Statutory Accounting Principles (E) Working Group

**Maintenance Agenda Submission Form**

**Form A**

## **Issue: SCA Loss Tracking – Accounting Guidance**

**Check (applicable entity):**

 P/C Life Health

Modification of existing SSAP [x]  [x]  [x]

New Issue or SSAP [ ]  [ ]  [ ]

Interpretation [ ]  [ ]  [ ]

Description of Issue:

This agenda item has been drafted to clarify the accounting guidance for SCA losses that result in zero or negative equity in an SCA. Agenda item 2018-09 - SCA Loss Tracking clarified the reporting guidance for SCA losses that result in zero, or negative, equity in an SCA. When reviewing that agenda item, it was identified that there could be uncertainty on the existing provisions that require a negative SCA reporting amount (rather than a zero reporting value). The intent of this agenda item is to clarify the instances that require a negative SCA value and ensure the accounting guidance in *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities* for these instances is clear.

Existing Authoritative Literature:

SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets

### Guarantees

16. A guarantee contract is a contract that contingently requires the guarantor to make payments (either in cash, financial instruments, other assets, shares of its stock, or provision of services) to the guaranteed party based on changes in the underlying that is related to an asset, a liability, or an equity security of the guaranteed party. Commercial letters of credit and loan commitments, by definition, are not considered guarantee contracts. Also excluded from the definition are indemnifications or guarantees of an entity’s own performance, subordination arrangements or a noncontingent forward contract. This definition could include contingent forward contracts if the characteristics of this paragraph are met.

19. With the exception of the provision for guarantees made to/or on behalf of a wholly-owned subsidiaries in paragraph 18.f. and “unlimited” guarantees in 18.g., this guidance does not exclude guarantees issued as intercompany transactions or between related parties from the initial liability recognition requirement. Thus, unless the guarantee is provided on behalf of a wholly-owned subsidiary or considered “unlimited,” guarantees issued between the following parties are subject to the initial recognition and disclosure requirements:

1. Guarantee issued either between parents and their subsidiaries or between corporations under common control;
2. A parent’s guarantee of its subsidiary’s debt to a third party; and
3. A subsidiary’s guarantee of the debt owed to a third party by either its parent or another subsidiary of that parent.
4. At the inception of a guarantee, the guarantor shall recognize in its statement of financial position a liability for that guarantee. Except as indicated in paragraph 22, the objective of the initial measurement of the liability is the fair value[[1]](#footnote-1) of the guarantee at its inception.
5. The issuance of a guarantee obligates the guarantor (the issuer) in two respects: (a) the guarantor undertakes an obligation to stand ready to perform over the term of the guarantee in the event that the specified triggering events or conditions occur (the noncontingent aspect) and (b) the guarantor undertakes a contingent obligation to make future payments if those triggering events or conditions occur (the contingent aspect). Because the issuance of a guarantee imposes a noncontingent obligation to stand ready to perform in the event that the specified triggering event occurs, the provisions of paragraph 8 should not be interpreted as prohibiting the guarantor from initially recognizing a liability for that guarantee even though it is not probable that payments will be required under that guarantee.
6. In the event that, at the inception of the guarantee, the guarantor is required to recognize a liability under paragraph 8 for the related contingent loss, the liability to be initially recognized for that guarantee shall be the greater of (a) the amount the satisfies the fair value objective as discussed in paragraph 20 or (b) the contingent liability amount required to be recognized at inception of the guarantee by paragraph 8. For many guarantors, it would be unusual for the contingent liability under (b) to exceed the amount that satisfies the fair value objective at the inception of the guarantee.

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

1. On at least a quarterly basis, the procedures set forth below shall be followed by a reporting entity in applying an equity method of accounting (as described in paragraphs 8.b.i. through 8.b.iv.), as applicable, to investments in SCA entities:
2. For entities subject to 8.b.i., 8.b.iii. and 8.b.iv. a reporting entity’s share of losses of an investee may equal or exceed the carrying amount of an investment accounted for by an equity method plus advances made by the investor. The reporting entity shall discontinue applying an equity method when the investment (including advances) is reduced to zero[[2]](#footnote-2) and shall not provide for additional losses unless the reporting entity has guaranteed obligations of the investee or is otherwise committed to provide further financial support for the investee (guaranteed obligations meeting the definition of liabilities in *SSAP No. 5R*—*Liabilities, Contingencies and Impairments of Assets* shall be recorded as liabilities). If the investee subsequently reports net income, the reporting entity shall resume applying an equity method only after its share of that net income equals the share of net losses not recognized during the period that an equity method was suspended;

Disclosures

34. All SCA investments within the scope of this statement (except paragraph 8.b.i. entities) shall include disclosure of the SCA balance sheet value (admitted and nonadmitted) as well as information received from the NAIC in response to the SCA filing (e.g., date and type of filing, NAIC valuation amount, whether resubmission of filing is required). This disclosure shall include an aggregate total of all SCAs (except paragraph 8.b.i. entities) with detail of the aggregate gross value under this statement with the admitted and nonadmitted amounts reflected on the balance sheet. (As noted in paragraph 4, joint ventures, partnerships and limited liability companies are accounted for under the guidance in SSAP No. 48. As such, those entities are not subject to this disclosure.)

a. For all periods presented, a reporting entity whose shares of losses in an SCA exceeds its investment in the SCA shall disclose its share of losses. (This is required regardless of a guarantee or commitment of future financial support to the SCA.) This disclosure shall include the following:

i.The reporting entity’s accumulated share of the SCA losses not recognized during the period that the equity method was suspended;

ii. The reporting entity’s share of the SCA’s equity, including negative equity;

iii. Whether a guaranteed obligation or commitment for financial support exists; and

iv. The SCA’s reported value.

This disclosure shall apply beginning in the period the SCA’s equity initially falls below zero and shall continue to be disclosed as long as the SCA investment is in a deficit position. Additionally, the reporting entity shall detail in a narrative disclosure whether losses in the SCA have impacted other investments as required by INT 00-24: *EITF 98-13: Accounting by an Equity Method Investor for Investee Losses When the Investor Has Loans to and Investments in Other Securities of the Investee* and *EITF 99-10: Percentage Used to Determine the Amount of Equity Method Losses.*

SCA Loss Tracking FN1

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| 1 | 2 | 3 | 4 | 5 | 6 |
| SCA Entity | Reporting Entity’s Share of SCA Net Income (Loss) | Accumulated Share of SCA Net Income (Losses) | Reporting Entity’s Share of SCA’s Equity, Including Negative Equity | Guaranteed Obligation / Commitment for Financial Support(Yes / No) | SCAReported ValueFN2 |
|   |   |  |   |   |   |
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NOTE: FN1 - This disclosure is only required for SCAs in which the reporting entity’s share of losses exceed the investment in an SCA, (the SCA investment is in a negative equity position). This disclosure shall apply beginning in the period the investment in the SCA equity initially falls below zero and shall continue to be disclosed as long as the SCA investment is in a negative equity position. The disclosure is required whenever an investment in an SCA entity is in a negative equity position, and in the first year subsequent to the negative equity position in which a positive equity position has been attained.

FN2 - For Column 6, as detailed in SSAP No. 97, (unless the entity is subject to statutory adjustments under paragraph 9), once the reporting entity’s share of losses equals or exceeds the investment in the SCA, the SCA shall be reported at zero, with discontinuation of the equity method, unless there is a guaranteed obligation or a commitment for future financial support. If there is a guaranteed obligation or a commitment for future financial support, the guarantee requirement shall be recognized pursuant to SSAP No. 5R, and the reporting entity shall report the investment in the SCA reflecting their share of losses as a contra-asset. *(Disclosure of the guarantee or commitment would be captured in Note 14 and is not duplicated in this disclosure.)*

SSAP No. 97, Exhibit C – Implementation Questions and Answers

7. **Q - Is it possible for an SCA investment valued using an equity method to be reported as a negative value?**

7.1 **A -** Yes, the equity method noninsurance SCA could have a negative equity. SSAP No. 97 paragraph 8.b.ii. relating to noninsurance SCA entities requires some assets to be reported as a negative value (nonadmitted) in paragraph 9. For example an 8.b.ii. SCA subsidiary that is only holding furniture, which is nonadmitted, would be reflected with negative equity to the extent the value of the nonadmitted asset(s) exceed(s) reported equity. It should be noted that although SSAP No. 97, paragraph 13.e. discusses some situations in which the equity method should be discontinued, this does not apply to SCA entities, which meet the requirements of paragraph 8.b.ii. In addition, SSAP No. 97, paragraph 13.e. lists some situations where the equity method would result in a valuation that is less than zero; examples are if reporting entity has guaranteed obligations of the investee or is otherwise committed to provide further financial support for the investee, in these cases, the valuation of the investment in subsidiary could be a negative value.

