired securities are sold.)

iv. For repurchase transactions accounted for as a sale[fn], the maximum amount and end balance as of each reporting period (quarterly and annual) for the following:

(a) Fair value of securities sold (derecognized from the financial statements). (Book adjusted carrying value shall be provided as an end balance only, reflecting the amount derecognized from the sale transaction.) This information is required in the aggregate, and by type of security categorized by NAIC designation, with information on the book adjusted carrying value of nonadmitted assets sold.

(b) Cash and the fair value of securities (if any) received as proceeds and recognized in the financial statements. This information is required in the aggregate and by type of security categorized by NAIC designation, with identification of received assets nonadmitted in the financial statements. All securities received shall be coded as restricted pursuant to the annual statement instructions, disclosed in accordance with SSAP No. 1, reported in the general interrogatories, and included in any other statutory schedules or disclosure requirements requesting information for restricted assets.

(c) The forward repurchase commitment recognized to return the cash or securities received. Amount reported shall reflect the stated repurchase price under the repurchase transaction.

v. For reverse repurchase transactions accounted for as sale[fn], the maximum amount and end balance as of each reporting period (quarterly and annual):

(a) Fair value of securities acquired and recognized on the financial statements. (Book adjusted carrying value shall be provided as an end balance only.) This information shall be reported in the aggregate, and by type of security categorized by NAIC designation. The disclosure also requires the book adjusted carrying value of nonadmitted assets acquired.

(b) Cash collateral and the fair value of security collateral (if any) provided. (If security collateral was provided, book adjusted carrying value shall be provided as an end balance only.) Disclosure shall also identify whether any nonadmitted assets were provided as collateral (derecognized from the financial statements).

vi. If as of the date of the most recent balance sheet the amount at risk under repurchase agreements or the amount at risk under reverse repurchase agreements with any individual counterparty or group of related counterparties exceeds 10% of adjusted capital and surplus, an entity shall disclose the name(s) of those counterparties or group of related counterparties, the amount at risk with each, and the weighted-average maturity of the repurchase agreements or reverse repurchase agreements with each.

(a) For the purposes of this statement, the amount at risk under repurchase agreements is the excess of the carrying amount (or market value, if higher than the carrying amount or if there is no carrying amount) of the securities or other assets sold under agreement to repurchase, including accrued interest plus any cash or other assets on deposit to secure the repurchase obligation, over the amount of the repurchase liability (adjusted for accrued interest).

~~(a)~~(b) For the purposes of this statement, the amount at risk under reverse repurchase agreements is the excess of the carrying amount of the reverse repurchase agreements over the market value of assets delivered in accordance with the agreements by the counterparty to an entity (or to a third-party agent that has affirmatively agreed to act on behalf of the entity) and not returned to the counterparty, except in exchange for their approximate market value in a separate transaction.

**Relevant Literature**

135. This statement adopts, with modification, *ASU 2023-06, Disclosure Improvements, Codification Amendments in Response to the SEC's Disclosure Update and Simplification Initiative*. Statutory modifications include:

a. It is not feasible to require separate reporting of assets subject to reverse repurchase agreements in excess of 10% of total assets. Instead, this was modified to require separate disclosure and the threshold was modified to be "10% of total admitted assets."

b. The disclosure threshold for the amount at risk under repurchase agreements or reverse repurchase agreements was modified to be 10% of adjusted capital and surplus, rather than 10% of total equity.

c. The requirement to disclose the weighted-average interest rate of repurchase liabilities and related repurchase liabilities was rejected for statutory accounting purposes.

On August 13, 2024, the Statutory Accounting Principles (E) Working Group adopted, with modification, as final, certain disclosures from *ASU 2023-06, Disclosure Improvements, Codification Amendments in Response to the SEC's Disclosure Update and Simplification Initiative,* for statutory accounting within *SSAP No. 15—Debt and Holding Company Obligations* and *SSAP No. 86—Derivatives*. The partial adoption of ASU 2023-06 only includes the previously exposed disclosures on unused commitments, lines of credit, and derivative cash flows accounting policy. The Working Group also directed NAIC staff to incorporate the previously exposed disclosures from ASU 2023-06 concerning repos, reverse repos and securities borrowing into agenda item 2024-04: Conforming Repurchase Agreements for further consideration as part of the ongoing project looking at the statutory accounting treatment of repos and securities lending. The adopted revisions are reflected below.

***Adopted Revisions to SSAP No. 15—Debt and Holding Company Obligations – Adopted***

22. For unused commitments and lines of credit, the reporting entity shall separately disclose the following, disaggregated by short-term and long-term, in the notes to financial statements:

a. The amount and terms of unused commitments for financing arrangements (including commitment fees and the conditions under which commitments may be withdrawn).

~~a.~~b. The amount and terms of unused lines of credit for financing arrangements (including commitment fees and the conditions under which lines may be withdrawn) and the amount of those lines of credit that support commercial paper borrowing arrangements or similar arrangements.

**Relevant Literature**

32. This statement adopts, with modification, *ASU 2023-06, Disclosure Improvements, Codification Amendments in Response to the SEC's Disclosure Update and Simplification Initiative.* Statutory modifications include:

a. Extending the disclosure requirements to both short-term and long-term unused commitments and lines of credit, whereas ASU 2023-06 only required these disclosures for long-term unused commitments and short-term lines of credit.

b. The requirement to disclose the weighted-average interest rate of short-term borrowings was rejected for statutory accounting purposes.

***Proposed revisions to SSAP No. 86—Derivatives – Adopted***

**Disclosure Requirements**

63. Reporting entities shall disclose the following for all derivative contracts used:

b. General disclosures:

i. A description of the reporting entity's objectives for using derivatives, i.e., hedging, income generation or replication;

ii. A description of the context needed to understand those objectives and its strategies for achieving those objectives;

iii. The description for hedging objectives shall identify the category, e.g., fair value hedges, cash flow hedges, or foreign currency hedges, and for all objectives, the type of instrument(s) used;

iv. A description of the accounting policies for derivatives including the policies for recognizing (or reasons for not recognizing) and measuring the derivatives used, and when recognized, where those instruments and related gains and losses are reported;

v. Identification of whether the reporting entity has derivative contracts with financing premiums. (For purposes of this term, this includes scenarios in which the premium cost is paid at the end of the derivative contract or throughout the derivative contract.);

vi. The net gain or loss recognized in unrealized gains or losses during the reporting period representing the component of the derivative instruments' gain or loss, if any, excluded from the assessment of hedge effectiveness;~~ and~~

vii. The net gain or loss recognized in unrealized gains or losses during the reporting period resulting from derivatives that no longer qualify for hedge accounting. For portfolio layer method hedges, disclose circumstances that led to the breach; and

~~vii.~~viii. The reporting entity shall disclose its accounting policy for where cash flows associated with derivative instruments and their related gains and losses are presented in the statement of cash flow.

**Relevant Literature**

74. This statement adopts, with modification, *ASU 2023-06, Disclosure Improvements, Codification Amendments in Response to the SEC's Disclosure Update and Simplification Initiative*. The adopted guidance requires the reporting entity to disclose its accounting policy for where cash flows associated with derivative instruments are presented in the statement of cash flow.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2024/08-13-24 Summer National Meeting/Adoptions/23-26 - ASU 2023-06 - Disclosure Improvements.docx

 

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

| Topic | Codification | Abbreviated Summary of Change | Related Paragraphs | SAP Status/Recommendation |
|---|---|---|---|---|
| Statement of Cash Flows—Overall | 230-10 | Requires an accounting policy disclosure in annual periods of where cash flows associated with derivative instruments and their related gains and losses are presented in the statement of cash flows. | 50-9 | NAIC staff noted that this disclosure may be duplicative of *SSAP No. 86—Derivatives*, paragraph 63a.iv. However, this disclosure does not specifically require disclosure of the accounting policy for the presentation of cash flows from derivatives and the statutory statement of cash flows does not currently break out cash flows from derivatives.<br><br>No comments were received from regulators and Interested Parties had no comments on adoption of this disclosure.<br><br>**Staff recommends adoption of this disclosure for statutory accounting purposes.** |
| Accounting Changes and Error Corrections—Overall | 250-10 | Requires that when there has been a change in the reporting entity, the entity disclose any material prior-period adjustment and the effect of the adjustment on retained earnings in interim financial statements. | 50-6 | This disclosure is duplicative of *SSAP No. 3—Accounting Changes and Corrections of Errors*, paragraph 13.<br><br>**This update is not applicable – no action required.** |
| Earnings Per Share—Overall | 260-10 | Requires disclosure of the methods used in the diluted earnings-per-share computation for each dilutive security and clarifies that certain disclosures should be made during interim periods. Amends illustrative guidance to illustrate disclosure of the methods used in the diluted earnings-per-share computation. | 50-1<br>55-51<br>55-52 | **This update is not applicable – no action required.** |

| **Topic** | **Codification** | **Abbreviated Summary of Change** | **Related Paragraphs** | **SAP Status/Recommendation** |
|---|---|---|---|---|
| Interim Reporting—Overall | 270-10 | Conforms to the amendments made to Topic 250. | 45-12<br>45-19<br>50-1 | **This update is not applicable – no action required.** |
| Commitments—Overall | 440-10 | Requires disclosure of assets mortgaged, pledged, or otherwise subject to lien and the obligations collateralized. | 50-1 | This disclosure is duplicative of *SSAP No. 1—Accounting Policies, Risks & Uncertainties, and Other Disclosures*, paragraph 23b.<br><br>**This update is not applicable – no action required.** |
| Debt—Overall | 470-10 | Requires disclosure of amounts and terms of unused lines of credit and unfunded commitments and the weighted-average interest rate on outstanding short-term borrowings. Entities that are not public business entities are not required to provide information about the weighted-average interest rate. | 15-1<br>50-6<br>5-7 | Staff do not recommend adoption of the weighted-average interest rate calculation for statutory accounting purposes. Due to the complexity of this computation, this this disclosure is only required for public entities under GAAP. As SAP does not have the public/private entity distinction, adoption of this disclosure would be applicable to all insurance entities. This disclosure is not considered necessary in light of existing debt SAP disclosures and does not provide enough benefit to offset the cost of implementing such a potentially complex calculation.<br><br>**We recommend adoption, with modification, of the disclosures unused LOC and commitment disclosures.** |
| Equity—Overall | 505-10 | Requires entities that issue preferred stock to disclose preference in involuntary liquidation if the liquidation preference is other than par or stated value. | 50-4 | This disclosure is duplicative of *SSAP No. 72—Surplus and Quasi-Reorganizations*, paragraph 22b.<br><br>**This update is not applicable – no action required.** |

| Topic | Codification | Abbreviated Summary of Change | Related Paragraphs | SAP Status/Recommendation |
|---|---|---|---|---|
| Derivatives and Hedging—Overall | 815-10 | Adds inter-codification reference to 230-10-50-9 for disclosure of cash flows associated with derivative instruments. | 50-8C | **This update is not applicable – no action required.** |
| Transfers and Servicing—Secured Borrowing and Collateral | 860-30 | Requires:<br>a. That accrued interest be included in the disclosure of liabilities incurred in securities borrowing or repurchase or resale transactions.<br>b. Separate presentation of the aggregate carrying amount of reverse repurchase agreements on the face of the balance sheet if that amount exceeds 10 percent of total assets.<br>c. Disclosure of the weighted-average interest rates of repurchase liabilities for public business entities.<br>d. Disclosure of amounts at risk with an individual counterparty if that amount exceeds more than 10 percent of stockholder's equity.<br>e. Disclosure for reverse repurchase agreements that exceed 10 percent of total assets on whether there are any provisions in a reverse repurchase agreement to ensure that the market value of the underlying assets remains sufficient to protect against counterparty default and, if so, the nature of those provisions. | 15-1<br>45-2<br>45-2A<br>45-3<br>50-7<br>50-9 thru 12<br>55-4 | **We recommend adoption, with modification, of the disclosures in bullets a., b., d., and e. (see Abbreviated Summary of Changes)**<br><br>**The disclosure in bullet c. is not recommended for adoption within SAP – no action required.** |
| Extractive Activities—Oil and Gas—Notes to Financial Statements | 932-235 | Requires that paragraphs 932-235-50-3 through 50-36 be applicable for each annual period presented in the financial statements. | 50-2A | **This update is not applicable – no action required.** |
| Financial Services—Investment Companies—Investment Company Activities | 946-20 | Requires that investment companies disclose the components of capital on the balance sheet. | 50-11<br>50-12 | **This update is not applicable – no action required.** |
| Real Estate—Real Estate Investment Trusts—Overall | 974-10 | Requires disclosure for annual reporting periods of the tax status of distributions per unit (for example, ordinary income, capital | 50-1 | **This update is not applicable – no action required.** |

| Topic | Codification | Abbreviated Summary of Change | Related Paragraphs | SAP Status/Recommendation |
|---|---|---|---|---|
| | | gain, and return of capital) for a real estate investment trust. | | |
| Generally Accepted Accounting Principles—Overall | 105-10 | Adds in transition and open effective date information. | 65-7<br>65-8 | **This update is not applicable – no action required.** |

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

**Issue:** ASU 2023-01, Leases (Topic 842), Common Control Arrangements

**Check (applicable entity):**

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

**Description of Issue:** In March 2023, the Financial Accounting Standards Board (FASB) issued *Accounting Standard Update (ASU) 2023-01, Leases (Topic 842), Common Control Arrangements*. This ASU was issued as part of FASB's post-implementation review to address issues that have been found during the implementation of the new lease guidance from *ASU 2016-02, Leases (Topic 842)*. As a reminder, ASU 2016-02 was rejected for statutory accounting and the operating lease treatment was retained.

ASU 2023-01 focuses on two issues that are both related to private company stakeholders' concerns about applying Topic 842 to related party arrangements between entities under common control. The first issue provides a practical expedient for private companies and not-for-profit entities that are not conduit bond obligors to use the written terms and conditions of a common control arrangement to determine 1) whether a lease exists and, if so, 2) the classification of and accounting for that lease. The practical expedient may be applied on an arrangement-by-arrangement basis. If no written terms and conditions exist (including in situations in which an entity does not document existing unwritten terms and conditions in writing upon transition to the practical expedient), an entity is prohibited from applying the practical expedient and must evaluate the enforceable terms and conditions to apply Topic 842. The new U.S. GAAP guidance for this issue is only applicable to non-public entities.

The second issue involves the accounting for leasehold improvements associated with a lease between entities under common control. U.S. GAAP guidance for life of leasehold improvements prior to this update generally agrees to statutory accounting. It was noted in the ASU that private company stakeholders were concerned that amortizing leasehold improvements associated with arrangements between entities under common control determined to be leases (hereinafter referred to as common control leases) over a period shorter than the expected useful life of the leasehold improvements might result in financial reporting that do not faithfully represent the economics of those leasehold improvements, particularly in common control leases with short lease terms. While this issue originally came from private company stakeholder comments, the guidance for this issue is applicable for all lessees that are party to a lease between entities under common control in which there are leasehold improvements.

**Existing Authoritative Literature:**
The ASUs related to Topic 842 have previously been rejected in *SSAP No. 22R—Leases*. Guidance for leasehold improvements is included in *SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements* and *SSAP No. 73—Health Care Delivery Assets and Leasehold Improvements in Heath Care Facilities*, and guidance for related parties is included in *SSAP No. 25—Affiliates and Other Related Parties*.

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

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

**Convergence with International Financial Reporting Standards (IFRS):** ASC Topic 842 was the result of a joint project between FASB and the International Accounting Standards Board.

**Staff Recommendation:**
**NAIC staff recommends the Working Group move this item to the active listing of the maintenance agenda categorized as a SAP clarification and expose revisions to adopt, with modification, ASU 2023-01 in *SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements* and *SSAP No. 73—Health Care Delivery Assets and Leasehold Improvements in Heath Care Facilities*, as illustrated in the Form A. The proposed revisions reject the practical expedient for private companies and not-for-profit entities but recommend adoption of the leasehold improvement guidance from the ASU, with modification to the language to align with existing guidance in SSAP No. 19 and SSAP No. 73.**

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

5. Leasehold improvements that increase the value and enhance the usefulness of the leased asset meet the definition of assets established in SSAP No. 4. Within that definition, such items also meet the criteria defining nonadmitted assets. Accordingly, such assets shall be reported as nonadmitted assets and charged against surplus. These nonadmitted assets shall be amortized against net income over the shorter of their estimated useful life or the remaining lease term as defined in SSAP No. 22R. Leasehold improvements associated with a lease between entities under common control shall be amortized over the useful life of those improvements to the holding company group as long as the lessee controls the use of the underlying asset through a lease. If the lessor obtained the right to control the use of the underlying asset through a lease with another entity not within the same holding company group, the amortization period shall not exceed the amortization period of the holding company group. Leasehold improvements that do not meet the definition of assets shall be charged to expense when acquired. The amortization of leasehold improvements (including property improvements and integral equipment) shall cease, with any remaining amount immediately expensed, in any event in which the lease is terminated in advance of the lease term. This includes situations in which leased real estate is acquired by the reporting entity lessee. Such improvements related to the functionality of health care delivery assets shall follow the accounting, reporting and impairment guidance in *SSAP No. 73—Health Care Delivery Assets and Leasehold Improvements in Health Care Facilities*, and an exception to the application of this guidance to leasehold improvements necessary for the functionality of health care delivery assets is included in SSAP No. 73. If leased real estate is acquired, recognition of the real estate shall follow the provisions in *SSAP No. 40R—Real Estate Investments*.

20. This statement adopts, with modification, *ASU 2023-01, Leases (Topic 842), Common Control Arrangements*. The practical expedient for private companies and not-for-profit entities that are not conduit bond obligors to use the written terms and conditions of a common control arrangement is rejected for statutory accounting. The guidance for lessees that are a party to a lease between entities under common control in which there are leasehold improvements is adopted, with modification to align with existing statutory guidance.

