Statement of Statutory Accounting Principles No. 26

Bonds

STATUS

Type of Issue	Common Area
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Effective Date	January 1, 2025
Affects	Replaces SSAP No. 26R on January 1, 2025
Affected by	No other pronouncements
Interpreted by	INT 01-25; INT 06-02; INT 06-07; INT 07-01
Relevant Appendix A Guidance	None

SCOPE OF STATEMENT

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

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

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

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

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

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

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

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

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

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

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

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

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

4. This statement excludes:

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

b. Investments that qualify within the principles-based definition as an 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.

SUMMARY CONCLUSION

Principles-Based Bond Definition

5. A bond shall be defined as any security[2] representing a creditor relationship, whereby there is a fixed schedule for one or more future payments, and which qualifies as either an issuer credit obligation or an asset-backed security as described in this statement**.** Determining whether a security represents a creditor

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

Security: A share, participation, or other interest in property or in an entity of the issuer or an obligation of the issuer that has all of the following characteristics:

a. It is either represented by an instrument issued in bearer or registered form or, if not represented by an instrument, is registered in books maintained to record transfers by or on behalf of the issuer.
b. It is of a type commonly dealt in on securities exchanges or markets or, when represented by an instrument, is commonly recognized in any area in which it is issued or dealt in as a medium for investment.
c. It is either one of a class or series or by its terms is divisible into a class or series of shares, participations, interests or obligations.

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

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

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

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

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

d. In order for a debt instrument to represent a creditor relationship in accordance with Paragraph 6, it must have pre-determined principal and interest payments (whether fixed interest or variable interest) with contractual amounts that do not vary based on the appreciation or depreciation (i.e., performance) of any underlying collateral value or other non-debt variable. For example, an issued security that has varying principal and interest payments based on the appreciation of referenced equity, real estate or other non-debt variable is precluded from bond treatment. This exclusion is not intended to restrict variables that are commonly related to debt instruments such as, but not limited to, plain-vanilla[3] inflation or benchmark interest rate adjustments (such as with U.S. TIPs or SOFR-linked coupons, respectively), scheduled interest rate step-ups, or credit-quality related interest rate adjustments. This exclusion is also not intended to encompass nominal interest rate adjustments[4]. For clarification purposes, all returns from a debt instrument in excess of principal are required to be considered as interest. Therefore, investments with "stated" interest and then "additional returns" to which the holder of the debt instrument is entitled are collectively considered as interest and shall be assessed together in determining whether the investment has variable principal or interest due to underlying referenced non-debt variables. Examples of securities excluded from the bond definition under this guidance:

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

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

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

[4] 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.

6. 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[5] 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.

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

7. An asset-backed security[6] is a bond issued by an entity (an "ABS Issuer") created for the primary purpose of raising debt capital backed by financial assets[7] or cash generating non-financial assets owned by the 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[8]. 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.

8. 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.

[6] 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.

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

[8] 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.

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

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

9. 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*.)

10. 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.

11. 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 interest 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.

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

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

Accounting and Reporting Guidance for Investments that Qualify as Issuer Credit Obligations[9]

Acquisitions, Disposals and Changes in Unrealized Gains and Losses

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

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

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

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

Amortized Cost

17. Amortization of bond premium or discount shall be calculated using the scientific (constant yield) interest method taking into consideration specified interest and principal provisions over the life of the bond.[10] (INT 07-01) Bonds containing call provisions (where the issue can be called away from the reporting entity at the issuer's discretion), except "make-whole" call provisions, shall be amortized to the call or maturity value/date which produces the lowest asset value (yield-to-worst). Although the concept for yield-to-worst shall be followed for all callable bonds, make-whole call provisions, which allow the bond to be callable at any time, shall not be considered in determining the timeframe for amortizing bond premium or discount unless information is known by the reporting entity indicating that the issuer is expected to invoke the make-whole call provision.

Application of Yield-to-Worst

18. For callable bonds[11], the first call date after the lockout period (or the date of acquisition if no lockout period exists) shall be used as the "effective date of maturity." Depending on the characteristics of the callable bonds, the yield-to-worst concept in paragraph 18 shall be applied as follows:

a. For callable bonds with a lockout period, premium in excess of the next call price[12] (subsequent to acquisition[13] and lockout period) shall be amortized proportionally over the length of the lockout period. After each lockout period (if more than one), remaining premium shall be amortized to the call or maturity value/date which produces the lowest asset value.

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

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

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

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

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

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

Balance Sheet Amount

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

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

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

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

Impairment

21. 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.[14] 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] 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.

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

Income

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

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

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

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

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

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

b. For called or tendered bonds in which the consideration received is less than par[15]:

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

   ii. After determining any explicit prepayment penalty or acceleration fee, the reporting entity shall calculate the resulting realized gain as the difference between

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

the remaining consideration and the BACV, which shall be reported as realized capital gain, subject to the authoritative literature in SSAP No. 7.