8. **Q - Paragraph 13.e. of SSAP No. 97, lists some situations where the equity method should be discontinued. If the equity method is discontinued, does the reporting entity cease tracking equity losses?**

8.1 **A -** No, the reporting entity does not cease tracking losses related to the investment in the SCA if an equity method is discontinued. If the equity method is discontinued, follow the guidance in paragraphs 15-17 and *INT 00-24: EITF 98-13: Accounting by an Equity Method Investor for Investee Losses When the Investor Has Loans to and Investments in Other Securities of the Investee and EITF 99-10: Percentage Used to Determine the Amount of Equity Method Losses* (INT 00-24).

8.2 INT 00-24 lists situations that might require the reporting entity to write down other investments in the SCA subsidiary, such as loans, because of continuing losses in the SCA investment. Paragraphs 15-17 provides guidance to assist in determining whether prior losses are being funded if the reporting entity purchases additional stock, etc. after suspending the equity method. Paragraphs 15-17 in INT 00-24 note that even if the equity method is not being applied, the investment should be tracked to determine if additional losses have to be applied to other items and to determine if the investment in the SCA has a future recovery.

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 Statutory Accounting Principles (E) Working Group previously adopted agenda item 2018-09 – SCA Loss Tracking, which incorporated an additional disclosure to track an SCA’s losses.

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

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

Staff Recommendation:

Staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*, as detailed below, to clarify the existing reporting requirements for an SCA in a loss position. Staff would also request comments from regulators and interested parties regarding additional situations that require negative reporting.

Proposed Revisions:

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

1. On at least a quarterly basis, the procedures set forth below shall be followed by a reporting entity in applying an equity method of accounting (as described in paragraphs 8.b.i. through 8.b.iv.), as applicable, to investments in SCA entities:

e. For entities subject to 8.b.i., 8.b.ii., 8.b.iii. and 8.b.iv. a reporting entity’s share of losses of an investee may equal or exceed the carrying amount of an investment accounted for by an equity method plus advances made by the investor. The reporting entity shall discontinue applying an equity method when the investment (including advances) is reduced to zero[[3]](#footnote-3) and shall not provide for additional losses unless the situations in paragraph 13.e.i. or paragraph 13.e.ii. exist. If the investee subsequently reports net income, the reporting entity shall resume applying an equity method only after its share of that net income equals the share of net losses not recognized during the period that an equity method was suspended. In situations in which negative equity is reported (paragraph 13.e.i. and paragraph 13.e.ii.), the book adjusted carrying value for the investment in the SCA shall reflect the reporting entity’s negative equity value (reflecting the reporting entity’s share of the SCA losses). (This would be reported as a contra-asset.)

1. In all instances in which the limited statutory adjustments required by paragraph 9 results in a negative equity valuation of the investment. (This would apply to 8.b.ii and 8.b.iv entities.)

ii. When the reporting entity has guaranteed obligations or committed further financial support to an SCA. Recognition of the negative equity in the SCA is in addition to the guarantee liability required under SSAP No. 5R. (This applies to all SCA entities.)

Staff Review Completed by:

**Fatima Sediqzad - NAIC Staff**

**July 2018**

**Status:**

On August 4, 2018, the Statutory Accounting Principles (E) Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*, as shown above, to clarify the existing reporting requirements for when the reporting entity has a negative equity valuation in an SCA investment.

On November 15, 2018, the Statutory Accounting Principles (E) Working Group re-exposed this agenda item and directed NAIC staff to work with interested parties and research applicable U.S. GAAP guidance to consider revisions to existing guidance that requires negative subsidiary, controlled and affiliated (SCA) entity reporting when there is a guarantee or commitment to provide financial support.

On April 6, 2019, the Statutory Accounting Principles (E) Working Group exposed revisions to *SSAP No. 97­—Investments in Subsidiary, Controlled and Affiliated Entities*, as detailed below,to revise the existing reporting requirements for when a reporting entity has a negative value in an SCA investment when the reporting entity has provided a financial commitment or guarantee. The illustration from the existing *INT 00-24: EITF 98-13: Accounting by an Equity Method Investor for Investee Losses When the Investor Has Loans to and Investments in Other Securities of the Investee and EITF 99-10: Percentage Used to Determine the Amount of Equity Method Losses* has also been moved to SSAP No. 97, in its entirety, as a new exhibit. This INT provides examples of how losses in an SCA shall be applied to other investments once the SCA equity investment has been halted at zero.

Spring 2019 National Meeting Exposure:

*SSAP No. 97—Subsidiary, Controlled and Affiliated Entities:*

1. On at least a quarterly basis, the procedures set forth below shall be followed by a reporting entity in applying an equity method of accounting (as described in paragraphs 8.b.i. through 8.b.iv.), as applicable, to investments in SCA entities:

e. For entities subject to 8.b.i., 8.b.ii., 8.b.iii. and 8.b.iv. a reporting entity’s share of losses of an investee may equal or exceed the carrying amount of an investment accounted for by an equity method plus advances made by the investor. The reporting entity shall discontinue applying an equity method when the investment (including advances) is reduced to zero[[4]](#footnote-4) and shall not provide for additional losses, while still continuing to track the amount of unreported equity method losses, until any future equity method income can be reported. If the reporting entity has guaranteed obligations of the investee or is otherwise committed to provide further financial support for the investee, such as guaranteed obligations meeting the definition of liabilities in *SSAP No. 5R*—*Liabilities, Contingencies and Impairments of Assets* (SSAP No. 5R), they shall be recorded as liabilities. If the entire loss is recognized under SSAP No. 5R, it does not also need to be recognized under SSAP No. 97. However, if there is a guarantee or commitment, and the entire loss is not recognized under SSAP No. 5R, the reporting entity shall not stop at zero, and shall recognize a negative value of the SCA. If the investee subsequently reports net income, the reporting entity shall resume applying an equity method only after its share of that net income equals the share of net losses not recognized during the period that an equity method was suspended;

Footnote 2: Refer to the additional guidance related to discontinuance of an equity method in paragraphs 15-17 and *INT 00-24: EITF 98-13: Accounting by an Equity Method Investor for Investee Losses When the Investor Has Loans to and Investments in Other Securities of the Investee* and *EITF 99-10: Percentage Used to Determine the Amount of Equity Method Losses*. As detailed in INT 00-24, a reporting entity’s share of losses in an SCA shall be applied to other investments held in the SCA once the SCA (common stock) investment has been reduced to zero.

EXHIBIT F – ILLUSTRATION OF THE APPLICATION OF INT 00-24

XYZ Investment in ABC Company

1. ABC Company is a life insurance company, formed January 2, 20X1 to sell health insurance in the state of New York. On January 2, 20X1, XYZ Insurance Company invested $500,000 in ABC, and purchased 100,000 shares of common stock at par, and 40,000 shares of preferred stock at par. ABC Preferred stock is non-voting, 5% cumulative.

2. XYZ determined it has obtained a controlling interest in ABC as XYZ owns 50% of the voting interests of ABC. XYZ accounted for its investment in ABC Insurance Company under the statutory equity method of accounting. The following table is selected information from the financial statements of ABC Insurance Company.

**20X1 – 20X4**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | 1/2/20X1 | 12/31/20X1 | 12/31/20X2 | 12/31/20X3 | 12/31/20X4 |
| Capital and Surplus: |  |  |  |  |  |
| Common stock, $1 par, 200,000 shares issued and outstanding | $ 200,000 | $ 200,000 | $ 200,000 | $ 200,000 | $ 200,000 |
| Preferred stock, $10 par, 100,000 shares issued and outstanding | $1,000,000 | $1,000,000 | $1,000,000 | $1,000,000 | $1,000,000 |
| Surplus Notes |  |  | $ 500,000 | $ 500,000 | $ 500,000 |
| Unassigned Funds (Surplus) |  | $ 130,000 | ($ 180,000) | ($ 630,000) | ($1,430,000) |
| Total Capital and Surplus | $1,200,000 | $1,330,000 | $1,520,000 | $ 1,070,000 | $ 270,000 |

**20X5 – 20X9**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | 12/31/20X5 | 12/31/20X6 | 12/31/20X7 | 12/31/20X8 | 12/31/20X9 |
| Capital and Surplus: |  |  |  |  |  |
| Common stock, $1 par, 200,000 shares issued and outstanding | $ 200,000 | $ 200,000 | $ 200,000 | $ 200,000 | $ 200,000 |
| Preferred stock, $10 par, 100,000 shares issued and outstanding | $1,000,000 | $1,000,000 | $1,000,000 | $1,000,000 | $1,000,000 |
| Surplus Notes | $ 500,000 | $1,000,000 | $1,000,000 | $1,000,000 | $1,000,000 |
| Unassigned Funds (Surplus) | ($1,980,000) | ($1,830,000) | ($1,280,000) | ($ 430,000) | $ 820,000 |
| Total Capital and Surplus |  ($280,000) | $ 370,000 | $ 920,000 | $1,770,000 | $3,020,000 |

3. At 1/2/20X1, XYZ recorded the following entry to record its investment in ABC:

|  |  |  |
| --- | --- | --- |
| Investment in ABC Common stock | $ 100,000 |  |
| Investment in ABC Preferred stock | $ 400,000 |  |
|  Cash |  | $ 500,000 |

To record initial investment in ABC Insurance Company.