***SSAP No. 73—Health Care Delivery Assets and Leasehold Improvements in Health Care Facilities***

9. Furniture, medical equipment and fixtures, and leasehold improvements shall be depreciated over their estimated useful lives but for a period not to exceed three years, except for a leasehold improvement which shall be amortized against net income over the shorter of its estimated useful life or the remaining lease term, using methods detailed in SSAP No. 19. Leasehold improvements associated with a lease between entities under common control shall be amortized over the useful life of those improvements to the holding company group as long as the lessee controls the use of the underlying asset through a lease. If the lessor obtained the right to control the use of the underlying asset through a lease with another entity not within the same holding company group, the amortization period shall not exceed the amortization period of the holding company group. The amortization of leasehold improvements (including property improvements and integral equipment) shall cease, with any remaining amount immediately expensed, in any event in which the lease is terminated in advance of the lease term. This includes situations in which leased real estate is acquired by the reporting entity lessee but excludes situations where the real estate lease agreement has a purchase option that contains language that allows leasehold improvements necessary for the functionality of specific health care delivery assets to be excluded from the purchase cost of the real estate. Upon acquisition, such leasehold improvements necessary for the functionality of healthcare delivery assets shall follow the guidance for health care delivery assets in this statement. If

leased real estate is acquired, recognition of the real estate shall follow the provisions in *SSAP No. 40R—Real Estate Investments*.

13. This statement adopts, with modification, *ASU 2023-01, Leases (Topic 842), Common Control Arrangements*. The practical expedient for private companies and not-for-profit entities that are not conduit bond obligors to use the written terms and conditions of a common control arrangement is rejected for statutory accounting. The guidance for lessees that are a party to a lease between entities under common control in which there are leasehold improvements is adopted, with modification to align with existing statutory guidance.

**Staff Review Completed by:** Jake Stultz, NAIC Staff – February 2024

**Status:**
On March 16, 2024, the Statutory Accounting Principles (E) Working Group exposed revisions to adopt, with modification, *ASU 2023-01, Leases (Topic 842), Common Control Arrangements* in *SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements* and *SSAP No. 73—Health Care Delivery Assets and Leasehold Improvements in Heath Care Facilities*, as illustrated above. The proposed revisions reject the practical expedient for private companies and not-for-profit entities but recommend adoption of the leasehold improvement guidance from the ASU, with modification to the language to align with existing guidance in SSAP No. 19 and SSAP No. 73.

On August 13, 2024, the Statutory Accounting Principles (E) Working Group adopted the exposed revisions which adopt with modification, as final, *ASU 2023-01, Leases (Topic 842), Common Control Arrangements* in *SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements* and *SSAP No. 73—Health Care Delivery Assets and Leasehold Improvements in Heath Care Facilities.*

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2024/08-13-24 Summer National Meeting/Adoptions/24-02 - ASU 2023-01 Leases.docx

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

**Issue:** ASU 2023-08, Accounting for and Disclosure of Crypto Assets

**Check (applicable entity):**

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

**Description of Issue:** In December 2023, the Financial Accounting Standards Board (FASB) issued *Accounting Standard Update (ASU) 2023-08, Intangibles—Goodwill and Other—Crypto Assets (Subtopic 350-60), Accounting for and Disclosure of Crypto Assets*. This ASU establishes the accounting and reporting for crypto assets, which are defined in U.S. GAAP as assets that:

1. Meet the definition of intangible assets as defined in the Codification.
2. Do not provide the asset holder with enforceable rights to or claims on underlying goods, services, or other assets.
3. Are created or reside on a distributed ledger based on blockchain or similar technology.
4. Are secured through cryptography.
5. Are fungible.
6. Are not created or issued by the reporting entity or its related parties.

ASU 2023-08 also clarified the disclosure of crypto assets in the financial statements, which note that crypto assets are to be reported at fair value, are reported separately from the other intangible assets, describe how they are to be disclosed in the income statement and statement of cash flows, and includes a rollforward of activity and balances on an annual basis.

As background, on May 20, 2021, the Working Group adopted *Interpretation (INT) 21-01: Accounting for Cryptocurrencies*, which established statutory accounting for crypto assets. At that time, NAIC staff had received several questions on the proper treatment of cryptocurrencies, so with the absence of U.S. GAAP guidance, the Working Group adopted INT 21-01. The INT established that directly held cryptocurrencies have not been identified in the *Accounting Practices and Procedures Manual* (AP&P Manual) as an admitted asset, and do not meet the definition of any admitted asset that is defined in the AP&P Manual. Accordingly, by default they are a nonadmitted asset per *SSAP No. 4—Assets and Nonadmitted Assets*, paragraph 3, as they are not specifically identified in the AP&P Manual as an admitted asset. Additionally, a disclosure for crypto assets was added to the general interrogatories of the Annual Statement blanks and instructions.

This agenda item intends to codify the guidance that was adopted in INT 21-01, and formally establish that crypto assets are nonadmitted assets for statutory accounting.

**Existing Authoritative Literature:**
Accounting for cryptocurrencies is currently addressed by *INT 21-01 Accounting for Cryptocurrencies*, and the Annual Statement blanks included a disclosure in the general interrogatories.

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

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

**Convergence with International Financial Reporting Standards (IFRS):** None

**Staff Recommendation:**
**NAIC staff recommends that the Working Group move this item to the active listing of the maintenance agenda categorized as a SAP clarification and expose revisions to adopt, with modification ASU 2023-08 for statutory accounting. The agenda item proposes to adopt the definition of crypto assets from the ASU but establishes that directly held crypto assets are nonadmitted assets for statutory accounting. The recommendation is to add guidance to *SSAP No. 20—Nonadmitted Assets* that clarifies that directly-held crypto assets are nonadmitted assets for statutory accounting and to define crypto assets using the definition from ASU 2023-08. This agenda item does not intend to modify the general interrogatory disclosures that had previously been added to the Annual Statement blanks and instructions. Additionally, NAIC staff recommends that the Working Group expose the intent to nullify *INT 21-01, Accounting for Cryptocurrencies*, upon the adoption of this agenda item. The revisions to SSAP No. 20 are illustrated below.**

***SSAP No 20—Nonadmitted Assets***

Paragraph 4:

> f. Crypto assets are defined as intangible digital assets in which transactions are created or reside on a distributed ledger based on blockchain or similar technology and are verified with records maintained by a decentralized system using cryptography, rather than by a centralized authority, and do not provide the asset holder with enforceable rights to or claims on underlying goods, services, or other assets. Directly held crypto assets do not meet the definition of cash in *SSAP No. 2R—Cash, Cash Equivalents, Drafts, and Short-Term Investments*, and due to the volatile nature of the assets and liquidity issues, the assets shall not be considered available to satisfy policyholder obligations.

5. This statement adopts with modification *FASB Emerging Issues Task Force No. 08-7: Accounting for Defensive Intangible Assets* to nonadmit defensible intangible assets. This statement rejects Chapters 3A and 11 of *Accounting Research Bulletin No. 43, Restatement and Revision of Accounting Research Bulletins*. This statement adopts, with modification, *ASU 2023-08, Intangibles—Goodwill and Other—Crypto Assets (Subtopic 350-60), Accounting for and Disclosure of Crypto Assets*, which adopts the definition of crypto assets from the ASU and establishes that directly held crypto assets are nonadmitted assets for statutory accounting.

**Staff Review Completed by:** Jake Stultz, NAIC Staff—February 2024

**Status:**
On March 16, 2024, the Statutory Accounting Principles (E) Working Group exposed revisions to adopt, with modification *ASU 2023-08, Accounting for and Disclosure of Crypto Assets* for statutory accounting. The revisions propose to adopt the definition of crypto assets from the ASU but establishes within *SSAP No. 20—Nonadmitted Assets* that directly held crypto assets are nonadmitted assets for statutory accounting. Additionally, the exposure includes the intent to nullify *INT 21-01, Accounting for Cryptocurrencies*. This agenda item does not intend to modify the general interrogatory disclosures that had previously been added to the Annual Statement blanks and instructions.

On August 13, 2024, the Statutory Accounting Principles (E) Working Group adopted the exposed revisions to SSAP No. 20 which with modification, *ASU 2023-08, Accounting for and Disclosure of Crypto Assets* for statutory accounting. Upon adoption, this agenda also nullifies *INT 21-01, Accounting for Cryptocurrencies*.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2024/08-13-24 Summer National Meeting/Adoptions/24-03 - ASU 2023-08 Crypto.docx

 

# Interpretation of the
# Statutory Accounting Principles (E) Working Group

## INT 21-01: Accounting for Cryptocurrencies

## GUIDANCE NULLIFIED AUGUST 13, 2024

**INT 21-01 Dates Discussed**

March 15, 2021; May 20, 2021; August 13, 2024

**INT 21-01 References**

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

**INT 21-01 Issue**

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

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

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

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

**INT 21-01 Discussion**

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

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

 

## INT 21-01 Consensus

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

## INT 21-01 Status

8. No further discussion is planned.

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

 

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

**Issue: Consistency Revisions for Residuals**

**Check (applicable entity):**

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

**Description of Issue:** This agenda item has been developed to incorporate consistency revisions for residual tranches and residual security interests. Over the last couple of years, a variety of revisions have been incorporated for residual interests. These began with revisions to clarify the reporting on Schedule BA (instead of Schedule D-1) along with the residual definition and guidance within each investment SSAP to highlight that residuals shall be captured on Schedule BA. Although these revisions were necessary to immediately address the reporting of residuals, the discussion that accompanied these revisions have noted that conforming revisions would be needed coinciding with the effective date of the principles-based bond definition guidance to have consistency of guidance location, terminology and definitions.

With the revisions to *SSAP No. 21R—Other Admitted Assets* to provide the accounting and reporting for residuals, all residuals, regardless of investment structure, shall follow the guidance detailed in SSAP No. 21R and be reported on Schedule BA.

To ensure consistency in definitions and guidance, this agenda item proposes to centralize the guidance in SSAP No. 21R and use a consistent approach in the other investment SSAPs to exclude residuals from scope and direct to SSAP No. 21R.

**Existing Authoritative Literature: -** Key references **bolded** for emphasis.

- ***SSAP No. 21R—Other Admitted Assets (Effective 2025) – Adopted March 16, 2024***

*Residual Tranches or Interests/Loss Positions*

28. A residual interest or a residual security tranche (collectively referred to as residuals) exists in investment structures that issue one or more classes of debt securities created for the primary purpose of raising debt capital backed by collateral assets. The primary source of debt repayment is derived through rights to the cash flows of a discrete pool of collateral assets. These designs could be backed directly or indirectly through a feeder fund. The collateral assets generate cash flows that provide interest and principal payments to debt holders through a contractually prescribed distribution methodology (e.g., waterfall dictating the order and application of all collateral cash flows). Once those contractual requirements are met, the remaining cash flows generated by (or with the sale of) the collateral assets are provided to the holder of the residual security/residual interest holder. When an asset within the discrete pool of assets does not perform as expected, it impacts the extent to which cash flows will be generated and distributed. The residual holders in the structure continue to receive payments from the collateral so long as there are cash flows in excess of the debt obligations. The payments to the residual holder may vary significantly, both in timing and amount, based on the underlying collateral performance.

29. The structural design of a residual interest or residual security tranche can vary, but the overall concept is that they receive the remaining cash flows after all debt holders receive contractual interest and principal payments. Determining whether an investment in a structure reflects a residual interest or tranche shall be based on the substance of the investment held rather than its legal form. Common characteristics of residual interests/residual security tranches include the items noted below, but the presence or absence of any of these factors should not be definitive in determination. Classification as a residual should be based on the substance

of the investment and how cash flows to the holder are determined. Additionally, it would be expected that the equity position in an ABS Issuer, as defined in SSAP 26R, would be classified as a residual tranche.

a. Residuals often do not have contractual principal or interest.

b. Residuals may be structured with terms that appear to be stated principal or interest but that lack substance, and result in receiving the residual cash flows of the underlying collateral. The terms allow for significant variation in the timing and amount of cash flows without triggering a default of the structure.

c. Residuals do not have credit ratings or NAIC assigned designations. Rather, they are first loss positions that provide subordination to support the credit quality of the typically rated debt tranches.

d. Residuals may provide payment throughout the investment duration (and not just at maturity), but the payments received continue to reflect the residual amount permitted after debt tranche holders receive contractual principal and interest payments.

e. Frequently, there are contractual triggers that divert cash flows from the residual holders to the debt tranches if the structure becomes stressed.

30. Residual tranches or interests do not qualify for bond reporting. Residuals shall follow the accounting and admittance guidance within this statement and are required to be reported on Schedule BA: Other Long-Term Invested Assets.

31. As stated in paragraph 22, residuals are permitted to be admitted assets if debt securities from the same structure qualify (or would qualify) as admitted assets. If the debt security from a structure is (or would be) nonadmitted due to the requirements under paragraph 22, then any residual interests or first loss positions held from the same structure also do not qualify as admitted assets and shall be reported as nonadmitted assets.

32. Residuals shall be initially reported at cost, or allocated cost (using proportional fair values if acquired along with debt tranches from the securitization). Subsequent to initial acquisition, residuals shall be reported at either 1) the lower of amortized cost or fair value under the Allowable Earned Yield method detailed in paragraphs 33-34, with temporary reductions in fair value reported as an unrealized loss, or 2) at the calculated practical expedient method detailed in paragraph 35.

33. For purposes of this statement for residuals only, amortized cost shall be defined as the cost to acquire the residual reduced for distributions in excess of the Allowable Earned Yield and other-then-temporary impairments (OTTI). The Allowable Earned Yield shall be established at acquisition as the discount rate that equates the initial best estimate of the residual’s cash flows to its acquisition cost. The Allowable Earned Yield is not to be updated after acquisition.

34. Interest income shall be recorded under the effective yield method using the Allowable Earned Yield, capped by the amount of cash distributions received. To the extent that the Allowable Earned Yield, applied to the current amortized cost, exceeds the cash distributions received, such unrecognized interest income may be carried forward to future periods to be recognized when sufficient cash distributions are received. To the extent cash distributions exceed the Allowable Earned Yield (including any unrecognized interest carried forward), the amortized cost shall be reduced by the excess. As a result of this method, the amortized cost shall not be increased unless there is a subsequent investment (i.e., an additional purchase with additional consideration remitted).

35. Reporting entities may elect a practical expedient in lieu of the Allowable Earned Yield detailed in paragraphs 33-34 and calculate Book/Adjusted Carrying Value (BACV) such that all distributions received are treated as a reduction in BACV. With this approach, the reporting entity will not recognize any interest or investment income until the residual tranche has a BACV of zero. Once the residual has a zero BACV, distributions received shall be recognized as interest income.

 

a. Reporting entities applying the practical expedient shall continue to report residuals on Schedule BA, including those with a zero BACV. Any subsequent distributions shall be reported as interest income until the structure matures/terminates, is unwound, or no longer meets the definition of a residual.

b. Reporting entities are required to apply the practical expedient to all residuals held.

c. Reporting entities that wish to discontinue use of the practical expedient approach and move towards the Allowable Earned Yield method are required to specify and disclose an explicit transition date, and only apply the Allowable Earned Yield method to residuals acquired after that date. Residuals held prior to the disclosed accounting method transition date shall continue to follow the practical expedient until those residuals mature/terminate or are unwound.

36. Residuals shall be assessed for other-than-temporary impairment (OTTI) on an ongoing basis, with required assessment anytime that fair value is less than the reported value.

a. For residuals measured using the Allowable Earned Yield method, as detailed in paragraphs 33-34, an OTTI shall be considered to have occurred if the present value of expected cash flows discounted by the Allowable Earned Yield, is less than amortized cost. Upon identification of an OTTI, the reporting entity shall recognize a realized loss equal to the difference between the amortized cost and the present value of expected cash flows, with the present value of expected cash flows becoming the new amortized cost to which the Allowable Earned Yield is applied. After the OTTI is recognized, distributions received from the residual shall continue to be recorded in accordance with paragraphs 33-34. Subsequent recoveries in cash flows shall not result in increases to the amortized cost.

b. For residuals measured under the practical expedient, as detailed in paragraph 35, an OTTI shall be considered to have occurred if the fair value of the residual is less than the BACV. The reporting entity shall recognize a realized loss equal to the difference between the fair value and the BACV, with the fair value becoming the new BACV. After the OTTI is recognized, distributions received from the residual shall continue to be recorded in accordance with paragraph 35. Subsequent recoveries in cash flows shall not result in increases to the BACV.

37. Residuals recognized on Schedule BA as of December 31, 2024, and accounted for under a different SSAP, shall follow the following measurement transition guidance as of January 1, 2025:

a. Reporting entity shall determine whether they will follow the Allowable Earned Yield method detailed in paragraphs 33-34, or the practical expedient detailed in paragraph 35, for all residuals.

b. Residuals previously accounted for under SSAP No. 26R or SSAP No. 43R shall prospectively apply the Allowable Earned Yield measurement method elected under this Statement using the amortized cost as of December 31, 2024 as the starting point in the calculation. Residuals that will follow the practical expedient shall be recognized on January 1, 2025 at the lower of amortized cost or fair value as of December 31, 2024, realizing any unrealized loss existing at that date.

c. Residuals reported under the equity method or fair value as of December 31, 2024 (as they were previously captured in scope of SSAP No. 30R, 32R or 48) with unrealized gains or losses recognized, shall recognize any unrealized position as realized, with the reported value as of December 31, 2024 becoming the January 1, 2025 cost basis for subsequent measurement under this statement.

**Effective Date and Transition**

40. This statement is effective for years beginning January 1, 2001. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors.* The guidance for structured settlements when the reporting entity acquires the legal right to receive payments is effective December 31, 2018.

41. Revisions adopted March 16, 2024, to add guidance for “Debt Securities That Do Not Qualify as Bonds” and for “Residual Tranches or Interests/Loss Positions” are initially effective Jan. 1, 2025, to correspond with

the effective date of the principles-based bond definition. The guidance for residual tranches is permitted for early application. Reporting entities that apply this guidance in 2024 shall continue to follow the transition guidance in paragraph 37 using the modified dates that correspond to the reporting entity's application date.

- ***SSAP No. 26R—Bonds (Effective 2025)***

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 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 non-debt variable, as described in paragraph 6.d.

   d. Securities that do not qualify as bonds pursuant to the principles-based bond definition, including first loss positions that lack contractual payments or substantive credit enhancement. These investments shall follow the appropriate guidance in *SSAP No. 21R— Other Admitted Assets*.

   e. Replication (synthetic asset) transactions addressed in *SSAP No. 86—Derivatives*. The admissibility, classification and measurement of a replication (synthetic asset) transactions are not preemptively determined by the principles-based bond definition and should be evaluated in accordance with the guidance on replication (synthetic asset) transactions within SSAP No. 86.

   f. 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.

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 credit enhancement through guarantees (or other similar forms of recourse), subordination and/or overcollateralization.