Origination Fees

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

Origination, Acquisition and Commitment Costs

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

Commitment Fees

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

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

Exchanges and Conversions

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

SVO-Identified Bond Exchange –Traded Funds

31. SVO-identified bond exchange-traded fund (ETF) investments, as discussed in paragraph 2.d., are captured within the scope of this statement for accounting and reporting[16] purposes only. The inclusion of these investments within this statement is not intended to contradict state law regarding the classification

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

of these investments and does not intend to provide exceptions to state investment limitations involving types of financial instruments (e.g., equity/fund interests), or with regards to concentration risk (e.g., issuer).

32. SVO-identified bond ETF investments shall be initially reported at cost, including brokerage and other related fees. Subsequently, SVO-identified bond ETF investments shall be reported at fair value,[17] with changes in fair value recorded as unrealized gains or losses) unless the reporting entity has elected use[18] of a documented systematic approach to amortize or accrete the investment in a manner that represents the expected cash flows from the underlying bond holdings. This special measurement approach is referred to as the "systematic value" measurement method and shall only be used for the SVO-identified bond ETF investments within the scope of this statement.

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

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

b. Designated use of a systematic value is an irrevocable election per qualifying investment (by CUSIP) at the time investment is originally acquired[19]. Investments owned prior to being identified by the SVO as a qualifying SSAP No. 26R investment are permitted to be subsequently designated to the systematic value measurement method. This designation shall be applied as a change in accounting principle pursuant to *SSAP No. 3—Accounting Changes and Corrections of Errors*, which requires the reporting entity to recognize a cumulative effect to adjust capital and surplus as if the systematic value measurement method had been applied retroactively for all prior periods in which the investment was held. The election to use systematic value for investments shall be made before the year-end reporting of the investment in the year in which the SVO first identifies the investment as a qualifying SSAP No. 26R investment.

c. Once designated for a particular investment, the systematic value measurement method must be retained as long as the qualifying investment is held by the reporting entity and the investment remains within the scope of this statement with an allowable NAIC designation per paragraph 34.a. Upon a full sale/disposal of an SVO-identified investment (elimination of the entire CUSIP investment), after 90 days the reporting entity can reacquire the SVO-identified investment and designate a different measurement method. If the reporting entity was to reacquire the same investment within 90 days after it was sold/disposed, the reporting entity must utilize the measurement method previously designated for the investment. Subsequent/additional purchases of the same SVO-identified investment (same CUSIP) already held by a reporting entity must follow the election previously made by the reporting entity. If an investment no longer qualifies for a systematic value

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

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

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

measurement because the NAIC designation has declined, then the security must be subsequently reported at the lower of "systematic value" or fair value. If the security has been removed from the SVO-identified listings, and is no longer in scope of this statement, then the security shall be measured and reported in accordance with the applicable SSAP.

d. Determination of the designated systematic value must follow the established[20] approach, which is consistently applied for all SVO-identified bond ETF investments designated for a systematic value. In all situations, an approach that continuously reflects "original" or "historical cost" is not an acceptable measurement method. The designated approach shall result with systematic amortization or accretion of the equity/fund investment in a manner that represents the expected cash flows from the underlying bond holdings.

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

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

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

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

b. In situations in which an SVO-identified bond ETF investment has a fair value that is less than systematic value, the reporting entity must assess for other-than-temporary impairment. For these investments, a key determinant, along with other impairment indicators in *INT 06-07: Definition of Phrase "Other Than Temporary*," shall be whether the net present value of the projected cash flows for the underlying bonds in the SVO-identified investment have materially[21] declined from the prior reporting period (most recent issued financial statements) or from the date of acquisition. In calculating the net present value of the projected cash flows for each reporting period, entities shall discount cash flows using a constant purchase yield, which is the initial book yield at acquisition. Consistent with INT 06-07, a predefined threshold to determine whether the decline in projected cash flows (e.g., percentage change) shall result in an other than temporary impairment has not been set, as exclusive reliance on such thresholds removes the ability of management to apply its judgement.

c. Upon identification of an SVO-identified investment as OTTI, the reporting entity shall recognize a realized loss equal to the difference between systematic value and the current

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

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

fair value. (Although the determination of OTTI is likely based on projected cash flows, the realized loss recognized for the OTTI is based on the difference between systematic value and fair value.) The fair value of the SVO-identified investment on the date of the OTTI shall become the new cost basis of the investment.

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

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

Disclosures

38. The financial statements shall include the following disclosures:

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

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

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

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

i. Whether the reporting entity consistently utilizes the same measurement method for all SVO-identified investments[22] (e.g., fair value or systematic value). If different measurement methods are used[23], information on why the reporting entity

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

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

has elected to use fair value for some SVO-identified investments and systematic value for others.

