**Dec. 1, 2023, Exposed Revisions to SSAP No. 21R – 2023 Fall National Meeting**

Summary of Revisions:

1. All changes exposed in Summer 2023 have been accepted with new edits shown as tracked. (This has been done for readability and to highlight changes from the prior exposure.)
2. Paragraph 30: Revisions specify that temporary reductions in fair value shall be reported as unrealized losses. This guidance was revised to mirror the updated OTTI guidance proposed in paragraph 35.
3. Paragraphs 31-32: Revisions incorporate the measurement method of residuals to be the “effective yield method with a cap.” With the revised guidance, the BACV of a residual will be limited to the initial cost, and recognition of interest income / reduction of the cost basis will depend on the cash flows received. Cash flows received that are within the allowable earned yield will be reported as interest income and cash flows received in excess of the allowable earned yield will reduce the carrying value. This revised method intends to allow a systematic approach to recognizing interest income over the life of the security, while not permitting an increase in the cost basis based on an expectation of future cash flows.
4. Paragraph 33: Revisions incorporate a practical expedient to the measurement method detailed in paragraphs 31-32 that permits companies to utilize a “return of cost basis” approach. Under this approach, all cash flows received from residual tranches will be taken as a reduction of BACV. Once the BACV reaches zero, then all cash flows received will be recognized as interest income. (This was the approach exposed at the Summer NM for all residuals.) Although the industry comment letter has noted support for the ‘effective yield with a cap’ method detailed in paragraphs 31-32, they have noted that some companies would prefer the simplicity of the return of cash basis approach. For companies that do not have significant residual holdings, they would prefer the return of cost basis approach to avoid any operational complexity. NAIC staff supports the inclusion of this practical expedient as it is a more conservative approach in the measurement method of residuals.
5. Paragraph 34: Revisions provide guidance for accounting and reporting if the investment no longer meets the definition of a residual.
6. Paragraph 35: Guidance for OTTI has been revised to be consistent with SSAP No. 43R and the assessment of the present value of expected cash flows to the BACV.

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

*Debt Securities That Do Not Qualify as Bonds*

1. The guidance within paragraphs 20-28 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:
2. Debt securities for which the investment does not reflect a creditor relationship in substance.
3. Debt securities that do not qualify for bond reporting due to a lack of substantive credit enhancement.
4. Debt securities that do not qualify for bond reporting due solely to a lack of meaningful cash flows.
5. Debt securities as described in this statement meet the definition of assets as defined in SSAP 4 and are admitted assets to the extent they conform to the requirements of this statement. The guidance in these paragraphs shall not be inferred to other securities or investment structures that are not otherwise addressed in statutory accounting, nor shall it be applied to any investments that are captured within other statutory accounting guidance.
6. 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 29, in the section pertaining to residual tranches, any residual tranches or first loss positions held from the same securitization that did not quality as a bond under SSAP No. 26R also only qualify to the extent the underlying collateral primarily qualifies as admitted invested assets.
7. 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*.
8. Debt securities captured in scope 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.
9. 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).
10. Investment income shall be recorded, with assessments for collectability and nonadmittance completed and recognized, pursuant to *SSAP No. 34—Investment Income Due and Accrued*.
11. Securities captured within this section shall be included in all invested asset disclosures, along with the following disclosures:
12. Fair values in accordance with *SSAP No. 100R—Fair Value*.
13. Concentrations of credit risk in accordance with SSAP No. 27;
14. Basis at which the securities are stated;
15. The adjustment methodology used for each type of security (prospective or retrospective);
16. Descriptions of sources used to determine prepayment assumptions.
17. 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.
18. 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:
19. The amortized cost basis, prior to any current-period other-than-temporary impairment.
20. The other-than-temporary impairment recognized in earnings as a realized loss.
21. The fair value of the security.
22. The amortized cost basis after the current-period other-than-temporary impairment.
23. 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):
24. The aggregate amount of unrealized losses (that is, the amount by which cost or amortized cost exceeds fair value) and
25. The aggregate related fair value of securities with unrealized losses.
26. 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.
27. 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.
28. When it is not practicable to estimate fair value, the investor should disclose the following additional information, if applicable:
29. The aggregate carrying value of the investments not evaluated for impairment, and
30. The circumstances that may have a significant adverse effect on the fair value.
31. 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*

1. Residual tranches or interests from securitization tranches, beneficial interests and loss positions as defined in SSAP No. 43Rand *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies* (which are collectively referred to as residuals), do not qualify for bond reporting and are required to be reported on *Schedule BA: Other Long-Term Invested Assets.*
2. As stated in paragraph 22, residuals are permitted to be admitted assets if debt securities from the same securitization qualify (or would qualify) as admitted assets. If the debt security from a securitization is (or would be) nonadmitted due to the requirements under paragraph 22, then any residual interests or first loss positions held from the same securitization also do not qualify as admitted assets and shall be reported as nonadmitted assets.
3. 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 the lower of book adjusted carrying value (BACV) as detailed in paragraphs 31-32 or fair value, with temporary reductions in fair value reported as an unrealized loss.
4. BACV is defined as the cost to acquire the residual reduced for distributions in excess of the Allowable Earned Yield and other-than-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.
5. 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 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), BACV shall be reduced by the excess. As a result of this method, the BACV of residuals shall not be increased unless there is a subsequent investment (i.e., an additional purchase with additional consideration remitted).
6. Reporting entities may elect a practical expedient in lieu of the Allowable Earned Yield detailed in paragraphs 31-32 and calculate 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.
   1. 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.
   2. Reporting entities are required to apply the practical expedient to all residuals held.
   3. 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 transition date shall continue to follow the practical expedient until those residuals mature/terminate, are unwound or no longer meet the definition of a residual.
7. In situations where the residual structure ceases to meet the definition of a residual tranche (i.e., when all senior debt has been repaid), and the investment structure is expected to continue for more than a year (12 months), the investment shall be reclassified and accounted for prospectively in the scope of whichever SSAP applies.
   1. Although it will be determined based on the structure of the resulting investments, presumably, at the time a structure ceases to reflect a residual, it will likely be considered a debt security that does not qualify as a bond or an equity investment in scope *of SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*.
   2. Reporting entities are not required to reclassify an investment if the resulting structure is unwound within 12 months of the senior debt being repaid.
8. Residuals (under both methods described above) shall be assessed for OTTI on an ongoing basis. 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 the BACV. Upon identification of an OTTI, the reporting entity shall recognize a realized loss equal to the difference between the BACV and the present value of expected cash flows, with the present value of expected cash flows becoming the new BACV. After the OTTI is recognized, distributions received from the residual shall continue to be recorded in accordance with paragraphs 31-33. Subsequent recoveries in cash flows shall not result in increases to the BACV.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2023/12-1-23 Fall National Meeting/Exposures/19-21 - SSAP No. 21R - 12-1-23.docx