4. During the year ended 12/31/20X1, ABC had statutory net income before dividends of $200,000. At 12/31/20X1, ABC declared and paid a 5% preferred dividend, and a common stock dividend of $.10 per share. XYZ recorded the following entries:

|  |  |  |
| --- | --- | --- |
| Cash | $ 20,000 |  |
|  Dividend Income |  | $ 20,000 |

To record preferred dividend income from ABC Insurance Company for 20X1.

|  |  |  |
| --- | --- | --- |
| Investment in ABC Common stock | $ 75,000 |  |
|  Unrealized Gain/Loss |  | $ 75,000 |

To record 20X1 unrealized gain on investment in ABC Common. (($200,000 - $50,000) \* 50%)

|  |  |  |
| --- | --- | --- |
| Cash | $ 10,000 |  |
| Unrealized Gain/Loss | $ 10,000 |  |
|  Dividend Income |  | $ 10,000 |
|  Investment in ABC Common stock |  | $ 10,000 |

To record 20X1 dividend on ABC Common. (100,000 shares \* $.10)

5. During the year ended 12/31/20X2, ABC issued an 8% surplus note of $500,000. XYZ purchased 100% of the surplus note. During that same year, ABC incurred a statutory net loss before dividends of $250,000. At 12/31/20X2, ABC declared and paid a 5% preferred dividend, and a common stock dividend of $.05 per share. No interest or principal repayments of the surplus note were approved. XYZ recorded the following entries:

|  |  |  |
| --- | --- | --- |
| Investment in ABC Surplus Notes | $ 500,000 |  |
|  Cash |  | $ 500,000 |

To record investment in ABC Insurance Company surplus notes.

|  |  |  |
| --- | --- | --- |
| Cash | $ 20,000 |  |
|  Dividend Income |  | $ 20,000 |

To record preferred dividend income from ABC Insurance Company for 20X2.

|  |  |  |
| --- | --- | --- |
| Unrealized Gain/Loss | $ 150,000 |  |
|  Investment in ABC Common stock |  | $ 150,000 |

To record 20X2 unrealized loss on investment in ABC Common. (($-250,000 - $50,000) \* 50%)

|  |  |  |
| --- | --- | --- |
| Cash | $ 5,000 |  |
| Unrealized Gain/Loss | $ 5,000 |  |
|  Dividend Income |  | $ 5,000 |
|  Investment in ABC Common stock |  | $ 5,000 |

To record 20X2 dividend on ABC Common. (100,000 shares \* $.05)

6. During the year ended 12/31/20X3, ABC Insurance Company incurred a statutory net loss before dividends of $400,000. ABC Insurance Company did not declare any dividends, and no interest or principal repayments of the surplus note were approved. XYZ recorded the following entries:

|  |  |  |
| --- | --- | --- |
| Dividends Receivable | $ 20,000 |  |
|  Dividend Income |  | $ 20,000 |

To record preferred dividend income from ABC Insurance Company for 20X3.

|  |  |  |
| --- | --- | --- |
| Unrealized Gain/Loss | $ 182,000 |  |
|  Investment in ABC Preferred stock |  | $ 172,000 |
|  Investment in ABC Common stock |  | $ 10,000 |

To record 20X3 unrealized loss on investment in ABC Common and Preferred.

|  |  |
| --- | --- |
| Total net loss and preferred stock dividend ($450,000). |  |
| Common stock component reduces the Investment in ABC Common stock component to $0. (20,000 \* 50%) |  |
|  Total net loss and preferred dividend (-$400,000 - $50,000) | $450,000 |
|  Less amount used to reduce common stock investment to $0 |  20,000 |
|  Amount remaining to be allocated to investment in preferred |  430,000 |
|  XYZ ownership % of preferred |  40% |
| 1. XYZ reduction in investment in preferred
 | $172,000 |

7. During the year ended 12/31/20X4, ABC Insurance Company incurred a statutory net loss before dividends of $750,000. ABC Insurance Company did not declare any dividends, and no interest or principal repayments of the surplus note were approved. XYZ recorded the following entries:

|  |  |  |
| --- | --- | --- |
| Dividends Receivable | $ 20,000 |  |
|  Dividend Income |  | $ 20,000 |

To record preferred dividend income from ABC Insurance Company for 20X4.

|  |  |  |
| --- | --- | --- |
| Unrealized Gain/Loss | $ 458,000 |  |
|  Investment in ABC Preferred stock |  | $ 228,000 |
|  Investment in ABC Surplus note |  | $ 230,000 |

To record 20X4 unrealized loss on investment in ABC Preferred and Surplus Notes.

|  |  |
| --- | --- |
| Total net loss and preferred stock dividend ($800,000). |  |
| Common stock component reduces the Investment in ABC Preferred stock component to $0. (570,000 \* 40%) |  |
| Preferred stock component calculated as: |  |
|  Total net loss and preferred dividend (-$750,000 - $50,000) | $800,000 |
|  Less amount used to reduce preferred stock investment to $0 |  570,000 |
|  Amount remaining to be allocated to investment in surplus note |  230,000 |
|  XYZ ownership % of surplus note |  100% |
| 1. XYZ reduction in investment in ABC Surplus Notes
 | $230,000 |

8. During the year ended 12/31/20X5, ABC Insurance Company incurred a statutory net loss before dividends of $500,000. ABC Insurance Company did not declare any dividends, and no interest or principal repayments of the surplus note were approved. XYZ recorded the following entries:

|  |  |  |
| --- | --- | --- |
| Dividends Receivable | $ 20,000 |  |
|  Dividend Income |  | $ 20,000 |

To record preferred dividend income from ABC Insurance Company for 20X5.

|  |  |  |
| --- | --- | --- |
| Unrealized Gain/Loss | $ 270,000 |  |
|  Investment in ABC Surplus note |  | $ 270,000 |

To record 20X5 unrealized loss on investment in ABC Surplus Notes.

|  |  |
| --- | --- |
| Total ABC net loss and preferred stock dividend (-$500,000 - $50,000). |  |
| Surplus Note component calculated as: |  |
|  Total net loss and preferred dividend (-$500,000 - $50,000) | $550,000 |
| XYZ ownership % of ABC Surplus Note |  100% |
|  | $550,000 |
| Amount of unrealized loss recognized in 20X5 | $270,000 |
| 1. Amount of unrealized loss suspended
 | $280,000 |

9. Since XYZ has not guaranteed any liabilities of ABC, the reduction they would recognize is limited to their remaining investment in ABC Surplus Notes. Therefore, they would only recognize a 20X5 unrealized loss on their investment in ABC of $270,000.

10. During the year ended 12/31/20X6, ABC Insurance Company realigned their marketing efforts and modified the products they were selling. ABC also issued an additional 8% surplus note of $500,000. This surplus note was purchased by an unaffiliated third party. During the year ended 12/31/X6, ABC Insurance Company had statutory net income before dividends of $200,000. ABC Insurance Company did not declare any dividends on common stock, but declared and paid current and dividends in arrears on preferred. XYZ recorded the following entries:

|  |  |  |
| --- | --- | --- |
| Cash | $ 80,000 |  |
|  Dividends Receivable |  | $ 60,000 |
|  Dividend Income |  | $ 20,000 |

To record preferred dividend income from ABC Insurance Company for 20X6, and receipt of preferred dividends receivable for 20X3, 20X4 and 20X5.

11. XYZ did not record any change in their investment in ABC Surplus Notes, ABC Preferred or ABC Common, since ABCs’ net income after preferred dividends did not exceed the losses accumulated during the period that XYZ suspended recording unrealized losses.