    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 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 investment(s) does not qualify for reporting as a bond and shall be reported on Schedule BA: Other Long-Term Invested Assets at the lower of amortized cost or fair value consistent with the treatment for residuals. (These items are further addressed in *SSAP No. 21R—Other Admitted Assets*.)**

- ***SSAP No. 30R—Unaffiliated Common Stock***

1. This statement establishes statutory accounting principles for common stocks.

2. Investments in common stock of subsidiaries, controlled or affiliated entities (investments in affiliates) are not within the scope of this statement. They are addressed in SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities.

**3. Investments in the form of common stock that are in substance residual interests or a residual security tranche, as defined in SSAP No. 43R or SSAP No. 48, shall be reported on Schedule BA: Other Long-Term Assets in the dedicated reporting lines for residuals.**

- ***SSAP No. 32R—Preferred Stock***

1. This statement establishes statutory accounting principles for preferred stock.

2. Investments in preferred stock of entities captured in *SSAP No. 97—Investments in Subsidiaries, Controlled or Affiliated Entities* or *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies* as well as preferred stock interests of certified capital companies per *INT 06-02: Accounting and Reporting for Investments in a Certified Capital Company* (CAPCO) are included within the scope of this statement. The requirement to file investments in preferred stock of certain subsidiaries, controlled or affiliated entities with the NAIC pursuant to SSAP No. 97 does not affect the application of the accounting, valuation or admissibility under this statement. In addition to the provisions of this statement, preferred stock investments in SCAs are also subject to the provisions of *SSAP No. 25—Affiliates and Other Related Parties* and *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*.

**3. Investments in the form of preferred stock that are in substance residual interests or a residual security tranche, as defined in SSAP No. 43R or SSAP No. No. 48, shall be reported on Schedule BA: Other Long-Term Assets in the dedicated reporting lines for residuals.**

- ***SSAP No. 43R—Asset-Backed Securities (Effective 2025)***

4. This statement excludes:

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

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 that do not qualify as Asset-Backed Securities per the bond definition in *SSAP No. 26R—Bonds*. This exclusion includes residual or interests, as well as first loss positions, that do not have contractual payments or substantive credit enhancement. Debt**

**securities that do not qualify and residual interests shall follow guidance in *SSAP No. 21R—Other Admitted Assets.***

11. After initial recognition, the carrying 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):

a. For reporting entities that maintain an Asset Valuation Reserve (AVR), 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. 3

b. For reporting entities that do not maintain an AVR, 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[4], 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*. These items are captured in *SSAP No. 21R—Other Admitted Assets* and subject to admittance restrictions detailed in that statement.**

**Footnote 4: Reference to “residual tranches or interests” intends to capture securitization tranches and beneficial interests as well as other structures 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.**

### Residual Tranches or Interests

**27. A residual interest or a residual security tranche (collectively referred to as residuals) exists in investment structures that issue one or more classes of debt securities created for the primary purpose of raising debt capital backed by collateral assets. The primary source of debt repayment is derived through rights to the cash flows of a discrete pool of collateral assets. These designs could be backed directly or indirectly through a feeder fund. The collateral assets generate cash flows that provide interest and principal payments to debt holders through a contractually prescribed distribution methodology (e.g., waterfall dictating the order and application of all collateral cash flows). Once those contractual requirements are met, the remaining cash flows generated by (or with the sale of) the collateral assets are provided to the holder of the residual security/residual interest holder. When an asset within the discrete pool of assets does not perform as expected, it impacts the extent to which cash flows will be generated and distributed. The residual holders in the structure continue to receive payments from the collateral so long as there are cash flows in excess of the debt obligations. The payments to the residual holder may vary significantly, both in timing and amount, based on the underlying collateral performance.**

**28. The structural design of a residual interest or residual security tranche can vary, but the overall concept is that they receive the remaining cash flows after all debt holders receive contractual interest and principal payments. Determining whether an investment in a structure reflects a residual interest or tranche shall be based on the substance of the investment held rather than its legal form. Common characteristics of residual interests/residual security tranches include the items noted below, but the presence or absence of any of these factors should not be definitive**

**in determination. Classification as a residual should be based on the substance of the investment and how cash flows to the holder are determined.**

a. **Residuals often do not have contractual principal or interest.**

b. **Residuals may be structured with terms that appear to be stated principal or interest but that lack substance, and result in receiving the residual cash flows of the underlying collateral. The terms allow for significant variation in the timing and amount of cash flows without triggering a default of the structure.**

c. **Residuals do not have credit ratings or NAIC assigned designations. Rather, they are first loss positions that provide subordination to support the credit quality of the typically rated debt tranches.**

d. **Residuals may provide payment throughout the investment duration (and not just at maturity), but the payments received continue to reflect the residual amount permitted after debt tranche holders receive contractual principal and interest payments.**

e. **Frequently, there are contractual triggers that divert cash flows from the residual holders to the debt tranches if the structure becomes stressed.**

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

**Residual Interests and Reporting**

**18. Investments in scope of this statement are reported on *Schedule BA: Other Long-Term Assets*. Schedule BA includes dedicated reporting categories for joint ventures, partnerships, and limited liability company investments as well as for residual interests, both with reporting lines in accordance with underlying asset characteristics. Investments within scope of this standard shall be divided within these reporting categories, with investments that reflect residual interests, or that predominantly hold residual interests captured in the residual interest reporting category.**

**19. A residual interest or a residual security tranche (collectively referred to as residuals) exists in investment structures that issue one or more classes of debt securities created for the primary purpose of raising debt capital backed by collateral assets. The primary source of debt repayment is derived through rights to the cash flows of a discrete pool of collateral assets. These designs could be backed directly or indirectly through a feeder fund. The collateral assets generate cash flows that provide interest and principal payments to debt holders through a contractually prescribed distribution methodology (e.g., waterfall dictating the order and application of all collateral cash flows). Once those contractual requirements are met, the remaining cash flows generated by (or with the sale of) the collateral assets are provided to the holder of the residual security/residual interest holder. When an asset within the discrete pool of assets does not perform as expected, it impacts the extent to which cash flows will be generated and distributed. The residual holders in the structure continue to receive payments from the collateral so long as there are cash flows in excess of the debt obligations. The payments to the residual holder may vary significantly, both in timing and amount, based on the underlying collateral performance.**

**20. The structural design of a residual interest or residual security tranche can vary, but the overall concept is that they receive the remaining cash flows after all debt holders receive contractual interest and principal payments. Determining whether an investment in a structure reflects a residual interest or tranche shall be based on the substance of the investment held rather than its legal form. Common characteristics of residual interests/residual security tranches include the items noted below, but the presence or absence of any of these factors should not be definitive in determination. Classification as a residual should be based on the substance of the investment and how cash flows to the holder are determined.**

a. **Residuals often do not have contractual principal or interest.**

b. **Residuals may be structured with terms that appear to be stated principal or interest but that lack substance and result in receiving the residual cash flows of the underlying collateral. The terms allow for significant variation in the timing and amount of cash flows without triggering a default of the structure.**

c. **Residuals do not have credit ratings or NAIC assigned designations. Rather, they are first loss positions that provide subordination to support the credit quality of the typically rated debt tranches.**

d. **Residuals may provide payment throughout the investment duration (and not just at maturity), but the payments received continue to reflect the residual amount permitted after debt tranche holders receive contractual principal and interest payments.**

e. **Frequently, there are contractual triggers that divert cash flows from the residual holders to the debt tranches if the structure becomes stressed.**

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

- Agenda Item 2021-15 – SSAP No. 43R – Residual Tranches, was adopted November 10, 2021, to incorporate accounting guidance for residuals and clarify that residuals shall be reported on Schedule BA.

- Agenda item 2023-12 – Residuals in SSAP No. 48 Investments, was adopted September 21, 2023 to define residuals consistently between *SSAP No. 43R—Asset-Backed Securities* and *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies* and to add Annual Statement Instructions for the Schedule BA residual reporting category.

- Agenda Item 2023-23 – Residuals in Preferred Stock and Common Stock Structures was adopted during the 2023 Fall National Meeting to exclude residual interests from *SSAP No. 30R—Unaffiliated Common Stock* and *SSAP No. 32R—Preferred Stock*.

- Principles-Based Bond Definition – During the 2023 Summer National Meeting, the Working Group adopted the principles-based bond definition in a revised *SSAP No. 26R—Bonds* and *SSAP No. 43R—Asset-Backed Securities*. Subsequent to this adoption, revisions to *SSAP No. 21R—Other Admitted Asset*s were exposed to capture accounting and reporting guidance for non-bond debt securities as well as residual interests. The revisions to SSAP No. 21R for debt securities that do not qualify as bonds to prescribe the measurement method and accounting provisions for residual interests was adopted March 16, 2024 during the 2024 Spring National Meeting.

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

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

**Staff Recommendation:**
**NAIC staff recommend that the Working Group move this item to the active listing of the maintenance agenda categorized as a SAP clarification and expose revisions to incorporate consistency revisions for residuals so that all SSAPs refer to SSAP No. 21R for the formal definition and accounting and reporting guidance. This recommendation involves revisions to *SSAP No. 26R—Bonds* (Effective 2025), *SSAP No. 30R—Unaffiliated Common Stock*, *SSAP No. 32R—Preferred Stock*, *SSAP No. 43R—Asset-Backed Securities* (Effective 2025), and *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*.**

**Staff Review Completed by:** Julie Gann, NAIC Staff—February 2024

**Status:**
On March 16, 2024, the Statutory Accounting Principles (E) Working Group exposed consistency revisions for residuals so that *SSAP No. 26R—Bonds* (Effective 2025), *SSAP No. 30R—Unaffiliated Common Stock*, *SSAP No. 32R—Preferred Stock*, *SSAP No. 43R—Asset-Backed Securities* (Effective January 1, 2025), and *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies* refer directly to *SSAP No. 21R—Other Admitted Assets* for the formal definition and accounting and reporting guidance.

**Proposed Revisions:**

**SSAP No. 26R—Bonds (Effective Jan. 1, 2025)**

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 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 non-debt variable, as described in paragraph 6.d.

   d. Securities that do not qualify as bonds pursuant to the principles-based bond definition, including first loss positions that lack ~~contractual payments or~~ substantive credit enhancement as described in paragraph 10.b., as those items are residual interests. All investments that are in substance residual interests or that is a residual security tranche, as defined in *SSAP No. 21R—Other Admitted Assets*, ~~. These investments~~ shall follow the appropriate guidance in SSAP No. 21R~~—*Other Admitted Assets*~~.

   e. Replication (synthetic asset) transactions addressed in *SSAP No. 86—Derivatives*. The admissibility, classification and measurement of a replication (synthetic asset) transactions are not preemptively determined by the principles-based bond definition and should be evaluated in accordance with the guidance on replication (synthetic asset) transactions within SSAP No. 86.

   f. 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.

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 credit enhancement through guarantees (or other similar forms of recourse), subordination and/or overcollateralization.

   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 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 an ~~securitization~~ ABS structure 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~~ structure. 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~~structure, and does not have ~~contractual principal and interest payments along with~~ substantive credit enhancement and is held by a reporting entity, the investment(s) does not qualify for reporting as a bond as it is a residual interest. All residual interests shall follow the accounting and reporting guidance in *SSAP No. 21R—Other Admitted Assets*. ~~and shall be reported on Schedule BA: Other Long-Term Invested Assets at the lower of amortized cost or fair value consistent with the treatment for residuals. (These items are further addressed in SSAP No. 21R—Other Admitted Assets.)~~

- ***SSAP No. 30R—Unaffiliated Common Stock***

1. This statement establishes statutory accounting principles for common stocks.

2. Investments in common stock of subsidiaries, controlled or affiliated entities (investments in affiliates) are not within the scope of this statement. They are addressed in *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*.

3. Investments in the form of common stock that are in substance residual interests or a residual security tranche, as defined in *SSAP No. 21R—Other Admitted Assets*~~SSAP No. 43R or SSAP No. 48~~, shall follow the accounting and reporting guidance in SSAP No. 21R with reporting ~~be reported~~ on *Schedule BA: Other Long-Term Assets* in the dedicated reporting lines for residuals.

- ***SSAP No. 32R—Preferred Stock***

1. This statement establishes statutory accounting principles for preferred stock.

2. Investments in preferred stock of entities captured in *SSAP No. 97—Investments in Subsidiaries, Controlled or Affiliated Entities* or *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies* as well as preferred stock interests of certified capital companies per *INT 06-02: Accounting and Reporting for Investments in a Certified Capital Company* (CAPCO) are included within the scope of this statement. The requirement to file investments in preferred stock of certain subsidiaries, controlled or affiliated entities with the NAIC pursuant to SSAP No. 97 does not affect the application of the accounting, valuation or admissibility under this statement. In addition to the provisions of this statement, preferred stock investments in SCAs are also subject to the provisions of *SSAP No. 25—Affiliates and Other Related Parties* and *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*.

3. Investments in the form of preferred stock that are in substance residual interests or a residual security tranche, as defined in ~~SSAP No. 43R or SSAP No. No. 48~~*SSAP No. 21R—Other Admitted Assets*, shall follow the accounting and reporting guidance in SSAP No. 21R with reporting ~~be reported~~ on *Schedule BA: Other Long-Term Assets* in the dedicated reporting lines for residuals.

- ***SSAP No. 43R—Asset-Backed Securities (Effective 2025)***

4. This statement excludes:

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

   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 that do not qualify as Asset-Backed Securities per the bond definition in *SSAP No. 26R—Bonds* and residual interests as defined in *SSAP No. 21R—Other Admitted Assets*. ~~This exclusion includes residual or interests, as well as first loss positions, that do not have contractual payments or substantive credit enhancement.~~ These securities ~~Debt securities that do not qualify~~ and residual interests shall follow the accounting and reporting guidance in SSAP No. 21R. ~~—Other Admitted Assets~~

11. After initial recognition, the carrying 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):

   a. For reporting entities that maintain an Asset Valuation Reserve (AVR), 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. 3

   b. For reporting entities that do not maintain an AVR, 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[4], 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. These items are captured in SSAP No. 21R—Other Admitted Assets and subject to admittance restrictions detailed in that statement.**~~

~~**Footnote 4: Reference to "residual tranches or interests" intends to capture securitization tranches and beneficial interests as well as other structures 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.**~~

~~**Residual Tranches or Interests**~~

 

~~**27. A residual interest or a residual security tranche (collectively referred to as residuals) exists in investment structures that issue one or more classes of debt securities created for the primary purpose of raising debt capital backed by collateral assets. The primary source of debt repayment is derived through rights to the cash flows of a discrete pool of collateral assets. These designs could be backed directly or indirectly through a feeder fund. The collateral assets generate cash flows that provide interest and principal payments to debt holders through a contractually prescribed distribution methodology (e.g., waterfall dictating the order and application of all collateral cash flows). Once those contractual requirements are met, the remaining cash flows generated by (or with the sale of) the collateral assets are provided to the holder of the residual security/residual interest holder. When an asset within the discrete pool of assets does not perform as expected, it impacts the extent to which cash flows will be generated and distributed. The residual holders in the structure continue to receive payments from the collateral so long as there are cash flows in excess of the debt obligations. The payments to the residual holder may vary significantly, both in timing and amount, based on the underlying collateral performance.**~~

~~**28. The structural design of a residual interest or residual security tranche can vary, but the overall concept is that they receive the remaining cash flows after all debt holders receive contractual interest and principal payments. Determining whether an investment in a structure reflects a residual interest or tranche shall be based on the substance of the investment held rather than its legal form. Common characteristics of residual interests/residual security tranches include the items noted below, but the presence or absence of any of these factors should not be definitive in determination. Classification as a residual should be based on the substance of the investment and how cash flows to the holder are determined.**~~

~~**a. Residuals often do not have contractual principal or interest.**~~

~~**b. Residuals may be structured with terms that appear to be stated principal or interest but that lack substance, and result in receiving the residual cash flows of the underlying collateral. The terms allow for significant variation in the timing and amount of cash flows without triggering a default of the structure.**~~

~~**c. Residuals do not have credit ratings or NAIC assigned designations. Rather, they are first loss positions that provide subordination to support the credit quality of the typically rated debt tranches.**~~

~~**d. Residuals may provide payment throughout the investment duration (and not just at maturity), but the payments received continue to reflect the residual amount permitted after debt tranche holders receive contractual principal and interest payments.**~~

~~**e. Frequently, there are contractual triggers that divert cash flows from the residual holders to the debt tranches if the structure becomes stressed.**~~

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

1. This statement establishes statutory accounting principles for investments in any joint ventures, partnerships, and limited liability companies, including investments in certified capital companies (CAPCO) per *INT 06-02: Accounting and Reporting for Investments in a Certified Capital Company* (CAPCO), whether or not it is considered to be controlled by or affiliated with the reporting entity.

2. This statement excludes:

a. Single real estate property investments that are wholly-owned by an LLC that is directly and wholly-owned by the reporting entity, and that meet the criteria established in SSAP No. 40R—Real Estate Investments~~, are excluded from this statement~~.

b. ~~This statement does not address the accounting for i~~Investments in joint ventures, partnerships and limited liability companies that invest in tax credit programs and are in scope of ~~Low-Income Housing Tax Credit Properties as discussed in~~ *SSAP No. 93—Investments in Tax Credit Programs*~~Low-Income Housing Tax Credit Property Investments. However, investments in certain state Low-Income Housing~~

~~Tax Credit Property Investments that do not fall within the scope of SSAP No. 93 are covered by the requirements of this statement~~. ***(Staff Note: This text reflects edits proposed to reflect the revised tax credit guidance in SSAP No. 93 exposed under agenda item 2022-14.)***

c. Investments that are in substance residual interests or a residual security tranche, as defined in *SSAP No. 21R—Other Admitted Assets*, shall follow the accounting and reporting guidance in SSAP No. 21R with reporting on Schedule BA: Other Long-Term Assets in the dedicated reporting lines for residuals.