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

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

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

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

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

ii. After one year through five years;

iii. After five years through ten years;

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

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

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

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

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

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

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

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

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

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

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

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

Relevant Literature

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

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

Effective Date and Transition

42. Revisions to SSAP No. 26R, adopted August 2023, to incorporate the principle-based bond concepts are effective January 1, 2025. These revisions incorporate principle concepts on what should be reported as a long-term bond. Securities that qualify as issuer credit obligations within the principle concepts are captured within scope of SSAP No. 26R. Securities that qualify as asset-backed securities within the principle concepts are captured within scope of SSAP No. 43R. Securities that do not qualify as

issuer credit obligations or ABS, unless specifically permitted in scope of these statements, are not permitted to be reported as a bond.

43. At the time of transition, reporting entities shall make their best efforts to assess investments to determine whether they qualify within the bond definition for reporting on Schedule D-1. The bond definition requires assessments at the time of acquisition (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 issuer obligation or asset-backed security.

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

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

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

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

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

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

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

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

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

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

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

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

46. For clarification purposes, the transition guidance shall be applied prospectively beginning with the first year of adoption (Jan. 1, 2025). For disclosures that provide comparative information, reporting entities shall not restate the prior year's information in the 2025 disclosure.

Historical Adoption and Revisions to Original SSAP No. 26R

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

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

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

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

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

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

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

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

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

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

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

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

h. Revisions to clarify existing guidance that all prepayment penalties and acceleration fees for when a bond is liquidated prior to its scheduled maturity date, including those from tendered bonds, shall follow the guidance in SSAP No. 26R was effective January 1, 2021.

Reporting entities that have historically applied this guidance shall not change historical practices, but the effective date of January 1, 2021, with early application permitted, was allowed for reporting entities to make systems changes to capture tendered bonds in scope of this guidance.

REFERENCES

Other

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

Relevant Issue Papers

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

EXHIBIT A - EXAMPLES OF ANALYSIS FOR ASSET-BACKED SECURITIES

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

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

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

4. **Example 2:** A reporting entity invested in a debt instrument issued by a SPV. Payments under the instrument are secured by a note, a legal assignment from the borrower of a lease for real property and an assignment of the lease payments from an operating entity tenant. Additional security is provided by a mortgage on the leased property (the "underlying collateral"). The leased property is owned by the borrower under the note -- the SPV does not have any ownership interest in the underlying collateral, though it has legal recourse to it through the mortgage. The tenant makes contractually-fixed payments over the life of the lease to the borrower, who has assigned both the lease and the lease payments to the SPV as security for the debt. While the debt is outstanding, the lease, the lease payments, 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 all or a portion of the defaulted lease payments. The loan-to-value (as a percentage of property value) at origination is 100%.

5. The existing lease payments are sufficient to cover all interest payments and all scheduled debt amortization payments over the life of the debt instrument. However, at debt maturity, there is a balloon payment due, totaling 50% of the original outstanding debt principal amount. The corresponding lease has no balloon payment due at lease maturity, so the SPV will either need to refinance the debt or sell the underlying 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.

6. **Example 2 Rationale:** The reporting entity determined that the debtholder was 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 (<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.

7. The reporting entity also determined that the structure provides substantive credit enhancement in the form of overcollateralization to conclude that investors are in a different economic position than holding the real property directly, in accordance with the requirements in paragraph 10. 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., knowledgeable investor transacting at arm's length) would consider this level of overcollateralization to put the investor in a substantively different economic position than owning the underlying property directly.

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

9. **Example 3:** A reporting entity invested in a debt instrument with the same characteristics as described in Example 2, except that the existing 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.

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

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

produce meaningful cash flows to service the debt, it does not, in and of itself, preclude a reporting entity from concluding that the assets are expected to produce meaningful cash flows.

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

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

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

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

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

EXHIBIT B – SYSTEMATIC VALUE CALCULATION

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

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

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

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

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

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

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

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

EXHIBIT C – AMORTIZATION TREATMENT FOR CALLABLE BONDS

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

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

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

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

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

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

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

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

Example 2: Call Price Could be Greater Than BACV

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

The bolded numbers represent the lowest asset value:

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

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

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

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

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

Example 3: Call Price Could be Greater Than BACV

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

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

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

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

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

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

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

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

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

The bolded numbers represent the lowest asset value:

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

Standard Amortization This table shows the amortization with a purchase date of 12/15/2010 at $104 through the maturity date of 12/31/2018.								
12/15/2010	12/31/2011	12/31/2012	12/31/2013	12/31/2014	12/31/2015	12/31/2016	12/31/2017	12/31/2018
Amortization	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
BACV	103.50	103	102.50	102	101.50	101	100.50	100

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

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

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

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

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

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

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2023/8-13-23 Summer National Meeting/Adoptions/19-21a - SSAP 26R - 8-13-23.docx