1. The following amounts were tracked:

|  |  |
| --- | --- |
| Total ABC net income and preferred stock dividend ($200,000 - $50,000). |  |
| Surplus Note component calculated as: |  |
|  Total net income and preferred dividend ($200,000 - $50,000) | $150,000 |
| XYZ ownership % of ABC Surplus Note |  50% |
| Amount of unrealized loss suspended in 20X5 |  $ 75,000 |
| Remaining amount of unrealized loss suspended |  $280,000 |
|  |  $205,000 |

13. During the year ended 12/31/20X7, ABC Insurance Company had statutory net income before dividends of $600,000. At 12/31/20X7, ABC declared and paid a 5% preferred dividend. No interest or principal repayments of the surplus note were approved. XYZ recorded the following entries:

|  |  |  |
| --- | --- | --- |
| Cash | $ 20,000 |  |
|  Dividend Income |  | $ 20,000 |

To record preferred dividend income from ABC Insurance Company for 20X7.

|  |  |  |
| --- | --- | --- |
| Investment in ABC Surplus Notes | $ 70,000 |  |
|  Unrealized Gain/Loss |  | $ 70,000 |

To record 20X7 unrealized gain on investment in ABC Surplus Notes.

|  |  |
| --- | --- |
| Total ABC net income and preferred stock dividend ($600,000 - $50,000). |  |
| Surplus Note component calculated as: |  |
|  Total net income and preferred dividend ($600,000 - $50,000) | $550,000 |
| XYZ ownership % of ABC Surplus Note |  50% |
|  | $275,000 |
| Remaining amount of unrealized loss suspended in 20X5 | $205,000 |
| 1. 20X7 amount of unrealized gain on investment in ABC Surplus Note
 | $ 70,000 |

14. During the year ended 12/31/20X8, ABC Insurance Company had statutory net income before dividends of $900,000. At 12/31/20X8, ABC declared and paid a 5% preferred dividend. No interest or principal repayments of the surplus note were approved. XYZ recorded the following entries:

|  |  |  |
| --- | --- | --- |
| Cash | $ 20,000 |  |
|  Dividend Income |  | $ 20,000 |

To record preferred dividend income from ABC Insurance Company for 20X8.

|  |  |
| --- | --- |
| Total ABC net income and preferred stock dividend ($900,000 - $50,000). |  |
| Surplus Note component calculated as: |  |
|  Total net income and preferred dividend ($900,000 - $50,000) | $850,000 |
| XYZ ownership % of ABC Surplus Note |  50% |
| 1. 20X8 amount of unrealized gain on investment in ABC Surplus Note
 | $425,000 |
| Investment in ABC Surplus Notes | $ 425,000 |  |
|  Unrealized Gain/Loss |  | $ 425,000 |

To record 20X8unrealized gain on investment in ABC Surplus Notes.

1. During the year ended 12/31/20X9, ABC Insurance Company had statutory net income, before interest on surplus notes and dividends, of $1,400,000. The Commissioner approved one year’s interest payment on the surplus notes. At 12/31/20X9, ABC declared and paid a 5% preferred dividend, and a $.10 dividend per share on Common stock. XYZ recorded the following entries:

|  |  |  |
| --- | --- | --- |
| Cash | $ 20,000 |  |
|  Dividend Income |  | $ 20,000 |

To record preferred dividend income from ABC Insurance Company for 20X9.

|  |  |  |
| --- | --- | --- |
| Cash | $ 40,000 |  |
|  Interest Income |  | $ 40,000 |

To record surplus notes interest income from ABC Insurance Company for 20X9. ($500,000 \* 8%)

|  |  |  |
| --- | --- | --- |
| Investment in ABC Surplus Notes | $ 5,000 |  |
| Investment in ABC Preferred Stock | $ 400,000 |  |
| Investment in ABC Common Stock | $ 130,000 |  |
|  Unrealized Gain/Loss |  | $ 535,000 |

To record 20X9 unrealized gain on investment in ABC Common, Preferred and Surplus Notes.

Components computed as follows:

|  |  |
| --- | --- |
| Total Net Income net of preferred stock dividend and interest on surplus notes ($1,400,000 - $50,000 - $80,000) |  $ 1,270,000 |
| Less amount needed to restore investment in surplus notes | ($ 10,000) |
| Amount available for preferred stock and common stock investment restoration | $ 1,260,000 |
| Amount needed to restore preferred stock component | ($ 1,000,000) |
| Amount available to restore common stock component | $ 260,000 |
|  |  |
| Surplus Notes component ($10,000 \* 50%) | $ 5,000 |
| Preferred Stock component ($1,000,000 \* 40%) | $ 400,000 |
| 1. Common stock component ($260,000 \* 50%)
 | $ 130,000 |
|  |  |  |
| Cash | $ 10,000 |  |
| Unrealized Gain/Loss | $ 10,000 |  |
|  Dividend Income |  | $ 10,000 |
|  Investment in ABC Common stock |  | $ 10,000 |

To record 20X9 dividend on ABC Common. (100,000 shares \* $.10)

On August 3, 2019, the Statutory Accounting Principles (E) Working Group exposed revisions to *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets* and *SSAP No. 97­—Investments in Subsidiary, Controlled and Affiliated Entities*, as illustrated below,to require a financial commitment or guarantee for a subsidiary, controlled, or affiliated entity to be recognized as a non-contingent guarantee liability. These proposed revisions differ from the prior exposure as they would capture the entire financial guaranty or commitment for an SCA within scope of SSAP No. 5R and report a zero value for SCAs with a negative equity value.

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

1. An estimated loss from a loss contingency or the impairment of an asset shall be recorded by a charge to operations ifboth of the following conditions are met:
2. Information available prior to issuance of the statutory financial statements indicates that it is probable that an asset has been impaired or a liability has been incurred at the date of the statutory financial statements. It is implicit in this condition that it is probable that one or more future events will occur confirming the fact of the loss or incurrence of a liability; and
3. The amount of loss can be reasonably estimated.
4. The following types of guarantees are exempted from the initial liability recognition in paragraphs 20-25, but are subject to the disclosure requirements in paragraphs 29-32. For the guarantees addressed in paragraphs 18f and 18g, recognition of a contingent guarantee may be required subsequent to initial recognition in accordance with paragraph 24a:
5. Guarantee that is accounted for as a derivative instrument, other than credit derivatives within SSAP No. 86;
6. Guarantee for which the underlying is related to the performance of nonfinancial assets that are owned by the guaranteed party, including product warranties;
7. Guarantee issued in a business combination that represents contingent consideration;
8. Guarantee in which the guarantor’s obligation would be reported as an equity item;
9. Guarantee by an original lessee that has become secondarily liable under a new lease that relieved the original lessee from being the primary obligator;
10. Guarantees (as defined in paragraph 16) made to/or on behalf of directly or indirectly wholly-owned insurance or non-insurance subsidiaries[[5]](#footnote-5); and
11. Intercompany and related party guarantees that are considered “unlimited” (e.g., typically in response to a rating agency’s requirement to provide a commitment to support).
12. With the exception of the provision for guarantees made to/or on behalf of a wholly-owned subsidiaries in paragraph 18.f. and “unlimited” guarantees in 18.g., this guidance does not exclude guarantees issued as intercompany transactions or between related parties from the initial liability recognition requirement. Thus, unless the guarantee is provided on behalf of a wholly-owned subsidiary or considered “unlimited,” guarantees issued between the following parties are subject to the initial recognition and disclosure requirements:
13. Guarantee issued either between parents and their subsidiaries or between corporations under common control;
14. A parent’s guarantee of its subsidiary’s debt to a third party; and
15. A subsidiary’s guarantee of the debt owed to a third party by either its parent or another subsidiary of that parent.
16. At the inception of a guarantee, the guarantor shall recognize in its statement of financial position a liability for that guarantee. Except as indicated in paragraph 22, the objective of the initial measurement of the liability is the fair value[[6]](#footnote-6) of the guarantee at its inception.

Footnote: As practical expedients, when a guarantee is issued in a standalone arm’s-length transaction, the liability recognized at the inception of the guarantee should be the premium received or receivable by the guarantor. When a guarantee is issued as part of a transaction with multiple elements, the liability recognized at the inception of the guarantee should be an estimate of the guarantee’s fair value. In that circumstance, guarantors should consider what premium would be required by the guarantor to issue the same guarantee in a standalone arm’s-length transaction.