**~~Residual Interests and Reporting~~**

~~18. Investments in scope of this statement are reported on *Schedule BA: Other Long-Term Assets*. Schedule BA includes dedicated reporting categories for joint ventures, partnerships, and limited liability company investments as well as for residual interests, both with reporting lines in accordance with underlying asset characteristics. Investments within scope of this standard shall be divided within these reporting categories, with investments that reflect residual interests, or that predominantly hold residual interests captured in the residual interest reporting category.~~

~~19. A residual interest or a residual security tranche (collectively referred to as residuals) exists in investment structures that issue one or more classes of debt securities created for the primary purpose of raising debt capital backed by collateral assets. The primary source of debt repayment is derived through rights to the cash flows of a discrete pool of collateral assets. These designs could be backed directly or indirectly through a feeder fund. The collateral assets generate cash flows that provide interest and principal payments to debt holders through a contractually prescribed distribution methodology (e.g., waterfall dictating the order and application of all collateral cash flows). Once those contractual requirements are met, the remaining cash flows generated by (or with the sale of) the collateral assets are provided to the holder of the residual security/residual interest holder. When an asset within the discrete pool of assets does not perform as expected, it impacts the extent to which cash flows will be generated and distributed. The residual holders in the structure continue to receive payments from the collateral so long as there are cash flows in excess of the debt obligations. The payments to the residual holder may vary significantly, both in timing and amount, based on the underlying collateral performance.~~

~~20. The structural design of a residual interest or residual security tranche can vary, but the overall concept is that they receive the remaining cash flows after all debt holders receive contractual interest and principal payments. Determining whether an investment in a structure reflects a residual interest or tranche shall be based on the substance of the investment held rather than its legal form. Common characteristics of residual interests/residual security tranches include the items noted below, but the presence or absence of any of these factors should not be definitive in determination. Classification as a residual should be based on the substance of the investment and how cash flows to the holder are determined.~~

~~a. Residuals often do not have contractual principal or interest.~~

~~b. Residuals may be structured with terms that appear to be stated principal or interest but that lack substance and result in receiving the residual cash flows of the underlying collateral. The terms allow for significant variation in the timing and amount of cash flows without triggering a default of the structure.~~

~~c. Residuals do not have credit ratings or NAIC assigned designations. Rather, they are first loss positions that provide subordination to support the credit quality of the typically rated debt tranches.~~

~~d. Residuals may provide payment throughout the investment duration (and not just at maturity), but the payments received continue to reflect the residual amount permitted after debt tranche holders receive contractual principal and interest payments.~~

~~e. Frequently, there are contractual triggers that divert cash flows from the residual holders to the debt tranches if the structure becomes stressed.~~

On August 13, 2024, the Statutory Accounting Principles (E) Working Group adopted the exposed consistency revisions for residuals with an effective date of January 1, 2025. These revisions result with all noted SSAPs referring to *SSAP No. 21R—Other Admitted Assets* for the formal definition and accounting and reporting guidance.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2024/08-13-24 Summer National Meeting/Adoptions/06 - 24-08 - Residual Consistency Revisions.docx

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

**Issue: SSAP No. 2R – Clarification**

**Check (applicable entity):**

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

**Description of Issue:** This agenda item has been developed to update the guidance in *SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments* to remove a lingering reference to items that have been removed from scope pursuant to the principles-based bond definition project (asset-backed securities) or from agenda item 2023-17 (mortgage loans and Schedule BA assets). The edits are focused on the guidance that addresses 'rolling' cash equivalents and short-term investments in which there is a continued reference for SSAP No. 43R investments and 'other Invested assets.' This guidance has been revised to only reflect items in scope of SSAP No. 2R.

**Existing Authoritative Literature:**

- ***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 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.)

15. Regardless of maturity date, related party or affiliated investments in scope of *SSAP No. 26R—Bonds, SSAP No. 43R—Loan-Backed and Structured Securities,* or that would be reported as "Other Invested

[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.

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.)

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

- *SSAP No. 26R—Bonds* and *SSAP No. 43R—Asset-Backed Securities*, reflecting new guidance to incorporate a principles-based bond definition were adopted during the 2023 Summer National Meeting. This guidance is effective Jan. 1, 2025. Pursuant to the revisions adopted, all ABS are required to be reported as long-term investments on Schedule D-1-2 and are not permitted for cash equivalent or short-term reporting.

- Agenda item 2023-17 – Short-Term Investments, was adopted during the 2023 Fall National Meeting and removes mortgage loans and all Schedule BA investments from being reported as cash equivalents or short-term investments.

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

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

**Staff Recommendation:**
**NAIC staff recommend that the Working Group move this item to the active listing of the maintenance agenda categorized as a SAP Clarification and expose revisions to *SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments* to eliminate lingering references that imply that asset-backed securities, mortgage loans, or other Schedule BA items are permitted to be reported as cash equivalents or short-term investments.**

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[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.*

[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.

**Staff Review Completed by:** Julie Gann, NAIC Staff—February 2024

**Status:**
On March 16, 2024, the Statutory Accounting Principles (E) Working Group exposed revisions to *SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments* to eliminate lingering references that imply that asset-backed securities, mortgage loans, or other Schedule BA items are permitted to be reported as cash equivalents or short-term investments.

**Proposed Revisions to SSAP No. 2R—Bonds (Effective Jan. 1, 2025)**

7. Regardless of maturity date, related party or affiliated investments that would be in scope of this statement pursuant to paragraph 6 ~~*SSAP No. 26R—Bonds, SSAP No. 43R—Loan-Backed and Structured Securities,* or that would be reported as "Other Invested Assets"~~ shall be reported as long-term investments if any of the following conditions apply,[4] 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.)

15. Regardless of maturity date, related party or affiliated investments in scope of this statement pursuant to paragraph 14~~*SSAP No. 26R—Bonds, SSAP No. 43R—Loan-Backed and Structured Securities,* or that would be reported as "Other Invested Assets"~~ shall be reported as long-term investments if any of the following conditions apply,[5, 6] 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.

[4] 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.

[5] 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.*

[6] 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.

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.)

On August 13, 2024, the Statutory Accounting Principles (E) Working Group adopted the exposed revisions to *SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments* with an effective date of January 1, 2025. These revisions eliminate lingering references that imply that asset-backed securities, mortgage loans, or other Schedule BA items are permitted to be reported as cash equivalents or short-term investments.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2024/08-13-24 Summer National Meeting/Adoptions/24-09 - SSAP No. 2R Clarification.docx

**NAIC Accounting Practices and Procedures Manual**
**Editorial and Maintenance Update**
**March 16, 2024**

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

| SSAP/Appendix | Description/Revision |
|---|---|
| Removal of “Revised” and “R” identifiers from SSAP titles and references within the Manual. | Remove “Revised” and “R,” previously intended to identify a SSAP that has been substantively revised, from SSAP titles and SSAP references within the Manual. NAIC staff consider the “Revised” and “R” identifiers to no longer be useful as several SSAPs have now had multiple substantive revisions after their initial adoption. |

**Staff Recommendation:**
NAIC staff recommend that the Statutory Accounting Principles (E) Working Group move this agenda item to the active listing, categorize as a SAP Clarification, and expose editorial revisions as illustrated within.

***Removal of “R” identifier from SSAP titles and references within the AP&P Manual***
Remove the “Revised” and “R” identifiers from SSAP titles and SSAP references throughout the Manual. NAIC staff consider the “Revised” and “R” identifier to no longer be useful. The following SSAPs currently have an “Revised” and “R” identifier in the title.

2R—Cash, Cash Equivalents, Drafts and Short-Term Investments
5R—Liabilities, Contingencies and Impairments of Assets
16R—Electronic Data Processing Equipment and Software
21R—Other Admitted Assets
22R—Leases
26R—Bonds
30R—Unaffiliated Common Stock
32R—Preferred Stock
35R—Guaranty Fund and Other Assessments
40R—Real Estate Investments
41R—Surplus Notes
43R—Loan-Backed and Structured Securities
51R—Life Contracts
54R—Individual and Group Accident and Health Contracts
61R—Life, Deposit-Type and Accident and Health Reinsurance
62R—Property and Casualty Reinsurance
94R—Transferable and Non-Transferable State Tax Credits
100R—Fair Value
103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities
104R—Share-Based Payments
105R—Working Capital Finance Investments

**Status:**
On March 16, 2024, the Statutory Accounting Principles (E) Working Group exposed editorial revisions to the Accounting Practices and Procedures Manual to remove the “Revised” and “R” identifiers from SSAP titles and SSAP references throughout the Manual.

On August 13, 2024, the Statutory Accounting Principles (E) Working Group adopted, as final, the proposed editorial revisions to the Accounting Practices and Procedures Manual to remove the "Revised" and "R" identifiers from SSAP titles and SSAP references throughout the Manual.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2024/08-13-24 Summer National Meeting/Adoptions/24-14EP Spring 2024.docx

**Revisions to the**
***As of March 2024, Accounting Practices and Procedures Manual***

On **September 12, 2024**, the Statutory Accounting Principles (E) Working Group adopted via e-vote the following revisions to the *As of March 2024 Accounting Practices and Procedures Manual*. Documents associated with these revisions are linked to the reference items in bold text.

| Ref # | SSAP/ Appendix | Title | Summary |
|---|---|---|---|
| **2024-01** | SSAP No. 26<br><br>IP No. 169 | Bond Definition – Debt Securities Issued by Funds<br><br>*SAP Concept*<br><br>Effective January 1, 2025 | With the adopted revisions, debt securities issued by non-SEC registered funds that reflect operating entities can qualify as issuer credit obligations. The guidance requires assessment as to the purpose of the issued debt security and is explicit that debt securities issued for the raising of debt capital are required to be assessed as asset-backed securities. |

https://naiconline.sharepoint.com/teams/frsstatutoryaccounting/national meetings/a. national meeting materials/2024/09-12-24 - evote adoption/e-vote adoption 9.12.2024 toc.docx

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

**Issue: Bond Definition – Debt Securities Issued by Funds**

**Check (applicable entity):**

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

**Description of Issue:** This agenda item has been developed to clarify guidance in the principles-based bond definition on the treatment on debt securities issued by funds, particularly to eliminate inconsistent application between similar funds and to better align with the recently adopted definition of residual tranches. In the adopted bond definition, bonds issued by business development corporations (BDCs), closed-end funds (CEFs), or similar operating entities are provided as examples of issuer credit obligations (ICOs) when they are registered under the Investment Company Act of 1940 (1940 Act). It has been noted that this guidance is inconsistent with the stated intent of having the bond definition be principles-based as the registration of the fund appears to be the basis of classification as an ICO vs ABS, rather than based on principles. It has been noted that with the current guidance, two funds with issued debt that are virtually identical can have separate SSAP classification of the debt securities (resulting with different accounting/reporting) simply based on whether the fund is registered. Additionally, it would lead to debt securities being classified inconsistently with their equity counterparts. In concept, there should be consistency between the classification of a debt security as an asset-backed security, and the equity of that structure being classified as a residual interest. Using SEC-registration as currently adopted would result in misalignment of these concepts.

The changes captured within this agenda item propose to revise the principles-based bond definition guidance to clarify that debt securities issued by funds representing operating entities qualify as ICOs. This would allow consistent treatment of similar funds regardless of SEC registration status. Guidance is also proposed to assist with distinguishing whether a fund represents an operating entity or a securitization vehicle.

The original guidance, and the reference to the SEC registration, was an easy approach to determine whether a debt security from a fund qualified as an ICO. This is because SEC registered funds have leverage limits on how much debt can be issued. Although debt securities issued from SEC registered CEFs and BDCs are still permitted as ICOs, the proposed edits permit debt securities from non-registered funds to qualify as ICO if the funds are functioning as operating entities and are not issuing securities for the primary purpose of raising debt capital.

**Existing Authoritative Literature:**

- ***SSAP No. 26R—Bonds*** **(Effective Jan. 1, 2025)**

7. An issuer credit obligation is a bond, for which the general creditworthiness of an operating entity or entities through direct or indirect recourse, is the primary source of repayment. Operating entity or entities 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; (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. 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.

**Issue Paper – Exposure Draft As of 2023 Summer National Meeting**

32. Whether an issuer of debt represents an operating entity or ABS Issuer is expected to be clear in most instances, but certain instances may be less clear. Ultimately, for an issuer credit obligation, it comes down to whether support for repayment consists of direct or indirect recourse to an operating entity or entities. In addition to "traditional bond" structures previously included in SSAP No. 26R, examples of issuer credit obligations include:

a. Investments in the form of securities for which repayment is fully supported by an underlying contractual obligation of a single operating entity. (e.g., CTLs, ETCs, other lease backed securities, Funding Agreement Backed Notes (FABNs), etc.). For purposes of applying this principle 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.

b. Bonds issued by real estate investment trusts (REITS) or similar property trusts.

**c. Bonds issued by business development corporations, closed-end funds or similar operating entities, in each case registered under the 1940 Act. With this inclusion, it is important to highlight that the intent is specific to bonds issued from SEC-registered entities. The reference to "similar entities" is not intended to capture items issued from collateralized fund obligations (CFOs) or other such structures. Although some may consider CFOs to be similar to closed-end funds, that assessment is not supported for classification as an issuer credit obligation. Instruments considered to reflect CFOs (and other like structures) are required to be assessed as asset-backed securities for inclusion on Schedule D-1**.

d. Project finance debt issued by operating entities. These investments reflect financing of a single asset or "operation" (such as a toll road or power generation facility) that collateralizes a debt issuance and the cash flows produced by the asset/operation service the debt, where the issuer may also represent an operating entity. These designs have characteristics of both issuer credit operations, as the operation constitutes a stand-alone business, as well as characteristics of ABS, 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 holistically, these issuing entities are typically used to facilitate the financing of an operating component of a project sponsor or municipality.

Although the use of a bankruptcy-remote entity (e.g., SPV) facilitates the efficient raising of debt as a source of financing, the primary purpose is to finance an operating project. Therefore, when 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, the issuing entity shall be considered an operating entity despite certain characteristics that resemble ABS issuances.

i. It is important to highlight that the guidance for project finance is strictly for instruments issued by operating entities, similar to other instruments that qualify as issuer credit obligations under the principles-based bond definition. Consistent with other concepts, the naming convention (e.g., referring to an instrument as project finance) or the presence or absence of an SPV/trust structure are not definitive components in determining whether an investment qualifies for reporting on Schedule D-1, or is classified as an issuer credit obligation or ABS. Instruments (even if identified as "project finance") that do not qualify as issuer credit obligations as they not issued by operating entities, shall be assessed for qualification for reporting on Schedule D-1 as ABS. If the instruments do not qualify for reporting as ABS, they shall not be reported on Schedule D-1.

e. U.S. Treasury Inflation-Protected Securities (TIPs): The inclusion of U.S. TIPs specifically as an issuer credit obligation intends to highlight a specific exception to the determination as a creditor relationship as the variation is due to plain-vanilla inflation adjustment mechanisms. Although U.S. TIPs are specific as issuer credit obligations, Under the bond definition encompassing both issuer credit obligations and asset-backed securities, in order for a debt instrument to represent a creditor relationship, 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 (e.g., 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 variables are precluded from bond treatment as they do not reflect creditor relationships. Although US TIPS are indexed to the consumer price index and grows with inflation, these securities shall be captured as issuer credit obligations on Schedule D-1.

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

- *SSAP No. 26R—Bonds* and *SSAP No. 43R—Asset-Backed Securities*, reflecting new guidance to incorporate a principles-based bond definition were adopted during the 2023 Summer National Meeting. This guidance is effective Jan. 1, 2025. The corresponding Issue Paper has been updated as discussions occurred and has not yet been finalized as discussions involving SSAP No. 21R for the debt securities that do not qualify as bonds is not yet adopted.

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

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

**Recommendation:**
**NAIC staff recommend that the Working Group include this agenda item on their maintenance agenda as a SAP clarification and expose revisions to *SSAP No. 26R—Bonds* incorporating the principles-based bond definition to clarify that debt securities issued by funds that represent operating entities are permitted as issuer credit obligations. These revisions would be in effect pursuant to the effective date of the revised SSAP No. 26R guidance, which is Jan. 1, 2025. The edits revise paragraph 7.i and incorporate a new paragraph 12 to the SSAP No. 26R guidance.**

**This agenda item also proposes revisions to the draft Issue Paper (paragraph 32c) to update the guidance previously included addressing 1940 Act registered BDCs and CEFs as issuer credit obligations.**

**Proposed Revisions to *SSAP No. 26R—Bonds* (Effective Jan. 1, 2025)**

7. An issuer credit obligation is a bond, for which the general creditworthiness of an operating entity or entities through direct or indirect recourse, is the primary source of repayment. Operating entity or entities 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;(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. 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 funds representing operating entities as described in paragraph 12.~~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.

8. An asset[1]-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[2] or cash generating non-financial assets owned by the

[1] 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.

[2] *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

ABS Issuer, for which the primary source of repayment is derived from the cash flows associated with the underlying defined collateral rather than the cash flows of an operating entity[3]. 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.

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 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
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

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.

[3] 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.

 

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 credit enhancement through guarantees (or other similar forms of recourse), subordination and/or overcollateralization.

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 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 investment(s) does not qualify for reporting as a bond and shall be reported on Schedule BA: Other Long-Term Invested Assets at the lower of amortized cost or fair value consistent with the treatment for residuals. (These items are further addressed in *SSAP No. 21R—Other Admitted Assets*.)

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.

 

12. Likewise, distinguishing between a fund that represents an operating entity and a securitization vehicle that represents an ABS Issuer can involve similar ambiguity. Both types of entities may hold only passive investments and issue debt securities for which ultimate recourse upon default is to those investments. However, a clear distinction can generally be made by evaluating the substance of the entity and its primary purpose:

    a. A fund representing an operating entity has a primary purpose of raising equity capital and generating returns to its equity investors. Marginal amounts of debt may be issued to fund operations or produce levered returns to equity holders. However, this is in service to meeting the fund's primary equity-investor objective. For 1940-Act registered closed-end funds (CEFs) and business development corporations (BDCs), debt securities issued from the fund in accordance with permitted leverage ratios represent debt issued by operating entities and qualify as issuer credit obligations.

    b. In contrast, an ABS Issuer has a primary purpose of raising debt capital and its structural terms and features serve to support this purpose. Perhaps most distinctively, in addition to the characteristics detailed in Paragraph 8, the contractual terms of the structure generally define how each cash flow generated by the collateral is to be applied. There is generally little discretion afforded to the manager/servicer of the vehicle and any discretion that is allowed is narrowly defined in the contractual agreements. This hardwiring of debtholder protections allows for the issuance of higher amounts of leverage than would be possible for a fund representing an operating entity, further supporting the entity's primary purpose of raising debt capital.

~~12.~~13. 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.

~~13.~~14. 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.*

~~14.~~15. 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.

**Proposed Revisions to Draft Issue Paper:**

32. Whether an issuer of debt represents an operating entity or ABS Issuer is expected to be clear in most instances, but certain instances may be less clear. Ultimately, for an issuer credit obligation, it comes down to whether support for repayment consists of direct or indirect recourse to an operating entity or entities. In addition to "traditional bond" structures previously included in SSAP No. 26R, examples of issuer credit obligations include:

    a. Investments in the form of securities for which repayment is fully supported by an underlying contractual obligation of a single operating entity. (e.g., CTLs, ETCs, other lease backed securities, Funding Agreement Backed Notes (FABNs), etc.). For purposes of applying this principle 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.

b. Bonds issued by real estate investment trusts (REITS) or similar property trusts.

c. Bonds issued by funds representing operating entities. Determining whether a fund represents an operating entity can generally be made by evaluating the substance of the entity and its primary purpose. A fund representing an operating entity has the primary purpose of raising equity capital and generating returns to its equity investors. Marginal amounts of debt may be issued to fund operations or produce levered returns to equity holders. These debt issuances occur in accordance with the fund's primary equity-investor objective. Debt securities issued by closed-end funds and business development corps registered under the 1940 Act are permitted automatic qualification as issuer credit obligations as those funds are subject to strict limits or reporting components on the leverage (debt issuance) within the fund. ~~Bonds issued by business development corporations, closed-end funds or similar operating entities, in each case registered under the 1940 Act. With this inclusion, it is important to highlight that the intent is specific to bonds issued from SEC-registered entities. The reference to "similar entities" is not intended to capture items issued from collateralized fund obligations (CFOs) or other such structures.~~ In contrast, an ABS Issuer has a primary purpose of raising debt capital and its structural terms and features serve to support this purpose. More distinctively, the contractual terms of the structure generally define how each cash flow generated by the collateral is to be applied. For these structures, there is little or no discretion afforded to the manager/servicer of the vehicle and any discretion that is allowed is narrowly defined in the contractual agreements. The hardwiring of debtholder protections allows for the issuance of higher amounts of debt securities to be issued than what would be possible for a fund representing an operating entity. These features support the entity's primary purpose of raising debt capital. Although some may consider CFOs to be similar to closed-end funds, that assessment is not supported for classification as an issuer credit obligation. Instruments considered to reflect CFOs (and other like structures) are required to be assessed as asset-backed securities for inclusion on Schedule D-1.

d. Project finance debt issued by operating entities. These investments reflect financing of a single asset or "operation" (such as a toll road or power generation facility) that collateralizes a debt issuance and the cash flows produced by the asset/operation service the debt, where the issuer may also represent an operating entity. These designs have characteristics of both issuer credit operations, as the operation constitutes a stand-alone business, as well as characteristics of ABS, 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 holistically, these issuing entities are typically used to facilitate the financing of an operating component of a project sponsor or municipality. Although the use of a bankruptcy-remote entity (e.g., SPV) facilitates the efficient raising of debt as a source of financing, the primary purpose is to finance an operating project. Therefore, when 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, the issuing entity shall be considered an operating entity despite certain characteristics that resemble ABS issuances.

i. It is important to highlight that the guidance for project finance is strictly for instruments issued by operating entities, similar to other instruments that qualify as issuer credit obligations under the principles-based bond definition. Consistent with other concepts, the naming convention (e.g., referring to an instrument as project finance) or the presence or absence of an SPV/trust structure are not definitive components in determining whether an investment qualifies for reporting on Schedule D-1, or is classified as an issuer credit obligation or ABS. Instruments (even if identified as "project finance") that do not qualify as issuer credit obligations as they not issued by operating entities, shall be assessed for qualification for reporting on Schedule D-1 as ABS. If the instruments do not qualify for reporting as ABS, they shall not be reported on Schedule D-1.

e. U.S. Treasury Inflation-Protected Securities (TIPs): The inclusion of U.S. TIPs specifically as an issuer credit obligation intends to highlight a specific exception to the determination as a creditor relationship as the variation is due to plain-vanilla inflation adjustment mechanisms. Although U.S. TIPs are specific as issuer credit obligations, Under the bond definition encompassing both issuer credit obligations and asset-backed securities, in order for a debt instrument to represent a creditor relationship, 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 (e.g., 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 variables are precluded from bond treatment as they do not reflect creditor relationships. Although US TIPS are indexed to the consumer price index and grows with inflation, these securities shall be captured as issuer credit obligations on Schedule D-1.

**Status:**
On January 10, 2024, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a SAP clarification, and exposed this agenda item with the proposed revisions, as illustrated above, to clarify the guidance for debt securities issued by funds. These revisions permit debt securities issued by funds to be classified as issuer credit obligations if the fund represents an operating entity regardless of SEC-registration status. This item was exposed with a comment deadline of February 9, 2024.

On March 16, 2024, the Statutory Accounting Principles (E) Working Group re-exposed this item with a request for regulators and industry to provide comment on the proposed language that assists with clarifying the scope of guidance and to the types of debt securities issued by funds that should be considered as operating entities, and the proposed language to better define the extent of debt that may be issued to fund operations. This re-exposure and request for clarification intends to address interpretations from the original exposure that the revised guidance would permit feeder funds (and other structures that raise debt capital) to be classified as issuer credit obligations.

On August 13, 2024, the Statutory Accounting Principles (E) Working Group exposed revised language to SSAP No. 26 and the adopted issue paper for a shortened comment period ending September 6, 2024, as shown below. These revisions permit debt securities issued by funds that reflect operating entities to qualify as issuer credit obligations. These revisions clarify that SEC registration is a practical safe harbor intended only for SEC registered funds and should not be utilized as a proxy for other debt securities issued by funds. Other debt securities issued by funds should be assessed as to the issuer's primary purpose. Debt securities issued to raise debt capital must be assessed as an asset-backed security regardless of the amount of debt being issued. If no comments are received, or if only supportive comments are received, the Working Group may consider adoption via an evote.

**Proposed Revisions to *SSAP No. 26—Bonds***

*(Note: Non-revised subparagraphs have not been included for brevity.)*

7. An issuer credit obligation is a bond, for which the general creditworthiness of an operating entity or entities through direct or indirect recourse, is the primary source of repayment. Operating entity or entities 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:

i. Bonds issued by funds representing operating entities as described in paragraph 12.~~Bonds issued by business development corporations, closed-end funds, or similar operating entities, in each case registered under the 1940 Act.~~

12. Likewise, distinguishing between a fund that represents an operating entity and a securitization vehicle that represents an ABS Issuer can involve similar ambiguity. Both types of entities may hold only passive investments and issue debt securities for which ultimate recourse upon default is to those investments. However, a clear distinction can generally be made by evaluating the substance of the entity and its primary purpose:

a. A fund representing an operating entity has a primary purpose of raising equity capital and generating returns to its equity investors. ~~Marginal amounts of~~Ancillary debt may be issued to fund operations or produce levered returns to equity holders. However, this is in service to meeting the fund's primary equity-investor objective. As a practical safe harbor,~~For~~ 1940-Act registered closed-end funds (CEFs) and business development corporations (BDCs), debt securities issued from the fund in accordance with permitted leverage ratios represent debt issued by operating entities and qualify as issuer credit obligations. This safe harbor for SEC-registered funds should not be viewed to extend to funds that are not SEC-registered by analogy, through comparison of leverage levels for example. All other funds should be classified in accordance with the determination of the issuer's primary purpose.

b. In contrast, an ABS Issuer has a primary purpose of raising debt capital and its structural terms and features serve to support this purpose. Perhaps most distinctively, in addition to the characteristics detailed in paragraph 8, the contractual terms of the structure generally define how each cash flow generated by the collateral is to be applied. There is generally little discretion afforded to the manager/servicer of the vehicle and any discretion that is allowed is narrowly defined in the contractual agreements. This hardwiring of debtholder protections allows for the issuance of higher amounts of leverage than would be possible for a fund representing an operating entity, further supporting the entity's primary purpose of raising debt capital.

**Proposed Revisions to Issue Paper No. 169:**

32. Whether an issuer of debt represents an operating entity or ABS Issuer is expected to be clear in most instances, but certain instances may be less clear. Ultimately, for an issuer credit obligation, it comes down to whether support for repayment consists of direct or indirect recourse to an operating entity or entities. In addition to "traditional bond" structures previously included in SSAP No. 26R, examples of issuer credit obligations include:

c. Bonds issued by funds representing operating entities. Determining whether a fund represents an operating entity can generally be made by evaluating the substance of the entity and its primary purpose. A fund representing an operating entity has the primary purpose of raising equity capital and generating returns to its equity investors. ~~Marginal amounts of~~Ancillary debt may be issued to fund operations or produce levered returns to equity holders. These debt issuances occur in accordance with the fund's primary equity-investor objective. Debt securities issued by closed-end funds and business development corps registered under the 1940 Act are permitted automatic qualification as issuer credit obligations as those funds are subject to strict limits or reporting components on the leverage (debt issuance) within the fund. This safe harbor for SEC-registered funds should not be viewed to extend to funds that are not SEC-registered by analogy, through comparison of leverage levels for example. All other funds should be classified in accordance with the determination of the issuer's primary purpose. (For example, although some registered funds allow a large percentage of debt, non-registered funds with comparable amounts of issued debt may reflect debt securities from feeder funds or equity-backed ABS, and those debt securities are required to be assessed as ABS. As such the percentage of debt permitted for a registered funds should not be utilized as a proxy in determining whether debt issued from a fund is permitted to be captured within the guidance.) ~~Bonds issued by business development corporations, closed-end funds or similar operating entities, in each case registered under the 1940 Act. With this inclusion, it is important to highlight that the intent is specific to bonds issued from SEC-registered entities. The reference to "similar entities" is not intended to capture items issued from collateralized fund obligations (CFOs) or other such structures.~~ In contrast, an ABS Issuer has a primary purpose of raising debt capital and its structural terms and features serve to support this purpose. More distinctively, the contractual terms of the structure generally define how each cash flow generated by the collateral is to be applied. For these structures, there is little or no discretion afforded to the manager/servicer of the vehicle and any discretion that is allowed is narrowly defined in the contractual agreements. The hardwiring of debtholder protections allows for the issuance of higher amounts of debt securities to be issued than what would be possible for a fund representing an operating entity. These features support the entity's primary purpose of raising debt capital. Although some may consider CFOs or feeder funds to be similar to closed-end funds, that assessment is not supported for classification as an ICO. Instruments considered to reflect CFOs (and other like structures) are required to be assessed as ABS for inclusion as a bond reported on Schedule D-1. Paragraphs 27-28 also detail the assessment expected in classifying feeder funds, and the requirement to determine the source of the underlying cash flows in determining classification and if the structure qualifies for reporting as a bond on Schedule D-1.

On September 12, 2024, the Statutory Accounting Principles (E) Working Group concluded an e-vote to adopt the August 2024 exposed revised language to SSAP No. 26 (effective Jan. 1, 2025) and related bond project issue paper. This e-vote noted a single comment letter received from interested parties indicating support for the exposed revisions. As the edits revise the guidance adopted for the bond definition, which is effective Jan. 1, 2025, the edits will follow the same effective date.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2024/09-12-24 - Evote Adoption/B - 24-01 - PBBD - SEC Funds.docx

 

**Revisions to the**
***As of March 2024, Accounting Practices and Procedures Manual***

On **November 17, 2024**, the Statutory Accounting Principles (E) Working Group adopted the following revisions to the *As of March 2024 Accounting Practices and Procedures Manual*. Documents associated with these revisions are linked to the reference items in bold text.

| Ref # | SSAP/ Appendix | Title | Summary |
|---|---|---|---|
| 2019-21 | **INT 24-01** | Principles-Based Bond Definition Implementation Questions and Answers<br><br>*SAP Clarification*<br><br>Effective January 1, 2025 | Adopted INT 24-01 addresses specific questions related to the implementation of the Principles-Based Bond Project that had been brought to the Bond/AICPA small group. |
| **2024-11** | SSAP No. 101 | *ASU 2023-09, Improvements to Income Tax Disclosures*<br><br>*SAP Clarification*<br><br>Effective Immediately (November 17, 2024) | Adopted revisions to SSAP No. 101 reject ASU 2023-09 for statutory accounting purposes and deletes the disclosure detailed in SSAP No. 101, paragraph 23.b., as it was determined to be no longer relevant due to changes made to federal tax codes. |
| **2024-17** | SSAP No. 108 | *Clearly Defined Hedging Strategy*<br><br>*SAP Clarification*<br><br>Effective Immediately (November 17, 2024) | Adopted *SSAP No. 108—Derivatives Hedging Variable Annuity Guarantees* revisions update the definition of a clearly defined hedging strategy (CDHS) to reflect the revised guidance pursuant to VM-01. |
| **2024-18** | SSAP No. 48<br>SSAP No. 93<br>SSAP No. 94 | *Clarification of Accounting Guidance for Recognition of Tax Credits*<br><br>*SAP Clarification*<br><br>Effective January 1, 2025 | Adopted revisions in *SSAP No. 93—Investments in Tax Credit Structures* clarify the accounting guidance for recognizing allocated and purchased tax credits in relation to the journal entry example. Adopted revisions in *SSAP No. 94—State and Federal Tax Credits* fix an inconsistency between the accounting guidance and journal entry examples. Adopted revisions to *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies* revise a sentence which was inadvertently not updated as part of the project. |

| Ref # | SSAP/ Appendix | Title | Summary |
|---|---|---|---|
| **2024-19** | Appendix D | *ASU 2024-02, Codification Improvements—Amendments to Remove References to the Concepts Statements*<br><br>*SAP Clarification*<br><br>Effective Immediately (November 17, 2024) | Adopted revisions to *Appendix D—Nonapplicable GAAP Pronouncements* rejects ASU 2024-02 as not applicable to statutory accounting. |

https://naiconline.sharepoint.com/teams/frsstatutoryaccounting/national meetings/a. national meeting materials/2024/11-17-24 fall national meeting/adoptions/00 - adoptions .2024 toc.docx

# Interpretation of the
# Statutory Accounting Principles (E) Working Group

## INT 24-01: Principles-Based Bond Definition Implementation Questions and Answers

**INT 24-01 Dates Discussed**

August 13, 2024, October 4, 2024, November 17, 2024

**INT 24-01 References**

**Current:**
*SSAP No. 21—Other Admitted Assets*
*SSAP No. 26—Bonds*

**INT 24-014 Issue**

1. The principles-based bond definition was adopted in August 2023 with an effective date of January 1, 2025. In response to questions presented, question-and-answer implementation guidance was developed to assist with consistent assessment and application under the principles-based bond definition.

**INT 24-01 Discussion**

2. The Working Group reached consensus that Exhibit A provides question-and-answer guidance consistent with the intent of the principles-based bond definition, including application of debt securities that qualify for bonds under SSAP No. 26 and guidance for debt securities that do not qualify as bonds under SSAP No. 21.

**INT 24-01 Status**

3. This interpretation, and the question-and-answer guidance in Exhibit A is effective January 1, 2025. Consideration of further components may occur if future questions are received on the application of the principles-based bond guidance.

4. No further discussion is planned.

**Exhibit A – Principles-Based Bond Definition Implementation Questions and Answers**

Index to Questions:

**Exhibit A – Principles-Based Bond Definition Implementation Questions and Answers**

**1. Q – When assessing whether a security has substantive credit enhancement, how should future cash flows be considered? Should future expected cash flows be incorporated into the overcollateralization disclosure? [SSAP No. 26, paragraph 6.a. and 10.a.]**

1.1 A – There are two components to this question: 1) how to consider future cash flows in assessing substantive credit enhancement; and 2) how to disclose the overcollateralization percentage. For the first component, the purpose of the substantive credit enhancement concept is to determine whether the creditor is in a different economic position than owning the underlying collateral directly. This includes evaluating all forms of economic value that the creditor has recourse to, including "hard," saleable assets, contractual or expected future cash flows, operating entity guarantees or other sources, and determining whether there is another party that absorbs substantive losses in economic value before the creditor experiences any losses. Note however, **if** a reporting entity performs a quantitative assessment to support its conclusion, it should not double-count economic value. For example, in a lease-backed ABS, if the reporting entity incorporates future lease payments into its analysis, it should also consider the future, depreciated value of the "hard assets" rather than the current saleable value.

1.2 The second component of the question is how to complete the overcollateralization percentage disclosure on Schedule D, which is required for Non-Financial ABS that do not meet the practical expedient criteria and Financial ABS that are not self-liquidating. It was noted that including a quantification of all forms of economic value discussed in 1.1, which may include not only "hard," saleable assets but also future cash flows or operating entity guarantees, would be cumbersome to complete for each applicable investment, both at origination and an ongoing basis. It would also make the disclosure difficult to interpret, as it would not be apparent whether the overcollateralization is in the form of assets that could be liquidated upon default, or future cash flows which may be less readily able to be liquidated. Based on the discussion, it was determined that it would be most expedient, as well as most useful to annual statement users, for the overcollateralization percentage to only include "hard," saleable assets. For example, if a structure involved the leasing of railcars, and the structure had railcars and the associated lease cashflows pledged to the ABS Issuer as collateral, only the value of those railcars to the outstanding debt would be included in the disclosure. (This calculation is based on the value of the railcars, and not their future leasing potential.) Overcollateralization determined by the discounting of future cash flows is not permitted to be included in the disclosure.

1.3 Reporting entities shall report 'zero' when there is no "hard asset" overcollateralization in a structure on Schedule D. The column should not be left blank. A zero response is not standalone evidence that a structure does not qualify for bond reporting. A debt security can qualify for bond reporting without "hard asset" overcollateralization.

**2. Q – Are securities issued by foreign governments or foreign government agencies considered Issuer Credit Obligations? [SSAP No. 26, paragraph 7.a.]**

2.1 A – The examples of issuer credit obligations (ICO) in paragraph 7 are not all inclusive. Governmental entities are operating entities based on their substance, which does not change based on country. Securities issued as obligations of foreign governments or foreign government agencies are expected to be considered ICOs, unless the substance is more aligned with ABS. Schedule D-1-1 includes a reporting line for "Non-U.S. Sovereign Jurisdiction Securities." Foreign securities that reflect ABS, similar to US agency backed RMBS for example, are also expected to be considered ABS. Such ABS are anticipated to be reported on D-1-2 on the most appropriate reporting line that does not reflect a guarantee by the U.S. government.