1. The issuance of a guarantee obligates the guarantor (the issuer) in two respects: (a) the guarantor undertakes an obligation to stand ready to perform over the term of the guarantee in the event that the specified triggering events or conditions occur (the noncontingent aspect) and (b) the guarantor undertakes a contingent obligation to make future payments if those triggering events or conditions occur (the contingent aspect). Because the issuance of a guarantee imposes a noncontingent obligation to stand ready to perform in the event that the specified triggering event occurs, the provisions of paragraph 8 should not be interpreted as prohibiting the guarantor from initially recognizing a liability for that guarantee even though it is not probable that payments will be required under that guarantee.
2. In the event that, at the inception of the guarantee, the guarantor is required to recognize a liability under paragraph 8 for the related contingent loss, the liability to be initially recognized for that guarantee shall be the greater of (a) the amount the satisfies the fair value objective as discussed in paragraph 20 or (b) the contingent liability amount required to be recognized at inception of the guarantee by paragraph 8. For many guarantors, it would be unusual for the contingent liability under (b) to exceed the amount that satisfies the fair value objective at the inception of the guarantee.
3. The offsetting entry pursuant to the liability recognition at the inception of the guarantee depends on the circumstances in which the guarantee was issued. Examples include:
4. If the guarantee was issued in a standalone transaction for a premium, the offsetting entry would the consideration received.
5. If the guarantee was issued in conjunction with the sale of assets, a product, or a business, the overall proceeds would be allocated between the consideration being remitted to the guarantor for issuing the guarantee and the proceeds from that sale. That allocation would affect the calculation of the gain or loss on the sale transaction.
6. If a residual value guarantee were provided by a lessee-guarantor when entering into an operating lease, the offsetting entry would be reflected as prepaid rent, which would be nonadmitted under SSAP No. 29.
7. If a guarantee were issued to an unrelated or related party for no consideration on a standalone basis, the offsetting entry would be to expense.
8. Except for the measurement and recognition of continued guarantee obligations after the settlement of a contingent guarantee liability described in paragraph 25, and the provisions for SCAs detailed in paragraph 24a, this standard does not describe in detail how the guarantor’s liability for its obligations under the guarantee would be measured subsequent to initial recognition. The liability that the guarantor initially recognized in accordance with paragraph 20 would typically be reduced (as a credit to income) as the guarantor is released from risk under the guarantee. Depending on the nature of the guarantee, the guarantor’s release from risk has typically been recognized over the term of the guarantee (a) only upon either expiration or settlement of the guarantee, (b) by a systematic and rational amortization method, or (c) as the fair value of the guarantee changes (for example, guarantees accounted for as derivatives). The reduction of liability does not encompass the recognition and subsequent adjustment of the contingent liability recognized under paragraph 8 related to the contingent loss for the guarantee. If the guarantor is required to subsequently recognize a contingent liability for the guarantee, the guarantor shall eliminate any remaining noncontingent liability for that guarantee and recognize a contingent liability in accordance with paragraph 8.

a. In situations in which a reporting entity has provided a financial guarantee or commitment to support a subsidiary, controlled or affiliated entity (SCA), and the reporting entity’s share of losses in the SCA exceed the equity method carrying amount of the SCA (resulting in a negative equity value in the SCA), the reporting entity shall adjust the initially recognized guarantee obligation to reflect the greater of the then-current fair value of the guarantee or the negative equity position. (For guarantees captured in paragraphs 18f and 18g, this guidance requires recognition of a contingent guaranty when negative equity exists in an SCA.) The recognized guarantee liability shall not exceed the maximum amount of the financial guarantee or commitment provided by the reporting entity. The guidance in paragraphs 24 and 25 shall be followed for recognizing a contingent liability and subsequent re-recognition of a noncontingent liability as applicable.

1. After recognition and settlement of a contingent guarantee liability in accordance with paragraph 8, a guarantor shall assess whether remaining potential obligations exist under the guarantee agreement. If the guarantor still has potential obligations under the guarantee contract, the guarantor shall recognize the remaining noncontingent guarantee that represents the current fair value of the potential obligation remaining under the guarantee agreement. This noncontingent guarantee liability shall be released in accordance with paragraph 24.

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

1. On at least a quarterly basis, the procedures set forth below shall be followed by a reporting entity in applying an equity method of accounting (as described in paragraphs 8.b.i. through 8.b.iv.), as applicable, to investments in SCA entities:

e. For entities subject to 8.b.i., 8.b.ii., 8.b.iii. and 8.b.iv. a reporting entity’s share of losses of an investee may equal or exceed the carrying amount of an investment accounted for by an equity method plus advances made by the investor. The reporting entity shall discontinue applying an equity method when the investment (including advances) is reduced to zero[[7]](#footnote-7) and shall not provide for additional losses, while still continuing to track the amount of unreported equity method losses, until any future equity method income can be reported. If the reporting entity has guaranteed obligations of the investee or is otherwise committed to provide further financial support for the investee, the provisions of *SSAP No. 5R*—*Liabilities, Contingencies and Impairments of Assets* shall be followed As the entire equity method loss (subject to the financial guarantee / commitment) shall be recognized under SSAP No. 5R, it does not also need to be recognized under SSAP No. 97. If the investee subsequently reports net income, the reporting entity shall resume applying an equity method only after its share of that net income equals the share of net losses not recognized during the period that an equity method was suspended;

Footnote 2: Although the SCA is reported at zero in the investment schedule, a guarantee liability (either contingent or noncontingent) may be required to be reported under SSAP No. 5R. Additionally, refer to the guidance related to discontinuance of an equity method in paragraphs 15-17 and *INT 00-24: EITF 98-13: Accounting by an Equity Method Investor for Investee Losses When the Investor Has Loans to and Investments in Other Securities of the Investee* and *EITF 99-10: Percentage Used to Determine the Amount of Equity Method Losses*. As detailed in INT 00-24, a reporting entity’s share of losses in an SCA shall be applied to other investments held in the SCA once the SCA (common stock) investment has been reduced to zero.

1. All SCA investments within the scope of this statement (except paragraph 8.b.i. entities) shall include disclosure of the SCA balance sheet value (admitted and nonadmitted) as well as information received from the NAIC in response to the SCA filing (e.g., date and type of filing, NAIC valuation amount, whether resubmission of filing is required). This disclosure shall include an aggregate total of all SCAs (except paragraph 8.b.i. entities) with detail of the aggregate gross value under this statement with the admitted and nonadmitted amounts reflected on the balance sheet. (As noted in paragraph 4, joint ventures, partnerships and limited liability companies are accounted for under the guidance in SSAP No. 48. As such, those entities are not subject to the disclosures in this statement, unless specifically directed by SSAP No. 48.)
2. For all periods presented, a reporting entity whose shares of losses in an SCA exceeds its investment in the SCA shall disclose its share of losses. (This is required regardless of a guarantee or commitment of future financial support to the SCA.) This disclosure shall include the following:
3. The reporting entity’s accumulated share of the SCA losses not recognized during the period that the equity method was suspended;
4. The reporting entity’s share of the SCA’s equity, including negative equity;
5. Whether a guaranteed obligation or commitment for financial support exists; and
6. The amount of the recognized guarantee under SSAP No. 5R .

***2019 Fall National Meeting Exposure***

***SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets - (Industry edits are shaded.)***

1. An estimated loss from a loss contingency or the impairment of an asset shall be recorded by a charge to operations ifboth of the following conditions are met:
2. Information available prior to issuance of the statutory financial statements indicates that it is probable that an asset has been impaired or a liability has been incurred at the date of the statutory financial statements. It is implicit in this condition that it is probable that one or more future events will occur confirming the fact of the loss or incurrence of a liability; and
3. The amount of loss can be reasonably estimated.
4. 18. The following types of guarantees are exempted from the initial liability recognition in paragraphs 20-25, but are subject to the disclosure requirements in paragraphs 29-32. Guarantee that is accounted for as a derivative instrument, other than credit derivatives within SSAP No. 86;
5. Guarantee for which the underlying is related to the performance of nonfinancial assets that are owned by the guaranteed party, including product warranties;
6. Guarantee issued in a business combination that represents contingent consideration;
7. Guarantee in which the guarantor’s obligation would be reported as an equity item;
8. Guarantee by an original lessee that has become secondarily liable under a new lease that relieved the original lessee from being the primary obligator;
9. Guarantees (as defined in paragraph 16) made to/or on behalf of directly or indirectly wholly-owned insurance or non-insurance subsidiaries[[8]](#footnote-8); and
10. Intercompany and related party guarantees that are considered “unlimited” (e.g., typically in response to a rating agency’s requirement to provide a commitment to support).

The exemptions for items f and g above do not apply in situations in which a reporting entity has provided a financial guarantee or commitment to support a subsidiary, controlled or affiliated entity (SCA), and the SCA’s equity is negative (see paragraph 24).

1. With the exception of the provision for guarantees made to/or on behalf of a wholly-owned subsidiaries in paragraph 18.f. and “unlimited” guarantees in 18.g., this guidance does not exclude guarantees issued as intercompany transactions or between related parties from the initial liability recognition requirement. Thus, unless the guarantee is provided on behalf of a wholly-owned subsidiary or considered “unlimited,” guarantees issued between the following parties are subject to the initial recognition and disclosure requirements:
2. Guarantee issued either between parents and their subsidiaries or between corporations under common control;
3. A parent’s guarantee of its subsidiary’s debt to a third party; and
4. A subsidiary’s guarantee of the debt owed to a third party by either its parent or another subsidiary of that parent.
5. At the inception of a guarantee, the guarantor shall recognize in its statement of financial position a liability for that guarantee. Except as indicated in paragraph 22, the objective of the initial measurement of the liability is the fair value[[9]](#footnote-9) of the guarantee at its inception.