 

**3. Q – Are "Municipals" always Issuer Credit Obligations? [SSAP No. 26, paragraph 7.c. and 11]**

3.1 A – The question received inquired on the classification of "municipals" noting the various structures and designs, and the explicit reporting lines on Schedule D-1-1 for general obligation and special revenue municipal structures. The answer to this question is that the naming convention of investment structures does not determine whether the investment qualifies for reporting as a bond or whether the investment is an issuer credit obligation (ICO) or asset-backed security (ABS). The first step in determining if an investment qualifies as a bond is whether it reflects a creditor-relationship in substance. The second step is determining whether the structure is an ICO or ABS, and that determination focuses on the primary source of cash flows that provides payment of interest and principal to the debtholder. Municipal securities are subject to the same assessment as other structures as to whether the cash flows are generated by the operations of an operating entity (the municipality) or whether the cash flows are generated from collateral outside of the operations of the municipality in determining whether the security shall be classified as ICO or ABS. However, this distinction is not always clear for several types of common municipal securities which warrants some additional interpretive guidance to promote consistency and streamline implementation efforts. The following summarizes preliminary assessments based on common designs of these structures. These assessments are contingent on the actual substance of the investment and shall not be inferred based on naming convention if the investment being reviewed does not conform to the traditional design.

a. General Obligation Municipal Bonds – These bonds are backed by the full faith and credit of the government issuer (municipality), which is an operating entity with the power to tax residents to pay bondholders. These securities, as general obligations of an operating entity (the municipality), would qualify as ICOs as explicitly stated in paragraph 7.c. of SSAP No. 26, and shall be reported in the "Municipal Bonds – General Obligation" reporting line.

b. Special Revenue Municipal Bonds – These bonds are not backed by the government's general taxing power but by revenues from a specific municipality-owned project or source, such as highway tolls, water and sewer, electric utility, lease fees or usage charges. Payment of interest and principal depends on the adequacy of the revenues derived from the project. Although the operating asset and/or its associated cash flows are often walled off in a bankruptcy remote SPV in order to facilitate more efficient financing of such projects, the primary purpose is still to raise debt capital to fund a component of a municipality's operations. Both paragraph 7.c. and 11 of SSAP No. 26 explicitly contemplate securities of this type qualifying as ICO, and shall be reported in the "Municipal Bonds – Special Revenue" reporting line.

c. Tax Revenue Bonds – These bonds are backed from certain dedicated tax revenues overseen by the municipality, such as sales taxes, gasoline or tobacco taxes, hotel or tourist taxes, special tax assessments or incremental property taxes. Payment of interest and principal depends on the adequacy of tax revenue. Although the obligation is secured only by a single revenue source, rather than the full faith and credit of the municipality, it is still backed by the municipality's taxing authority and is ultimately used to facilitate the raising of financing to be used in funding the needs and responsibilities of the municipality. Tax revenue bonds are determined to have the substance of an ICO and should be reported in the "Municipal Bonds – Special Revenue" reporting line.

d. Housing Bonds – These securities may be issued by a state or local government housing authority to facilitate construction or rehabilitation of multi-family apartments for low to moderate income residents. The bonds are secured by a pledge of rental or lease revenues and/or mortgage payments. These bonds generally only have recourse to the assets or mortgages pledged. These securities are not backed by the operations of the municipality, the financing is not being used to fund any operations of the municipality and the primary source of repayment are non-municipal collateral assets. Based on these observations, their substance appears to more closely reflect that of an ABS and shall be assessed for bond qualification under the ABS requirements. If qualifying as ABS, these structures shall be reported on Schedule D-1-2, likely as a non-guaranteed, non-agency, mortgage-backed security.

e. Conduit Bonds – These debt securities are issued by a government entity as a conduit for the benefit of a business or non-governmental enterprise, such as a manufacturing company, developer, college, hospital or non-profit organization. Revenues pledged by the business or enterprise are used to pay interest and principal on the investments. The government issuer is not responsible for making payments on the bonds if the business or enterprise defaults. These debt securities will need to be assessed to determine whether the structure qualifies as an ICO or ABS. If the structure is backed by the creditworthiness of a single operating entity (such as a college), then the structure is expected to be an ICO. If qualifying as an ICO, the specific reporting line used should be the one that most closely reflects the nature of the investment. If historical reporting and/or market conventions would consider the ICO investment to be a municipal security, then it would be reasonable for the investment to be reported as a special-revenue municipal bond. However, this reporting is contingent on the ICO classification. If the structure represents an ABS (such as a conduit bond secured by housing assets or mortgages pledged), it should not be reported as a municipal on Schedule D-1-1 simply due to historical reporting or market convention as a municipal bond.

**4. Q – Should common types of "Sports Deals" be classified as ICO or ABS? [SSAP No. 26, paragraphs 7-8]**

4.1 A – There are two main types of leaguewide sports financing vehicles, with the key difference being whether or not noteholders have recourse to the individual sports teams.

4.2 <u>Leaguewide Deals **with** Recourse to Teams</u> - The League sets up an SPV or Trust that serves to aggregate debt issued by multiple teams within the League. The SPV (Trust) issues a Note, representing the aggregation of each underlying team's debt obligation. Through the SPV, Noteholders have recourse back to each individual team for its respective debt on a several (but not joint) basis. The Notes are also secured by Franchise rights for each team that participates in the financing and all revenues from current and future League media contracts and typically other ancillary revenue streams (e.g. online/streaming revenues, royalty fees from sports gear sold to fans, etc.). No cross-collateralization among teams or their respective revenue streams, but Noteholders have some protection from the League (which exercises considerable control over individual teams) and a pledge of team ownership rights as collateral. Should any individual team default, the League could (and in all practicality, would) step in to orchestrate a sale of the team, otherwise Noteholders could take ownership of the team.

4.3 The question raised was whether this type of deal would fall under the ICO or ABS criteria. Each team represents an operating entity, and each are individual obligors for their pro rata portion of the financing. Though the direct issuer is an SPV, it is being used to facilitate the efficient raising of debt capital by the individual teams/operating entities, as opposed to redistributing or transforming the underlying risk. In addition, the league itself is an operating entity, and though it is not a direct obligor on the financing, it has a significant role in the facilitation of the financing, its actions can significantly impact the paying ability of the individual teams and it has levers it can and would pull to ensure debtholders receive payment. Through discussion of this example, it was determined that the substance was more aligned with that of an ICO than an ABS. Under one perspective, the league could be viewed as a single-operating entity with all of its affiliated teams being part of that operating entity. This would allow the debt to be considered a "single operating entity backed obligation" under paragraph 7.g. of SSAP No. 26. Under another perspective, debtholders effectively hold debt obligations of each of the individual teams. If each team were to individually issue their debt to the noteholders, rather than through a coordinated offering, the noteholders would be in no different economic situation and each individual security would qualify as an ICO. As a result, this investment is effectively a series of "single operating entity backed obligations" under paragraph 7.g. Based on these observations, it was determined that this type of deal is an ICO in substance.

4.4 Leaguewide Deals **without** Recourse to Teams - Each participating team sells its share of all current and future contracted media revenues (and other ancillary revenues) to a newly created, bankruptcy remote subsidiary of the team in a true sale. The subsidiary then pledges the purchased assets to an SPV/Trust set up by the League. The SPV/Trust then issues Notes to investors. The structure has many features associated with ABS securities, including a bankruptcy-remote legal opinion, a true sale legal opinion, debt service reserves, and a payment waterfall (with Noteholders receiving priority of payment). The Notes are secured by revenues generated from the media contracts and other ancillary revenues (e.g. online/streaming revenues, royalty fees from sports gear sold to fans, etc.).

4.5 Unlike the previous example, these securities do not have recourse to an operating entity. They have all of the characteristics of a securitization of a revenue stream. Therefore, they must be evaluated under the ABS criteria. Also, there is a performance obligation for the cash flows to become collectible, as the product must be provided in order for the revenue to be generated (i.e. games must be played). As a result, the collateral are deemed to be non-financial assets, requiring the security to be assessed under the non-financial ABS criteria.

**5. Q – Do cashflows produced by non-financial assets backing an ABS have to actually be used to make interest and principal payments throughout the life of the debt security for an investment to qualify as a non-financial backed ABS under the meaningful cash flow test? [SSAP No. 26, paragraph 8]**

5.1 A – The principles-based bond definition is clear that the collateral supporting non-financial ABS must have a means of producing meaningful cash flows through other than sale or refinancing. However, it does not specify whether those cash flows must actually be used to pay the principal and interest in all scenarios. For example, it is not uncommon for an ABS to allow cash flows to be paid to equity holders prior to the debt tranches being repaid, so long as no covenants or triggering events have been breached. The example given was a continuation of the leaguewide sports deal **without** recourse to the individual teams as discussed in Question #4 in which the ABS was backed by current and future contracted media revenues (non-financial assets). The notes were issued as non-amortizing bullet maturities (e.g., 100% balloon payments). Therefore, the base case expectation is that the bonds will be refinanced at maturity. However, after full analysis, it was identified that the non-financial assets backing the structure generated substantially more cash flows over the life of the debt security than what would be needed to provide all interest and principal payments and would produce enough cash flows to "turbo" amortize and pay 100% of principal and interest in a short time frame if refinancing were not to occur. Additionally, there exist covenants (e.g. upon a significant decrease in media revenue) which, if triggered, would cause all cash flows to be diverted away from the equity holders and used to "turbo" amortize the debt. The question is, does the fact that the base case expectation is that the cash flows will not be used to pay down the debt result in the ABS lacking meaningful cash flows? Based on these discussions, it was determined that this situation would not preclude a conclusion that meaningful cash flows exist. Despite the meaningful cash flows not being used to pay the debt in the base case, the creditor still has rights to them and would collect them prior to experiencing any loss upon default. Therefore, all such cash flows available to creditors may be included in the assessment of meaningful cash flows.

**6. Q – How should CMBS Interest Only (IO) strips be assessed under the PBBD? [SSAP No. 26, paragraphs 8-10]**

6.1 A – The question pertains to the classification of CMBS IO strips that are paid from the excess spread of a CMBS structure. Excess spread is the excess of the interest collected on the underlying commercial mortgages over the contractual interest to be paid on the issued securitized tranches. In these instances, the IO strip is "linked" to either a specific tranche (such as a specific B-rated or AAA-rated tranche), or the IO strip could be linked to a combination of the issued tranches (from the residual tranche through the top AAA tranche). The tranche or tranches to which an IO is linked refers to the notional amount of principal from which the IO interest is calculated. Regardless of which tranche an IO is linked to, it is paid pari-passu with AAA rated tranche. The calculation of the IO strip interest to be paid is the product of the remaining principal of the linked debt tranche and the contractual rate of the IO strip and the contractual rate is equal to the difference between the weighted average coupon of the underlying loans, and the weighted average coupon of the issued securitization tranches. The contractual rate of the IO strip is recalculated each period based on the loan and debt tranche balances that remain outstanding. For example, if weighted average coupon on the underlying loans is 9.2% and the weighted average coupon on the securitization tranches is 8%, the contractual rate on the CMBS IO is 1.2%. If the IO strip is linked to the BBB tranche and the BBB tranche has a principal value of $1,000, there would be a monthly coupon payment of $1.00 [(1.2% / 12 months) * 1,000]. The CMBS IO holder would receive their contractual interest pari-passu with the AAA tranche, meaning they would receive all contractual interest prior to any of the subordinated securitization tranches being entitled to receive interest. When losses or principal payments are applied to the linked securitization tranche, the notional amount on which the CMBS IO interest is calculated is reduced until fully paid or written off.

6.2 In assessing these structures under the bond definition, IO strips should be considered in the same manner as a debt security that reflect both principal and interest components. That is, for a CMBS security (a financial asset-backed security), the structure would be required to have substantive credit enhancement to qualify for bond classification. For these CMBS structures, even if the IO tranches may always be paid pari-passu with the AAA tranche, an assessment must still occur on whether there is substantive credit enhancement. If the IO tranche is linked to a debt tranche, or a combination of debt tranches, that have substantive credit enhancement, then the IO is also considered to have substantive credit enhancement resulting in an ABS bond classification. If the IO tranche is linked to a tranche that does not have substantive credit enhancement, or a combination of debt tranches that includes a tranche that does not have substantive credit enhancement (such as the residual tranche), the IO strip would also not be considered to have substantive credit enhancement and shall be classified as a non-bond debt security. This is because it would lack substantive credit enhancement to absorb losses before the notional balance from which the IO interest is calculated is reduced. As a result, principal losses on the underlying loans would result in an economic loss to the IO if there is no credit enhancement to absorb them.

**7. Q – How should debt securities that reflect Single Asset Single Borrower (SASB) Commercial Mortgage Loan (CML) securitizations be assessed under the PBBD? [SSAP No. 26, paragraphs 8-10]**

7.1 A – The question pertains to SASB commercial mortgage-backed security (CMBS) structures which involve securitizing a single mortgage loan collateralized by one property owned by a single borrower. Although structures can vary, SASBs are usually associated with high-value properties with many long-term tenants where the mortgage loan is too large for a single lender to hold. By securitizing the loan into rated, tradeable securities, it facilitates access to a broader lender base than would exist for commercial mortgage loans. SASB CMBS structures can issue multiple tranches with different priorities of payment, or they can issue one single tranche (i.e., uni-tranche) that simply passes through the cash flows of the underlying mortgage. In either scenario, the principal and interest payments on the underlying loan provide the cash flows to service the principal and interest on the issued debt securities. Usually, the principal and interest on the commercial mortgage loan and the issued securities are equal except for fees and expenses for servicing and structuring paid by the ABS Issuer.

7.2 Under the PBBD concepts, SASBs should be assessed as asset-backed securities (ABS), as the repayment of principal and interest is derived from the cash flows of the underlying collateral and not the general creditworthiness of an operating entity. SASB CMBS structures are not expected to qualify for reporting as issuer credit obligations reflecting a debt security fully supported by an underlying contractual obligation of a single operating entity pursuant to SSAP No. 26, paragraph 7.g. Although the ultimate cash flows for repayment are expected to be derived from the leasing of the property, the lease cash flows are typically not pledged and there are typically multiple lessees, thus not qualifying under paragraph 7.g. Under the ABS criteria, a SASB CMBS reflects a financial asset-backed structure (as a mortgage loan is a financial asset), therefore the debt security must qualify under the substantive credit enhancement concept to qualify for bond reporting. Determination of whether the debt issuance has substantive credit enhancement is contingent on the actual structure (multi-tranche or uni-tranche) and position of the security within the structure.

7.3. The senior tranches (those above the most junior tranche) in a multi-tranche SASB are expected to qualify under the substantive credit enhancement criteria, as the subordinated tranches will absorb losses first. Assuming the subordination is significant enough to be considered substantive, the subordination of the lowest tranche puts the reporting entity that holds a more senior tranche in a different economic position than if the mortgage loan was held directly.

7.4 The lowest tranche of a multi-tranche SASB, any tranche in which the subordinated tranches below it do not provide substantive credit enhancement, and uni-tranche SASBs are not expected to qualify for reporting as a bond as they do not meet the requirement for substantive credit enhancement. For these situations, the reporting entity is not in a different economic position than if they held the underlying mortgage loan directly. This is true regardless of the LTV or overcollateralization of the property compared to the underlying mortgage loan as the bond definition does not contemplate a broad look-through of the underlying collateral to indirect subordination. This is most clearly illustrated in Example 1 of Exhibit A of SSAP No. 26 which does not contemplate looking through the mortgage loan collateral to overcollateralization of the mortgage loans themselves through recourse to the underlying properties. While this is a legitimate source of overcollateralization, it represents overcollateralization of the mortgage loans in relation to the underlying properties, not overcollateralization of the debt securities in relation to the mortgage loans. The investor is in the same economic position as holding the mortgage loans directly. Therefore, these structures fail the substantive credit enhancement requirement and do not qualify for reporting as a bond.

7.5 SASB structures that do not qualify for reporting as a bond shall be captured as non-bond debt securities on Schedule BA within the reporting line specific for "Debt Securities That Lack Substantive Credit Enhancement." Life reporting entities can file these debt securities within the NAIC SVO to obtain an NAIC designation that can be used for RBC.

**8. Q – Do synthetic or referenced pool structures within an ABS disqualify the ABS for reporting on Schedule D-1-2? [SSAP No. 26, paragraph 9]**

8.1 A – The principles-based bond definition refers to ABS as being repaid with cash flows produced by collateral "owned" by the issuer. The term "owned" as used for this purpose is not necessarily intended to align with a legal view of ownership, but rather, all economic value to which the creditor has recourse. This may include rights to assets or payments derived through assignment, or other provisions. An example that has become common due to evolving banking regulations was discussed whereby a bank has a portfolio of auto loans but wants to transfer their credit risk without transferring or selling their loans. The bank creates a special purpose trust (or vehicle) to which the bank issues a "credit linked note" (effectively equivalent to a "credit risk transfer") which references the performance of the bank's portfolio of auto loans. The securities issued by the special purpose trust (e.g., debt tranche(s) and an equity tranche) are exposed to the reference pool of collateral and the payments received are linked to the credit and principal payment risk of the underlying borrowers captured in the reference pool. The specific underlying collateral, and whether it resides within the ABS, or if the ABS references a collateral item/pool that generates cash flows is not a determining factor as long as the ABS Issuer has contractual rights to the cash flows produced to repay the debt. An ABS Issuer that owns derivatives in the structures (such as a credit default swap or total return swap) that solely transfers the performance of the referenced pool into the ABS structure does not automatically disqualify ABS classification, but the assessment of derivatives within a structure must be closely considered. Structures with derivatives that influence payments based on variables unrelated to the ultimate collateral would not qualify as a creditor relationship in substance. Further, consideration should be given to *SSAP No. 86—Derivatives* in determining whether structures with derivatives are subject to specific guidance, such as that for structured notes.

**9. Q – Can expected but non-contractual cash flows (e.g., from future leases) be considered in determining the meaningful cash flow practical expedient for non-financial ABS? [SSAP No. 26, paragraph 9.b.]**

9.1 A – The example given was a single-family rental where the lease duration is shorter than the duration of the debt security, subjecting the investor to re-leasing risk. The insurer has a high degree of confidence based on its understanding of the market that the property will be able to be re-leased and that the leases (including consideration of unleased time) will produce sufficient cash flows to satisfy all of the interest and at least 50% of the original principal. The question is whether this example qualifies under the practical expedient. Paragraph 9.b. explicitly states that only contractual cash flows are to be considered in assessing qualification under the practical expedient. As such, evaluating qualification under the practical expedient should not include any future leases that are not yet in place and this example would therefore not qualify. However, this does not necessarily mean that the full analysis will require significantly more effort than using the practical expedient in this case. In fact, the analysis the insurer performed to determine that all of the interest and at least 50% of the principal would be satisfied through expected lease payments is likely sufficient to conclude that there are meaningful cashflows, even though the practical expedient is not met.

9.2 This question was brought forward because, although paragraph 9.b. is explicit that only contractual cash flows are included, a paragraph in a prior draft of the issuer paper addressing this topic omitted the word "contractual". This has since been corrected. This question highlights an important point. Issue papers intend to provide key context regarding the discussions leading to the development of new accounting standards. However, any unintended language that conflicts with statements in the SSAP should be disregarded.

9.3 As one more element of clarity coming from the discussions on this topic, the meaningful cash flow practical expedient is that less than 50% of the original principal relies on sale or refinancing risk. In some cases, this has been phrased in the inverse, that all interest and more than 50% of the original principal must be satisfied by the contractual cash flows at investment acquisition for the investment to qualify under the practical expedient. These two phrasings would be expected to have the same meaning, but for the avoidance of doubt, the standard should be interpreted that any outstanding amounts that rely on sale or refinancing at maturity, whether characterized as principal or accrued interest, must be less than 50% of the original principal in order to qualify under the practical expedient.

**10. Q – How should hybrid securities be accounted and reported? [SSAP No. 26, paragraph 13]**

10.1 A – SSAP No. 26 prior to the principles-based bond definition explicitly scoped in a class of assets referred to as "hybrid securities" which are defined as "securities whose proceeds are accorded some degree of equity treatment by one or more of the nationally recognized statistical rating organizations (NRSRO) and/or which are recognized as regulatory capital by the issuer's primary regulatory authority. Hybrid securities are designed with characteristics of debt and equity and are intended to provide protection to the issuer's senior note holders. Hybrid securities are sometimes referred to as capital securities." During the development of the principles-based bond definition, it was decided to remove the explicit scope-in and instead rely on the new principles to determine whether bond classification is appropriate. As these securities come in several forms, additional clarity on where to report such securities is warranted.

10.2 Equity Securities: Investments that represent shares, units, or an ownership interest in a company or other entity but do not reflect common stock that were previously considered hybrids under SSAP No. 26 are equity investments and shall be captured as preferred stock in scope of *SSAP No. 32—Preferred Stock*. Investments in debt securities are not permitted to be reported in scope of *SSAP No. 30—Unaffiliated Common Stock* or SSAP No. 32.

10.3 Debt Securities: Investments in debt securities previously considered hybrids under SSAP No. 26 (including those debt securities with cumulative interest features) **that qualify** under the principles-based bond definition shall be reported as bonds on Schedule D. An example may include certain debt securities which NRSROs allow to be treated as equity but for which all the principles-based bond definition requirements are present. To be clear, a set maturity date for a debt security is not a requirement for bond classification if the bond otherwise qualifies under the definition. (Perpetual bonds that qualify under the bond definition are permitted as bonds.)

10.4 Investments in debt securities treated as regulatory capital by the issuer's primary regulatory authority, and **that do not qualify** under the principles-based bond definition solely because interest can be cancelled in the event of financial stress in a non-resolution scenario without triggering an act of default are capital notes and shall be captured in *SSAP No. 41—Surplus Notes*. These capital notes are often issued by domestic or foreign banks, and the domestic or foreign bank regulator or the Issuer has the ability to cancel interest or dividends, without future interest accumulation or payment.

10.5 Debt securities other than capital notes (as defined in 10.4 above) that permit the issuing entity to cancel interest without future interest accumulation or payment and without triggering an act of default, or that incorporate other equity components that do not permit bond classification under the principles-based bond definition are non-bond debt securities and shall be captured in scope of *SSAP No. 21—Other Admitted Assets*.

10.6 Debt securities issued by regulated institutions where only the issuer's primary regulator may have regulatory power to cancel or convert to equity all or a portion of the debt and/or its related interest payments, solely **in a resolution scenario** were not previously considered hybrid securities and should continue to be reported as Schedule D bonds, as Issuer Credit Obligations under SSAP No. 26, so long as all principles-based bond definition requirements are met.

10.7 Exhibit A to this Q&A provides a summary of common types of securities and how they are to be treated under this Q&A.

 

**11. Q – When do non-bond debt securities need to be assessed for admittance based on underlying collateral? [SSAP No. 21, paragraph 22]**

11.1 A – All debt securities that do not qualify as bonds, regardless of the reason for which they do not qualify, shall be assessed as to the primary source of repayment. If the primary source of repayment is derived through underlying collateral, then the collateral must qualify as an admitted asset in order for the non-bond debt security to be admitted. For example, if the source of repayment is derived from mortgage loans, and the structure failed because it did not reflect a creditor relationship, have substantive credit enhancement or meaningful cash flows, the debt security is permitted to be admitted if the mortgage loans would have qualified as admitted assets if held directly. If the source of repayment is derived from railcar leases, and the structure failed because it did not reflect a creditor relationship, have substantive credit enhancement or meaningful cash flows, the debt security shall be nonadmitted as directly held railcars would not qualify as admitted assets.

## Appendix A – Summary of Securities for Application under Question 10

| Bank Debt/Capital & Hybrid Securities Matrix | Bank Issuers | | | | | All Issuers | |
|---|---|---|---|---|---|---|---|
| | | | | Additional Tier 1 Capital | | | |
| | Sr. Unsecured OpCo Debt | Sr. Unsecured HoldCo Debt | Tier 2 Capital (Subordinated Debt) | Debt Form | Perpetual Preferred Form | Debt Issued for Partial Equity Treatment from NRSROs | Debt Issued for Partial Equity Treatment from NRSROs |
| In scope of "hybrid securities" definition in Q&A? | No | **Yes*** | **Yes*** | **Yes*** | **Yes*** | **Yes** | **Yes** |
| Issuer Can Cancel Interest (or Dividend) Non-Cumulatively w/out Default** | No | No | No | **Yes** | **Yes** | **Yes** | **No** |
| Regulator Can Force Cancellation of Interest (or Dividends) Non-Cumulatively w/out Default | No | No*** | No*** | **Yes** | **Yes** | No | No |
| Regulator Can Force Write-down or Equity Conversion of Debt | No | **Yes** | **Yes** | **Yes** | **Yes** | No | No |
| Proposed Accounting Treatment | SSAP 26 Bond Schedule D, Part 1 | SSAP 26 Bond Schedule D, Part 1 | SSAP 26 Bond Schedule D, Part 1 | SSAP 41 Capital Notes Section of Schedule BA | SSAP 32 Preferred Stock Schedule D, Part 2 | SSAP 21 Non-Bond Section of Schedule BA | SSAP 26 Bond Schedule D, Part 1 |

*Bank regulators require a specific amount of debt that is subject to "bail-in" during a resolution. Additional Tier 1 Captial, Tier 2 Capital and Total Loss Absorbing Capacity (the latter of which includes Sr. Unsecured HoldCo Debt) are all subject to bail-in requirements and count towards various solvency ratio tests.

**Older verions of bank capital exist where the Issuer can defer interest on a cumulative basis without triggering a default. These securities would be treated as SSAP 26 Schedule D, Bonds, as would any security with cumulative interest features.

***Interest amount can be cancelled or reduced following a write-down of debt in resolution scenario only.

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

**Issue: ASU 2023-09, Improvements to Income Tax Disclosures**

**Check (applicable entity):**

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

**Description of Issue:** In December 2023, the Financial Accounting Standards Board (FASB) issued *Accounting Standards Update (ASU) 2023-09, Improvements to Income Tax Disclosures* (the ASU) to enhance the transparency and decision usefulness of income tax disclosures. The ASU amends and expands the disclosures for rate reconciliation between income tax expense and statutory expectations for both public and private entities. Per the ASU, "The objective of these disclosure requirements is for an entity, particularly an entity operating in multiple jurisdictions, to disclose sufficient information to enable users of financial statements to understand the nature and magnitude of factors contributing to the difference between the effective tax rate and the statutory tax rate." Public entities are required to provide detailed quantitative and qualitative disclosures, while private are only required to provide qualitative rate reconciliation disclosures on certain specified categories. Additionally, the ASU also requires all entities to provide additional disclosures on income tax expense and income taxes paid, and removes the disclosure requirement for positions for which it is reasonably possible that the total amounts of unrecognized tax benefits will significantly increase or decrease within 12 months of the reporting date (ASC 740-10-50-15d), and the cumulative amount of each type of temporary difference related to unrecognized deferred tax liabilities (ASC 740-30-50-2b).

**Existing Authoritative Literature:**
*SSAP No. 101—Income Taxes:*

**Disclosures**

21. Statutory financial statement disclosures shall be made in a manner consistent with the provisions of paragraphs 43-45 and 48 of FAS 109. However, required disclosures with regard to a reporting entity's GAAP valuation allowance shall be replaced with disclosures relating to the statutory valuation allowance adjustment and the nonadmittance of some portion or all of a reporting entity's DTAs. The financial statements shall include the disclosures required by paragraph 47 of FAS 109 for non-public companies. Paragraphs 22-28 describe the disclosure requirements as modified for the difference between the requirements of FAS 109 and those prescribed by this statement.

22. The components of the net DTA or DTL recognized in a reporting entity's financial statements shall be disclosed as follows:

a. The total of all DTAs (gross, adjusted gross, admitted and nonadmitted) by tax character;

b. The total of all DTLs by tax character;

c. The total DTAs nonadmitted as the result of the application of paragraph 11;

d. The net change during the year in the total DTAs nonadmitted;

e. The amount of each result or component of the calculation, by tax character of paragraphs 11.a., 11.b.i., 11.b.ii., and 11.c., and the ExDTA ACL RBC Ratio, the ExDTA Surplus plus Contingency Reserves/Required Aggregate Risk Capital Ratio, or the Adjusted Gross DTA/Adjusted Capital and Surplus Ratio used in the applicable *Realization Threshold*

*Limitation Table* (the RBC Reporting Entity Table, the Financial Guaranty or Mortgage Guaranty Non-RBC Reporting Entity Table, or the Other Non-RBC Reporting Entity Table) in paragraph 11.b., as applicable; and

f. The impact of tax-planning strategies on the determination of adjusted gross DTAs and the determination of net admitted DTAs, by percentage and by tax character, and whether the tax-planning strategies include the use of reinsurance-related tax planning strategies.

23. To the extent that DTLs are not recognized for amounts described in paragraph 31 of FAS 109, the following shall be disclosed:

a. A description of the types of temporary differences for which a DTL has not been recognized and the types of events that would cause those temporary differences to become taxable;

b. The cumulative amount of each type of temporary difference;

c. The amount of the unrecognized DTL for temporary differences related to investments in foreign subsidiaries and foreign corporate joint ventures that are essentially permanent in duration if determination of that liability is practicable or a statement that determination is not practicable; and

d. The amount of the DTL for temporary differences other than those in paragraph 23.c. that is not recognized in accordance with the provisions of paragraphs 31 of FAS 109.

24. The significant components of income taxes incurred (i.e., current income tax expense) and the changes in DTAs and DTLs shall be disclosed. Those components would include, for example:

a. Current tax expense or benefit;

b. The change in DTAs and DTLs (exclusive of the effects of other components listed below);

c. Investment tax credits;

d. The benefits of operating loss carryforwards;

e. Adjustments of a DTA or DTL for enacted changes in tax laws or rates or a change in the tax status of the reporting entity; and

f. Adjustments to gross deferred tax assets because of a change in circumstances that causes a change in judgment about the realizability of the related deferred tax asset, and the reason for the adjustment and change in judgment.

25. Additionally, to the extent that the sum of a reporting entity's income taxes incurred and the change in its DTAs and DTLs is different from the result obtained by applying the federal statutory rate to its pretax net income, a reporting entity shall disclose the nature of the significant reconciling items.

26. A reporting entity shall also disclose the following:

a. The amounts, origination dates and expiration dates of operating loss and tax credit carryforwards available for tax purposes;

b. The amount of federal income taxes incurred in the current year and each preceding year, which are available for recoupment in the event of future net losses; and

c. The aggregate amount of deposits admitted under Section 6603 of the Internal Revenue Service Code.

27. For any federal or foreign income tax loss contingencies as determined in accordance with paragraph 3.a. for which it is reasonably possible that the total liability will significantly increase within 12 months of the reporting date, the reporting entity shall disclose an estimate of the range of the reasonably possible increase or a statement that an estimate of the range cannot be made.

28. If a reporting entity's federal income tax return is consolidated with those of any other entity or entities, the following shall be disclosed:

a. A list of names of the entities with whom the reporting entity's federal income tax return is consolidated for the current year; and

b. The substance of the written agreement, approved by the reporting entity's Board of Directors, which sets forth the manner in which the total combined federal income tax for all entities is allocated to each entity which is a party to the consolidation. (If no written agreement has been executed, explain why such an agreement has not been executed.) Additionally, the disclosure shall include the manner in which the entity has an enforceable right to recoup federal income taxes in the event of future net losses which it may incur or to recoup its net losses carried forward as an offset to future net income subject to federal income taxes.

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

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

**Convergence with International Financial Reporting Standards (IFRS):**
None.

**Staff Recommendation:**
**NAIC staff recommends that the Working Group move this item to the active listing of the maintenance agenda categorized as a SAP clarification and expose revisions, as detailed below, to reject *ASU 2023-09 Improvements to Income Tax Disclosures* in *SSAP No. 101—Income Taxes*.** NAIC staff does recommend that the Working Group remove the disclosure detailed in paragraph 23b as it is no longer considered relevant due to changes in federal tax law.

The disclosure detailed in ASC 740-30-50-2(b) (SSAP No. 101, paragraph 23b) was removed by ASU 2023-09 as it requires disclosure of the cumulative amount of each type of temporary tax difference when a deferred tax liability is not recognized for undistributed foreign earnings. Based on discussion within the ASU, Stakeholders indicated that the changes as a result of the Tax Cuts and Jobs Act reduces the relevance of the existing disclosure of the cumulative temporary differences related to foreign subsidiaries when a deferred tax liability is not recognized. As the rationales detailed within the ASU would also be relevant under statutory accounting, we have recommended that paragraph 23b disclosures be removed.

The disclosure detailed in ASC 740-10-50-15(d) (SSAP No. 101, paragraph 27) was removed by ASU 2023-09 due to a conflict with Chapter 8 of the FASB Concepts Statement 8, however the FASB Concepts Statements have not been adopted within the statutory accounting framework. As this conflict does not exist within statutory accounting, we do not recommend removal of the disclosure detailed in SSAP 101 paragraph 27.

**Staff Review Completed by:**
NAIC Staff – William Oden, February 2024

**Status:**
On March 16, 2024, the Statutory Accounting Principles (E) Working Group exposed revisions to adopt, with modification, *ASU 2023-09 Improvements to Income Tax Disclosures* in *SSAP No. 101—Income Taxes*, as illustrated below.

**Spring National Meeting - Proposed Revisions to SSAP No. 101:**

**Disclosures**

23. To the extent that DTLs are not recognized for amounts described in paragraph 31 of FAS 109, the following shall be disclosed:

a. A description of the types of temporary differences for which a DTL has not been recognized and the types of events that would cause those temporary differences to become taxable;

b. ~~The cumulative amount of each type of temporary difference;~~

26. A reporting entity shall also disclose the following:

a. The amounts, origination dates and expiration dates of operating loss and tax credit carryforwards available for tax purposes;

b. The amount of federal income taxes incurred in the current year and each preceding year, which are available for recoupment in the event of future net losses; and

c. The aggregate amount of deposits admitted under Section 6603 of the Internal Revenue Service Code.

d. Income (or loss) from continuing operations before income tax expense (or benefit) disaggregated between domestic and foreign shall.

~~d.~~e. Income tax expense (or benefit) from continuing operations disaggregated by federal (national), state, and foreign. Income taxes on foreign earnings that are imposed by the jurisdiction of domicile shall be included in the amount for that jurisdiction of domicile (that is, the jurisdiction imposing the tax).

f. The amount of income taxes paid (net of refunds received) disaggregated by federal (national), state, and foreign.

~~e.~~g. The amount of income taxes paid (net of refunds received) to each individual jurisdiction in which income taxes paid (net of refunds received) is equal to or greater than 5% of total income taxes paid (net of refunds received)

29. Nothing in this statement is intended to discourage an entity from reporting additional information specific to the disclosures detailed below to further an understanding of the entity and the related disclosures. If not already disclosed in paragraph 24, the reporting entity shall disclose the following:

a. The nature and effect of specific categories of reconciling items, as listed below, and individual jurisdictions that result in a significant difference between the tax rate and the effective tax rate. The objective of this disclosure requirement is for an entity, particularly an entity operating in multiple jurisdictions, to disclose sufficient information to enable users of financial statements to understand the nature and magnitude of factors contributing to the difference between the effective tax rate and the tax rate.

i. State and local income tax, net of federal (national) income tax effect

ii. Foreign tax effects

iii. Effect of changes in tax laws or rates enacted in the current period

iv. Effect of cross-border tax laws

v. Tax credits

vi. Changes in valuation allowances

vii. Nontaxable or nondeductible items

viii. Changes in unrecognized tax benefits.

**Relevant Literature**

30. This statement adopts, with modification, *ASU 2023-09 Improvements to Income Tax Disclosures*. The statutory modifications include:

a. Did not include public entity only disclosures as statutory accounting does not a the private/public company concept. Additionally, the public entity rate reconciliation was determined to be too onerous to apply to all insurance companies.

~~a.~~b. Did not delete the disclosure detailed in paragraph 27 from this statement as the conceptual conflict between the disclosure and FASB Concepts Statement 8, Chapter 8, does not exist within statutory accounting.

On August 13, 2024, the Statutory Accounting Principles (E) Working Group exposed revisions, as detailed below, to reject ASU 2023-09 Improvements to Income Tax Disclosures in *SSAP No. 101—Income Taxes* and delete the disclosure in SSAP No. 101, paragraph 23.b., as it is no longer considered relevant due to changes in federal tax law.

**Summer National Meeting - Proposed Revisions to SSAP No. 101:**

**Disclosures**

23. To the extent that DTLs are not recognized for amounts described in paragraph 31 of FAS 109, the following shall be disclosed:

a. A description of the types of temporary differences for which a DTL has not been recognized and the types of events that would cause those temporary differences to become taxable;

~~b. The cumulative amount of each type of temporary difference;~~

~~c.~~b. The amount of the unrecognized DTL for temporary differences related to investments in foreign subsidiaries and foreign corporate joint ventures that are essentially permanent in duration if determination of that liability is practicable or a statement that determination is not practicable; and

~~d.~~c. The amount of the DTL for temporary differences other than those in paragraph 23.c. that is not recognized in accordance with the provisions of paragraphs 31 of FAS 109.