Footnote: As practical expedients, when a guarantee is issued in a standalone arm’s-length transaction, the liability recognized at the inception of the guarantee should be the premium received or receivable by the guarantor. When a guarantee is issued as part of a transaction with multiple elements, the liability recognized at the inception of the guarantee should be an estimate of the guarantee’s fair value. In that circumstance, guarantors should consider what premium would be required by the guarantor to issue the same guarantee in a standalone arm’s-length transaction.

1. The issuance of a guarantee obligates the guarantor (the issuer) in two respects: (a) the guarantor undertakes an obligation to stand ready to perform over the term of the guarantee in the event that the specified triggering events or conditions occur (the noncontingent aspect) and (b) the guarantor undertakes a contingent obligation to make future payments if those triggering events or conditions occur (the contingent aspect). Because the issuance of a guarantee imposes a noncontingent obligation to stand ready to perform in the event that the specified triggering event occurs, the provisions of paragraph 8 should not be interpreted as prohibiting the guarantor from initially recognizing a liability for that guarantee even though it is not probable that payments will be required under that guarantee.
2. In the event that, at the inception of the guarantee, the guarantor is required to recognize a liability under paragraph 8 for the related contingent loss, the liability to be initially recognized for that guarantee shall be the greater of (a) the amount the satisfies the fair value objective as discussed in paragraph 20 or (b) the contingent liability amount required to be recognized at inception of the guarantee by paragraph 8. For many guarantors, it would be unusual for the contingent liability under (b) to exceed the amount that satisfies the fair value objective at the inception of the guarantee.
3. The offsetting entry pursuant to the liability recognition at the inception of the guarantee depends on the circumstances in which the guarantee was issued. Examples include:
4. If the guarantee was issued in a standalone transaction for a premium, the offsetting entry would the consideration received.
5. If the guarantee was issued in conjunction with the sale of assets, a product, or a business, the overall proceeds would be allocated between the consideration being remitted to the guarantor for issuing the guarantee and the proceeds from that sale. That allocation would affect the calculation of the gain or loss on the sale transaction.
6. If a residual value guarantee were provided by a lessee-guarantor when entering into an operating lease, the offsetting entry would be reflected as prepaid rent, which would be nonadmitted under SSAP No. 29.
7. If a guarantee were issued to an unrelated or related party for no consideration on a standalone basis, the offsetting entry would be to expense.
8. Except for the measurement and recognition of continued guarantee obligations after the settlement of a contingent guarantee liability described in paragraph 25, and the provisions for SCAs detailed in paragraph 24a this standard does not describe in detail how the guarantor’s liability for its obligations under the guarantee would be measured subsequent to initial recognition. The liability that the guarantor initially recognized in accordance with paragraph 20 would typically be reduced (as a credit to income) as the guarantor is released from risk under the guarantee. Depending on the nature of the guarantee, the guarantor’s release from risk has typically been recognized over the term of the guarantee (a) only upon either expiration or settlement of the guarantee, (b) by a systematic and rational amortization method, or (c) as the fair value of the guarantee changes (for example, guarantees accounted for as derivatives). The reduction of liability does not encompass the recognition and subsequent adjustment of the contingent liability recognized under paragraph 8 related to the contingent loss for the guarantee. If the guarantor is required to subsequently recognize a contingent liability for the guarantee, the guarantor shall eliminate any remaining noncontingent liability for that guarantee and recognize a contingent liability in accordance with paragraph 8.
9. In situations in which a reporting entity has provided a financial guarantee or commitment to support a subsidiary, controlled or affiliated entity (SCA), and the reporting entity’s share of losses in the SCA exceed the equity method carrying amount of the SCA (resulting in a negative equity value in the SCA), the reporting entity shall recognize the greater impact of (i) the then-current fair value liability for the guarantee or (ii) the negative equity position, limited to the maximum amount of the financial guarantee or commitment provided by the reporting entity. (This guidance requires the recognition of a guarantee liability for guarantees captured in paragraphs 18f and 18g, when negative equity exists in an SCA.) The guidance in paragraphs 20 through 26 shall be followed for the recognition of a contingent liability and a noncontingent liability, as applicable.

1. After recognition and settlement of a contingent guarantee liability in accordance with paragraph 8, a guarantor shall assess whether remaining potential obligations exist under the guarantee agreement. If the guarantor still has potential obligations under the guarantee contract, the guarantor shall recognize the remaining noncontingent guarantee that represents the current fair value of the potential obligation remaining under the guarantee agreement. This noncontingent guarantee liability shall be released in accordance with paragraph 24.

***SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities – No industry edits to this section***

1. On at least a quarterly basis, the procedures set forth below shall be followed by a reporting entity in applying an equity method of accounting (as described in paragraphs 8.b.i. through 8.b.iv.), as applicable, to investments in SCA entities:

e. For entities subject to 8.b.i., 8.b.ii., 8.b.iii. and 8.b.iv. a reporting entity’s share of losses of an investee may equal or exceed the carrying amount of an investment accounted for by an equity method plus advances made by the investor. The reporting entity shall discontinue applying an equity method when the investment (including advances) is reduced to zero[[10]](#footnote-10) and shall not provide for additional losses, while still continuing to track the amount of unreported equity method losses, until any future equity method income can be reported. If the reporting entity has guaranteed obligations of the investee or is otherwise committed to provide further financial support for the investee, the provisions of *SSAP No. 5R*—*Liabilities, Contingencies and Impairments of Assets* shall be followed (As the entire equity method loss (subject to the financial guarantee / commitment) shall be recognized under SSAP No. 5R, it does not also need to be recognized under SSAP No. 97. If the investee subsequently reports net income, the reporting entity shall resume applying an equity method only after its share of that net income equals the share of net losses not recognized during the period that an equity method was suspended;

Footnote 2: Although the SCA is reported at zero in the investment schedule, a guarantee liability (either contingent or noncontingent) may be required to be reported under SSAP No. 5R. Additionally, refer to the guidance related to discontinuance of an equity method in paragraphs 15-17 and *INT 00-24: EITF 98-13: Accounting by an Equity Method Investor for Investee Losses When the Investor Has Loans to and Investments in Other Securities of the Investee* and *EITF 99-10: Percentage Used to Determine the Amount of Equity Method Losses*. As detailed in INT 00-24, a reporting entity’s share of losses in an SCA shall be applied to other investments held in the SCA once the SCA (common stock) investment has been reduced to zero.

1. All SCA investments within the scope of this statement (except paragraph 8.b.i. entities) shall include disclosure of the SCA balance sheet value (admitted and nonadmitted) as well as information received from the NAIC in response to the SCA filing (e.g., date and type of filing, NAIC valuation amount, whether resubmission of filing is required). This disclosure shall include an aggregate total of all SCAs (except paragraph 8.b.i. entities) with detail of the aggregate gross value under this statement with the admitted and nonadmitted amounts reflected on the balance sheet. (As noted in paragraph 4, joint ventures, partnerships and limited liability companies are accounted for under the guidance in SSAP No. 48. As such, those entities are not subject to the disclosures in this statement, unless specifically directed by SSAP No. 48.)
2. For all periods presented, a reporting entity whose shares of losses in an SCA exceeds its investment in the SCA shall disclose its share of losses. (This is required regardless of a guarantee or commitment of future financial support to the SCA.) This disclosure shall include the following:
3. The reporting entity’s accumulated share of the SCA losses not recognized during the period that the equity method was suspended;
4. The reporting entity’s share of the SCA’s equity, including negative equity;
5. Whether a guaranteed obligation or commitment for financial support exists; and
6. . The amount of the recognized guarantee under SSAP No. 5R.

**Proposed New Exhibit F – This is not new guidance, it pulls in prior guidance from INT 00-24**

**EXHIBIT F –** **ILLUSTRATION OF THE APPLICATION OF INT 00-24**

**XYZ Investment in ABC Company**

1. ABC Company is a life insurance company, formed January 2, 20X1 to sell health insurance in the state of New York. On January 2, 20X1, XYZ Insurance Company invested $500,000 in ABC, and purchased 100,000 shares of common stock at par, and 40,000 shares of preferred stock at par. ABC Preferred stock is non-voting, 5% cumulative.

2. XYZ determined it has obtained a controlling interest in ABC as XYZ owns 50% of the voting interests of ABC. XYZ accounted for its investment in ABC Insurance Company under the statutory equity method of accounting. The following table is selected information from the financial statements of ABC Insurance Company.