**Relevant Literature**

38. This statement rejects *ASU 2023-09, Improvements to Income Tax Disclosures*. The disclosure detailed in paragraph 23.b. was deleted from statutory accounting guidance as the Tax Cuts and Jobs Act made this disclosure effectively irrelevant.

On November 17, 2024, the Statutory Accounting Principles (E) Working Group adopted the revisions exposed at the Summer National meeting, as shown above, to reject *ASU 2023-09 Improvements to Income Tax Disclosures* in *SSAP No. 101—Income Taxes* and delete the disclosure detailed in SSAP No. 101, paragraph 23.b

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2024/11-17-24 Fall National Meeting/Adoptions/24-11 - ASU 2023-09 Improvements to Income Tax Disclosures.docx

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

**Issue: Clearly Defined Hedging Strategy**

**Check (applicable entity):**

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

**Description of Issue:** This agenda item has been prepared to update the guidance in *SSAP No. 108—Derivatives Hedging Variable Annuity Guarantees* for a clearly defined hedging strategy (CDHS) to mirror guidance adopted by the Life Actuarial (A) Task Force in 2022, and in effect starting with the 2023 version of the Valuation Manual. The guidance previously included in SSAP No. 108 referred to the CDHS defined in VM-21, and the actuarial guidance has been modified to ensure consistent definitions of a CDHS in both VM-20 and VM-21 and is now captured within VM-01.

The proposed revisions are limited to the definition of a CDHS in paragraph 7 of SSAP No. 108 as well as references in SSAP No. 108 that refer to VM-21 as the location of the definition of a CDHS.

**Existing Authoritative Literature:**

- ***SSAP No. 108—Derivatives Hedging Variable Annuity Guarantees***

7. As identified in paragraph 2, eligibility for the special accounting provision within this standard is strictly limited to variable annuity contracts and other contracts involving certain guaranteed benefits similar to those offered with variable annuities that are reserved for in accordance with VM-21. This special accounting provision requires the reporting entity to engage in highly effective fair value hedges that follow a Clearly Defined Hedging Strategy, as defined in VM-21, meeting all required provisions of VM-21 allowing the reporting entity to reduce the amount of the Conditional Tail Expectation (CTE) Amount. In order to qualify as a Clearly Defined Hedging Strategy (which may be dynamic, static, or a combination thereof), the strategy must meet the principles outlined in VM-21, be in place (implemented) for at least three months[1], and shall at a minimum, identify:

    a. Specific risks being hedged[2],

    b. Hedge objectives,

    c. Risks not being hedged,

    d. Financial instruments that will be used to hedge the risks,

    e. Hedge trading rules, including permitted tolerances from hedging objectives,

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[1] As detailed in VM-21, before a new or revised hedging strategy can be used to reduce the amount of the Conditional Tail Expectation (CTE) otherwise calculated, the hedging strategy should be in place (effectively implemented) for at least three months. As detailed in VM-21, the reporting entity may meet the time requirement by having evaluated the effective implementation of the hedging strategy for at least three months without actually having executed the trades indicated by the hedging strategy (e.g., mock testing or by having effectively implemented the strategy with similar annuity products for at least three months.)

[2] The specific risk being hedged shall include a measure of the hedge coverage (e.g., percentage of interest rate sensitivity being hedged).

f. Metric(s) used for measuring hedging effectiveness,

g. Criteria that will be used to measure effectiveness,

h. Frequency of measuring hedging effectiveness,

i. Conditions under which hedging will not take place, and

j. The individuals responsible for implementing the hedging strategy.

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

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

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

**Staff Recommendation:**
**NAIC staff recommends that the Working Group move this item to the active listing and expose revisions to SSAP No. 108 to update the definition of a clearly defined hedging strategy (CDHS) to reflect the revised guidance pursuant to VM-01. (Only references to the CDHS are being revised to VM-01. Other references to VM-21 are product specific to variable annuity contracts and shall be retained in SSAP No. 108.)**

**<u>Proposed revisions to SSAP No. 108:</u>**

6.b.ii Certification by a financial officer of the company (CFO, treasurer, CIO, or designated person with authority over the actual trading of assets and derivatives) that the hedging strategy meets the definition of a Clearly Defined Hedging Strategy within ~~VM-21~~<u>VM-01</u> and that the Clearly Defined Hedging Strategy is the hedging strategy being used by the company in its actual day-to-day risk mitigation efforts. This provision does not require reporting entities to use a hedging strategy in determining VM-21 reserves, nor does it require entities to use the special accounting provision within this standard. However, it does require reporting entities that use the special accounting provisions within this standard to certify that the hedging strategy within scope of this standard is a Clearly Defined Hedging Strategy and is reflected in the establishment of VM-21 reserves.

7. As identified in paragraph 2, eligibility for the special accounting provision within this standard is strictly limited to variable annuity contracts and other contracts involving certain guaranteed benefits similar to those offered with variable annuities that are reserved for in accordance with VM-21. This special accounting provision requires the reporting entity to engage in highly effective fair value hedges that follow a Clearly Defined Hedging Strategy, as defined in ~~VM-21~~<u>VM-01</u>, meeting all required provisions of VM-21 allowing the reporting entity to reduce the amount of the Conditional Tail Expectation (CTE) Amount. In order to qualify as a Clearly Defined Hedging Strategy (which may be dynamic, static, or a combination thereof), the strategy must meet the principles outlined in VM-21, be in place (implemented) for at least three months[3], and shall at a minimum, identify:

[3] As detailed in VM-21, before a new or revised hedging strategy can be used to reduce the amount of the Conditional Tail Expectation (CTE) otherwise calculated, the hedging strategy should be in place (effectively implemented) for at least three months. As detailed in VM-21, the reporting entity may meet the time requirement by having evaluated the effective implementation of the hedging strategy for at least three months without actually having executed the trades indicated by the hedging strategy (e.g., mock testing or by having effectively implemented the strategy with similar annuity products for at least three months.)

a. The ~~S~~specific risks being hedged[4],

b. The hedging~~Hedge~~ objectives,

c. The material ~~R~~risks that are not ~~being~~ hedged,

d. The f~~F~~inancial instruments ~~that will be~~ used to hedge the risks,

e. The hedging strategy's ~~Hedge~~ trading rules, including permitted tolerances from hedging objectives,

f. The metrics, criteria, and frequency for measuring effectiveness, ~~Metric(s) used for measuring hedging effectiveness,~~

~~g. Criteria that will be used to measure effectiveness,~~

~~Frequency of measuring hedging effectiveness,~~

~~h.~~g. The ~~C~~conditions under which hedging will not take place, and for how long the lack of hedging can persist,

h. The group or area, including whether internal or external, ~~The individuals~~ responsible for implementing the hedging strategy,~~.~~

i. Areas where basis, gap, or assumption risk related to the hedging strategy have been identified, and

~~i.~~j. The circumstances under which hedging strategy will not be effective in hedging the risks.

23.a. Discussion of hedged item, including information on the guarantees sensitive to interest rate risk, along with information on the designated hedging instruments being used to hedge the risk. Discussion of the hedging instruments shall identify whether a hedging instrument is a single instrument or portfolio, as well as information on the hedging strategy (including whether there have been changes in strategy from the prior reporting period, along with detailed information on the changes), and assessment of hedging effectiveness and compliance with the "Clearly Defined Hedging Strategy" of ~~VM-21~~VM-01. Identification shall occur on whether the hedged item is intended to be fully hedged under the hedging strategy, or if the strategy is only focused on a portion of the liability characteristics or a portion of the interest rate sensitivity. Hedging strategies shall be identified as highly effective or not highly effective. If the strategy for a particular hedging relationship excludes a specific component of the gain or loss, or related cash flows, from the assessment of hedge effectiveness, details on the excluded components shall be disclosed.

**Staff Review Completed by:** Julie Gann, NAIC Staff—May 2024

On August 13, 2024, the Statutory Accounting Principles (E) Working Group moved this item to the active listing as a SAP clarification, and exposed revisions to SSAP No. 108, as shown above, to update the definition of a clearly defined hedging strategy to mirror guidance previously adopted by the Life Actuarial (A) Task Force. This item was exposed until September 27, 2024, to allow for consideration at the 2024 Fall National Meeting.

[4] The specific risk being hedged shall include a measure of the hedge coverage (e.g., percentage of interest rate sensitivity being hedged).

On November 17, 2024, the Statutory Accounting Principles (E) Working Group adopted the exposed revisions to SSAP No. 108, as shown above, to update the definition of a clearly defined hedging strategy to mirror guidance previously adopted in 2022 by the Life Actuarial (A) Task Force.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2024/11-17-24 Fall National Meeting/Adoptions/24-17 - SSAP No. 108 - VM-01.docx

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

**Issue:** *Clarification of Accounting Guidance for Recognition of Tax Credits*

**Check (applicable entity):**

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

**Description of Issue:**
On March 16, 2024, the Statutory Accounting Principles (E) Working Group adopted, as final, agenda item 2022-14 which exposed revisions to *SSAP No. 34—Investment Income Due and Accrued*, *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*, *SSAP No. 93—Low-Income Housing Tax Credit Property Investments*, and *SSAP No. 94R—Transferable and Non-Transferable State Tax Credits* to expand and amend statutory guidance to include all tax credit investments regardless of structure and type of state or federal tax credit program, and all state and federal purchased tax credits.

After adoption of agenda item 2022-14, NAIC staff received questions from public accounting firms on the accounting guidance and example journal entries provided in the new guidance. It was noted that the SSAP No. 94R accounting guidance appeared inconsistent with the journal entry examples and the guidance in SSAP No. 93 for recognizing allocated tax credits was confusing when compared to the journal entry examples. Both interested parties and NAIC staff agreed that the journal entries reflect the proper accounting for both the recognition and utilization of tax credits, as such revisions have been drafted to revise the accounting guidance to match the journal entry examples more accurately.

It was also noted that a sentence in SSAP No. 48 was accidentally not updated as part of the New Market Tax Credit project. Updates to this sentence are proposed below.

**Existing Authoritative Literature:**
*SSAP No. 93—Low-Income Housing Tax Credit Property Investments* (Superseded 1/1/2025)
*SSAP No. 94R—Transferable and Non-Transferable State Tax Credits* (Superseded 1/1/2025)

*SSAP No. 93—Investments in Tax Credit Structures* (Effective 1/1/2025)
*SSAP No. 94—State and Federal Tax Credits* (Effective 1/1/2025)

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

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

**Convergence with International Financial Reporting Standards (IFRS):** None

**Staff Recommendation:**
**NAIC staff recommends that the Working Group move this item to the active listing, categorized as a SAP clarification, and expose revisions to *SSAP No. 93—Investments in Tax Credit Structures, SSAP No. 94—State and Federal Tax Credit*, and *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*, to be effective as of January 1, 2025.**

**Staff Review Completed by:** William Oden – June 2024

**Status:**
On August 13, 2024, the Statutory Accounting Principles (E) Working Group exposed revisions to *SSAP No. 93—Investments in Tax Credit Structures*, *SSAP No. 94—State and Federal Tax Credit*, and *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*.

**Drafting Note:** The SSAP guidance shown below includes the revisions adopted in agenda item 2022-14, which are effective 1/1/2025.

Proposed Revisions to SSAP No. 93:

14. Tax credits and other tax benefits, not to include amortization of the investment, shall be reflected as follows:

a. Tax credits shall be recognized in the period that they are allocated to the reporting entity for tax purposes:

i. ~~Federal tax credits that can be utilized in the year allocated shall be reported in the income statement as an offset to federal taxes in accordance with *SSAP No. 101—Income Taxes*. Federal tax credits that cannot be utilized in the year allocated and are carried forward to a future tax year shall be reported as a deferred tax asset (DTA) in accordance with SSAP No. 101.~~If utilized in the same year allocated, federal tax credits shall be recognized and reported as a reduction to federal income tax liabilities and federal income tax expense. If the allocated tax credits are not utilized in the year allocated, they shall be reported as a deferred tax asset (DTA) and change in DTA in accordance with *SSAP No. 101—Income Taxes*.

ii. ~~State tax credits that can be utilized in the year allocated shall be reported in the income statement as an offset to state premium tax or state income tax, whichever is applicable, in the tax-reporting year in which the credit is utilized. State tax credits that cannot be utilized in the year allocated and are carried forward to a future tax year shall be reported gross of any related state tax liabilities and reported in the category of other-than-invested assets (not to be reported net).~~If utilized in the same year allocated, state tax credits shall be recognized and reported as a reduction to the related state tax liability and state premium tax or state income tax, whichever is applicable. If the allocated tax credits are not utilized in the year allocated, they shall be reported gross of the related state tax liability in the category of other-than-invested assets (not to be reported net).

iii. ~~Use~~ Utilization of tax credits in settlement of tax liabilities ~~carried forward in a future period~~ shall be reflected ~~as an offset to~~net of the corresponding income or premium tax liability in the ~~tax~~ reporting ~~year~~ period in which the tax credit is utilized.

iv. Tax credits allocated from tax credit investments, as defined within this SSAP, and held by reporting entities meet the definition of assets as specified in SSAP No. 4 and are admitted assets to the extent that they comply with the requirements of this statement. The admissibility of tax credits is subject to SSAP No. 101.

b. Federal tax benefits other than tax credits (e.g., tax benefits from investment depreciation) shall be recognized in the year allocated pursuant to SSAP No. 101. When utilized, the federal tax benefits are recognized as a component of income tax expense.

c. State tax benefits other than tax credits shall be recognized in the year allocated gross of any related state tax liabilities pursuant to SSAP No. 101. When utilized, the state tax benefits are recognized as a component of taxes, licenses, and fees.

Proposed Revisions to SSAP No. 94R:

9. Tax credits shall be recognized in the period that they are purchased or allocated to the reporting entity for tax purposes:

a. ~~Federal tax credits that can be utilized in the year allocated or purchased shall be reported in the income statement as an offset to federal taxes in accordance with *SSAP No. 101—Income Taxes*.~~ Federal tax credits ~~that cannot be utilized in the year allocated or purchased and are carried forward to a future tax year shall~~are to be recognized and reported as a deferred tax asset (DTA) in accordance with *SSAP No. 101—Income Taxes*~~SSAP No. 101~~.

b. ~~State tax credits that can be utilized in the year allocated or purchased shall be reported in the income statement as an offset to state premium tax or state income tax, whichever is applicable, in the tax-reporting year in which the credit is utilized.~~ State tax credits ~~that cannot be utilized in the year allocated or purchased and are carried forward to a future tax year shall~~ are to be recognized reported gross of any related state tax liabilities ~~and reported~~ in the category of other-than-invested-assets (not to be reported net).

10. ~~Use~~ Utilization of ~~carried forward~~ tax credits in settlement tax liabilities ~~in a future period~~ shall be reflected ~~as an offset to~~ net of the corresponding income or premium tax liability in the ~~tax~~ reporting ~~year~~ period in which the tax credit is utilized.

Proposed Revisions to SSAP No. 48:

1. This statement establishes statutory accounting principles for investments in any joint ventures, partnerships, and limited liability companies, including investments in certified capital companies (CAPCO) per *INT 06-02: Accounting and Reporting for Investments in a Certified Capital Company (CAPCO)*, whether or not it is considered to be controlled by or affiliated with the reporting entity. Single real estate property investments that are wholly-owned by an LLC that is directly and wholly-owned by the reporting entity, and that meet the criteria established in *SSAP No. 40R—Real Estate Investments*, are excluded from this statement. This statement does not address the accounting for investments in joint ventures, partnerships, and limited liability companies that invest in tax credit programs and are in the scope of *SSAP No. 93—Investments in Tax Credit Structures.* However, investments in joint ventures, partnerships, and limited liability companies which allocate tax credits but ~~certain state Low-Income Housing Tax Credit Property Investments that~~ do not fall within the scope of SSAP No. 93 are covered by the requirements of this statement.

On November 17, 2024, the Statutory Accounting Principles (E) Working Group adopted the exposed revisions to *SSAP No. 93—Investments in Tax Credit Structures*, *SSAP No. 94—State and Federal Tax Credit*, and *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies* as shown above, as clarifying edits to the previously-adopted tax credit guidance.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2024/11-17-24 Fall National Meeting/Adoptions/24-18 - Clarifications to NMTC Project.docx

**Statutory Accounting Principles (E) Working Group**
**Maintenance Agenda Submission Form**
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**Issue:** *ASU 2024-02, Codification Improvements—Amendments to Remove References to the Concepts Statements*

**Check (applicable entity):**

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

**Description of Issue:**
FASB issued *ASU 2024-02, Codification Improvements—Amendments to Remove References to the Concepts Statements*, which removes references to FASB Concept Statements from the Codification. The main rationale for this amendment is to simplify the Codification by removing Concepts Statements in the guidance and draw a clear distinction between authoritative and nonauthoritative literature. The Board was concerned that references to Concept Statements would result in users incorrectly inferring that the referenced Concept Statements were authoritative.

The FASB Concept Statements are referenced in the *Accounting Policies and Procedures Manual* within the Statutory Hierarchy which notes that FASB Concept Statements as either Level 4 or 5. However, the revisions in ASU 2024-02 are not relevant to this and other references to FASB Concept Statements in the AP&P Manual.

**Existing Authoritative Literature:**
None

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

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

**Convergence with International Financial Reporting Standards (IFRS):** None

**Staff Recommendation:**
**NAIC staff recommends that the Working Group move this item to the active listing, categorized as a SAP clarification, and expose revisions to *Appendix D—Nonapplicable GAAP Pronouncements* to reject *ASU 2024-02, Codification Improvements—Amendments to Remove References to the Concepts Statements* as not applicable to statutory accounting. This guidance is not considered relevant to the existing statutory accounting references to FASB Concept statements.**

**Staff Review Completed by:** William Oden – May 2024

**Status:**
On August 13, 2024, the Statutory Accounting Principles (E) Working Group exposed revisions to *Appendix D—Nonapplicable GAAP Pronouncements* to reject *ASU 2024-02, Codification Improvements—Amendments to Remove References to the Concepts Statements* as not applicable to statutory accounting.

On November 17, 2024, the Statutory Accounting Principles (E) Working Group adopted revisions to *Appendix D—Nonapplicable GAAP Pronouncements* to reject *ASU 2024-02, Codification Improvements—Amendments to Remove References to the Concepts Statements* as not applicable to statutory accounting.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2024/11-17-24 Fall National Meeting/Adoptions/24-19 - ASU 2024-02, Codification Improvements.docx

 