**20X1 – 20X4**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | 1/2/20X1 | 12/31/20X1 | 12/31/20X2 | 12/31/20X3 | 12/31/20X4 |
| Capital and Surplus: |  |  |  |  |  |
| Common stock, $1 par, 200,000 shares issued and outstanding | $ 200,000 | $ 200,000 | $ 200,000 | $ 200,000 | $ 200,000 |
| Preferred stock, $10 par, 100,000 shares issued and outstanding | $1,000,000 | $1,000,000 | $1,000,000 | $1,000,000 | $1,000,000 |
| Surplus Notes |  |  | $ 500,000 | $ 500,000 | $ 500,000 |
| Unassigned Funds (Surplus) |  | $ 130,000 | ($ 180,000) | ($ 630,000) | ($1,430,000) |
| Total Capital and Surplus | $1,200,000 | $1,330,000 | $1,520,000 | $ 1,070,000 | $ 270,000 |

**20X5 – 20X9**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | 12/31/20X5 | 12/31/20X6 | 12/31/20X7 | 12/31/20X8 | 12/31/20X9 |
| Capital and Surplus: |  |  |  |  |  |
| Common stock, $1 par, 200,000 shares issued and outstanding | $ 200,000 | $ 200,000 | $ 200,000 | $ 200,000 | $ 200,000 |
| Preferred stock, $10 par, 100,000 shares issued and outstanding | $1,000,000 | $1,000,000 | $1,000,000 | $1,000,000 | $1,000,000 |
| Surplus Notes | $ 500,000 | $1,000,000 | $1,000,000 | $1,000,000 | $1,000,000 |
| Unassigned Funds (Surplus) | ($1,980,000) | ($1,830,000) | ($1,280,000) | ($ 430,000) | $ 820,000 |
| Total Capital and Surplus |  ($280,000) | $ 370,000 | $ 920,000 | $1,770,000 | $3,020,000 |

3. At 1/2/20X1, XYZ recorded the following entry to record its investment in ABC:

|  |  |  |
| --- | --- | --- |
| Investment in ABC Common stock | $ 100,000 |  |
| Investment in ABC Preferred stock | $ 400,000 |  |
|  Cash |  | $ 500,000 |

To record initial investment in ABC Insurance Company.

4. During the year ended 12/31/20X1, ABC had statutory net income before dividends of $200,000. At 12/31/20X1, ABC declared and paid a 5% preferred dividend, and a common stock dividend of $.10 per share. XYZ recorded the following entries:

|  |  |  |
| --- | --- | --- |
| Cash | $ 20,000 |  |
|  Dividend Income |  | $ 20,000 |

To record preferred dividend income from ABC Insurance Company for 20X1.

|  |  |  |
| --- | --- | --- |
| Investment in ABC Common stock | $ 75,000 |  |
|  Unrealized Gain/Loss |  | $ 75,000 |

To record 20X1 unrealized gain on investment in ABC Common. (($200,000 - $50,000) \* 50%)

|  |  |  |
| --- | --- | --- |
| Cash | $ 10,000 |  |
| Unrealized Gain/Loss | $ 10,000 |  |
|  Dividend Income |  | $ 10,000 |
|  Investment in ABC Common stock |  | $ 10,000 |

To record 20X1 dividend on ABC Common. (100,000 shares \* $.10)

5. During the year ended 12/31/20X2, ABC issued an 8% surplus note of $500,000. XYZ purchased 100% of the surplus note. During that same year, ABC incurred a statutory net loss before dividends of $250,000. At 12/31/20X2, ABC declared and paid a 5% preferred dividend, and a common stock dividend of $.05 per share. No interest or principal repayments of the surplus note were approved. XYZ recorded the following entries:

|  |  |  |
| --- | --- | --- |
| Investment in ABC Surplus Notes | $ 500,000 |  |
|  Cash |  | $ 500,000 |

To record investment in ABC Insurance Company surplus notes.

|  |  |  |
| --- | --- | --- |
| Cash | $ 20,000 |  |
|  Dividend Income |  | $ 20,000 |

To record preferred dividend income from ABC Insurance Company for 20X2.

|  |  |  |
| --- | --- | --- |
| Unrealized Gain/Loss | $ 150,000 |  |
|  Investment in ABC Common stock |  | $ 150,000 |

To record 20X2 unrealized loss on investment in ABC Common. (($-250,000 - $50,000) \* 50%)

|  |  |  |
| --- | --- | --- |
| Cash | $ 5,000 |  |
| Unrealized Gain/Loss | $ 5,000 |  |
|  Dividend Income |  | $ 5,000 |
|  Investment in ABC Common stock |  | $ 5,000 |

To record 20X2 dividend on ABC Common. (100,000 shares \* $.05)

6. During the year ended 12/31/20X3, ABC Insurance Company incurred a statutory net loss before dividends of $400,000. ABC Insurance Company did not declare any dividends, and no interest or principal repayments of the surplus note were approved. XYZ recorded the following entries:

|  |  |  |
| --- | --- | --- |
| Dividends Receivable | $ 20,000 |  |
|  Dividend Income |  | $ 20,000 |

To record preferred dividend income from ABC Insurance Company for 20X3.

|  |  |  |
| --- | --- | --- |
| Unrealized Gain/Loss | $ 182,000 |  |
|  Investment in ABC Preferred stock |  | $ 172,000 |
|  Investment in ABC Common stock |  | $ 10,000 |

To record 20X3 unrealized loss on investment in ABC Common and Preferred.

|  |  |
| --- | --- |
| Total net loss and preferred stock dividend ($450,000). |  |
| Common stock component reduces the Investment in ABC Common stock component to $0. (20,000 \* 50%) |  |
|  Total net loss and preferred dividend (-$400,000 - $50,000) | $450,000 |
|  Less amount used to reduce common stock investment to $0 |  20,000 |
|  Amount remaining to be allocated to investment in preferred |  430,000 |
|  XYZ ownership % of preferred |  40% |
|  XYZ reduction in investment in preferred | $172,000 |

7. During the year ended 12/31/20X4, ABC Insurance Company incurred a statutory net loss before dividends of $750,000. ABC Insurance Company did not declare any dividends, and no interest or principal repayments of the surplus note were approved. XYZ recorded the following entries:

|  |  |  |
| --- | --- | --- |
| Dividends Receivable | $ 20,000 |  |
|  Dividend Income |  | $ 20,000 |

To record preferred dividend income from ABC Insurance Company for 20X4.

|  |  |  |
| --- | --- | --- |
| Unrealized Gain/Loss | $ 458,000 |  |
|  Investment in ABC Preferred stock |  | $ 228,000 |
|  Investment in ABC Surplus note |  | $ 230,000 |

To record 20X4 unrealized loss on investment in ABC Preferred and Surplus Notes.

|  |  |
| --- | --- |
| Total net loss and preferred stock dividend ($800,000). |  |
| Common stock component reduces the Investment in ABC Preferred stock component to $0. (570,000 \* 40%) |  |
| Preferred stock component calculated as: |  |
|  Total net loss and preferred dividend (-$750,000 - $50,000) | $800,000 |
|  Less amount used to reduce preferred stock investment to $0 |  570,000 |
|  Amount remaining to be allocated to investment in surplus note |  230,000 |
|  XYZ ownership % of surplus note |  100% |
|  XYZ reduction in investment in ABC Surplus Notes | $230,000 |

8. During the year ended 12/31/20X5, ABC Insurance Company incurred a statutory net loss before dividends of $500,000. ABC Insurance Company did not declare any dividends, and no interest or principal repayments of the surplus note were approved. XYZ recorded the following entries:

|  |  |  |
| --- | --- | --- |
| Dividends Receivable | $ 20,000 |  |
|  Dividend Income |  | $ 20,000 |

To record preferred dividend income from ABC Insurance Company for 20X5.

|  |  |  |
| --- | --- | --- |
| Unrealized Gain/Loss | $ 270,000 |  |
|  Investment in ABC Surplus note |  | $ 270,000 |

To record 20X5 unrealized loss on investment in ABC Surplus Notes.

|  |  |
| --- | --- |
| Total ABC net loss and preferred stock dividend (-$500,000 - $50,000). |  |
| Surplus Note component calculated as: |  |
|  Total net loss and preferred dividend (-$500,000 - $50,000) | $550,000 |
| XYZ ownership % of ABC Surplus Note |  100% |
|  | $550,000 |
| Amount of unrealized loss recognized in 20X5 | $270,000 |
| Amount of unrealized loss suspended | $280,000 |

9. Since XYZ has not guaranteed any liabilities of ABC, the reduction they would recognize is limited to their remaining investment in ABC Surplus Notes. Therefore, they would only recognize a 20X5 unrealized loss on their investment in ABC of $270,000.

10. During the year ended 12/31/20X6, ABC Insurance Company realigned their marketing efforts and modified the products they were selling. ABC also issued an additional 8% surplus note of $500,000. This surplus note was purchased by an unaffiliated third party. During the year ended 12/31/X6, ABC Insurance Company had statutory net income before dividends of $200,000. ABC Insurance Company did not declare any dividends on common stock but declared and paid current and dividends in arrears on preferred. XYZ recorded the following entries:

|  |  |  |
| --- | --- | --- |
| Cash | $ 80,000 |  |
|  Dividends Receivable |  | $ 60,000 |
|  Dividend Income |  | $ 20,000 |

To record preferred dividend income from ABC Insurance Company for 20X6, and receipt of preferred dividends receivable for 20X3, 20X4 and 20X5.

11. XYZ did not record any change in their investment in ABC Surplus Notes, ABC Preferred or ABC Common, since ABCs’ net income after preferred dividends did not exceed the losses accumulated during the period that XYZ suspended recording unrealized losses.

1. The following amounts were tracked:

|  |  |
| --- | --- |
| Total ABC net income and preferred stock dividend ($200,000 - $50,000). |  |
| Surplus Note component calculated as: |  |
|  Total net income and preferred dividend ($200,000 - $50,000) | $150,000 |
| XYZ ownership % of ABC Surplus Note |  50% |
| Amount of unrealized loss suspended in 20X5 |  $ 75,000 |
| Remaining amount of unrealized loss suspended |  $280,000 |
|  |  $205,000 |

13. During the year ended 12/31/20X7, ABC Insurance Company had statutory net income before dividends of $600,000. At 12/31/20X7, ABC declared and paid a 5% preferred dividend. No interest or principal repayments of the surplus note were approved. XYZ recorded the following entries:

|  |  |  |
| --- | --- | --- |
| Cash | $ 20,000 |  |
|  Dividend Income |  | $ 20,000 |

To record preferred dividend income from ABC Insurance Company for 20X7.

|  |  |  |
| --- | --- | --- |
| Investment in ABC Surplus Notes | $ 70,000 |  |
|  Unrealized Gain/Loss |  | $ 70,000 |

To record 20X7 unrealized gain on investment in ABC Surplus Notes.

|  |  |
| --- | --- |
| Total ABC net income and preferred stock dividend ($600,000 - $50,000). |  |
| Surplus Note component calculated as: |  |
|  Total net income and preferred dividend ($600,000 - $50,000) | $550,000 |
| XYZ ownership % of ABC Surplus Note |  50% |
|  | $275,000 |
| Remaining amount of unrealized loss suspended in 20X5 | $205,000 |
| 20X7 amount of unrealized gain on investment in ABC Surplus Note | $ 70,000 |

14. During the year ended 12/31/20X8, ABC Insurance Company had statutory net income before dividends of $900,000. At 12/31/20X8, ABC declared and paid a 5% preferred dividend. No interest or principal repayments of the surplus note were approved. XYZ recorded the following entries:

|  |  |  |
| --- | --- | --- |
| Cash | $ 20,000 |  |
|  Dividend Income |  | $ 20,000 |

To record preferred dividend income from ABC Insurance Company for 20X8.

|  |  |
| --- | --- |
| Total ABC net income and preferred stock dividend ($900,000 - $50,000). |  |
| Surplus Note component calculated as: |  |
|  Total net income and preferred dividend ($900,000 - $50,000) | $850,000 |
| XYZ ownership % of ABC Surplus Note |  50% |
| 20X8 amount of unrealized gain on investment in ABC Surplus Note | $425,000 |
| Investment in ABC Surplus Notes | $ 425,000 |  |
|  Unrealized Gain/Loss |  | $ 425,000 |

To record 20X8unrealized gain on investment in ABC Surplus Notes.

15. During the year ended 12/31/20X9, ABC Insurance Company had statutory net income, before interest on surplus notes and dividends, of $1,400,000. The Commissioner approved one year’s interest payment on the surplus notes. At 12/31/20X9, ABC declared and paid a 5% preferred dividend, and a $.10 dividend per share on Common stock. XYZ recorded the following entries:

|  |  |  |
| --- | --- | --- |
| Cash | $ 20,000 |  |
|  Dividend Income |  | $ 20,000 |

To record preferred dividend income from ABC Insurance Company for 20X9.

|  |  |  |
| --- | --- | --- |
| Cash | $ 40,000 |  |
|  Interest Income |  | $ 40,000 |

To record surplus notes interest income from ABC Insurance Company for 20X9. ($500,000 \* 8%)

|  |  |  |
| --- | --- | --- |
| Investment in ABC Surplus Notes | $ 5,000 |  |
| Investment in ABC Preferred Stock | $ 400,000 |  |
| Investment in ABC Common Stock | $ 130,000 |  |
|  Unrealized Gain/Loss |  | $ 535,000 |

To record 20X9 unrealized gain on investment in ABC Common, Preferred and Surplus Notes.

Components computed as follows:

|  |  |
| --- | --- |
| Total Net Income net of preferred stock dividend and interest on surplus notes ($1,400,000 - $50,000 - $80,000) |  $ 1,270,000 |
| Less amount needed to restore investment in surplus notes | ($ 10,000) |
| Amount available for preferred stock and common stock investment restoration | $ 1,260,000 |
| Amount needed to restore preferred stock component | ($ 1,000,000) |
| Amount available to restore common stock component | $ 260,000 |
|  |  |
| Surplus Notes component ($10,000 \* 50%) | $ 5,000 |
| Preferred Stock component ($1,000,000 \* 40%) | $ 400,000 |
| Common stock component ($260,000 \* 50%) | $ 130,000 |
|  |  |  |
| Cash | $ 10,000 |  |
| Unrealized Gain/Loss | $ 10,000 |  |
|  Dividend Income |  | $ 10,000 |
|  Investment in ABC Common stock |  | $ 10,000 |

To record 20X9 dividend on ABC Common. (100,000 shares \* $.10)

On December 7, 2019, the Statutory Accounting Principles (E) Working Group exposed revisions, with modifications suggested by interested parties, as illustrated above, to *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets* to expand guidance regarding financial guarantees and the use of the equity method for when losses exceed the equity value of an SCA investment. With the revisions, the equity value of an SCA would not go negative, and guaranteed liabilities would be reported to the extent that there is a financial guarantee or commitment. The “Illustration of the Application of INT 00-24” will also be inserted into *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*.

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1. As practical expedients, when a guarantee is issued in a standalone arm’s-length transaction, the liability recognized at the inception of the guarantee should be the premium received or receivable by the guarantor. When a guarantee is issued as part of a transaction with multiple elements, the liability recognized at the inception of the guarantee should be an estimate of the guarantee’s fair value. In that circumstance, guarantors should consider what premium would be required by the guarantor to issue the same guarantee in a standalone arm’s-length transaction. [↑](#footnote-ref-1)
2. Refer to the additional guidance related to discontinuance of an equity method in paragraphs 15-17 and *INT 00-24: EITF 98-13: Accounting by an Equity Method Investor for Investee Losses When the Investor Has Loans to and Investments in Other Securities of the Investee* and *EITF 99-10: Percentage Used to Determine the Amount of Equity Method Losses*. [↑](#footnote-ref-2)
3. Refer to the additional guidance related to discontinuance of an equity method in paragraphs 15-17 and *INT 00-24: EITF 98-13: Accounting by an Equity Method Investor for Investee Losses When the Investor Has Loans to and Investments in Other Securities of the Investee* and *EITF 99-10: Percentage Used to Determine the Amount of Equity Method Losses*. [↑](#footnote-ref-3)
4. [↑](#footnote-ref-4)
5. The exclusion for wholly-owned subsidiaries includes guarantees from a parent to, or on behalf of, a direct wholly-owned insurance or non-insurance subsidiary as well as guarantees made from a parent to, or on behalf of, an indirect wholly-owned insurance or non-insurance subsidiary. The “wholly-owned” exclusion in paragraph 18.f. does not include guarantees issued from one subsidiary to another subsidiary, regardless if both subsidiaries are wholly-owned (directly or indirectly) by a parent company. [↑](#footnote-ref-5)
6. [↑](#footnote-ref-6)
7. [↑](#footnote-ref-7)
8. The exclusion for wholly-owned subsidiaries includes guarantees from a parent to, or on behalf of, a direct wholly-owned insurance or non-insurance subsidiary as well as guarantees made from a parent to, or on behalf of, an indirect wholly-owned insurance or non-insurance subsidiary. The “wholly-owned” exclusion in paragraph 18.f. does not include guarantees issued from one subsidiary to another subsidiary, regardless if both subsidiaries are wholly-owned (directly or indirectly) by a parent company. [↑](#footnote-ref-8)
9. [↑](#footnote-ref-9)
10. [↑](#footnote-ref-10)