Statutory Accounting Principles (E) Working Group

**Maintenance Agenda Submission Form**

**Form A**

## **Issue: Levelized and Persistency Commission**

**Check (applicable entity):**

 P/C Life Health

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

New Issue or SSAP [ ]  [ ]  [ ]

Interpretation [ ]  [ ]  [ ]

Description of Issue:

NAIC staff has received regulator inquiries on the application of the levelized commissions guidance in *SSAP No. 71—Policy Acquisition Costs and Commissions.* This agenda item is to recommend clarifications to the existing levelized commissions guidance and provide additional guidance regarding commission that is based on policy persistency. SSAP No. 71 describes that levelized commissions occur in situations in which a third party pays agents non-levelized commissions and the reporting entity pays a third party by levelized payments. The statement notes that it is intended, but not necessarily guaranteed, that the amounts paid to the agents by the third party would ultimately be repaid to the third party from the reporting entity. SSAP No. 71 identifies such arrangements as funding agreements between the reporting entity and the third party. SSAP No. 71 then identifies that the use of a commission arrangement where commission payments are not linked to traditional elements (such as premium payments and policy persistency) requires the establishment of a liability for the full amount of the unpaid principal and accrued interest which is payable to a third party related to levelized commissions is required.

The questions received by NAIC staff relate to the use of levelized commission arrangements and when the liability for commission based on annual persistency is required to be recorded as a liability in accordance with *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets*.

Levelized Commission

For the example in question, a third party is paying agent commissions and receiving periodic payments. Consistent with the guidance in SSAP No. 71, paragraph 4, the third party (funding agent) is paying the agents on behalf of the reporting entity and receiving levelized payments from the reporting entity which include additional fees or interest in excess of the commissions. The agreement between the reporting entity and the funding agent specifies that the funding agent will not be reimbursed by the reporting entity if the policies that generate the commission are cancelled prior to the policy anniversary date. The regulator noted that the reporting entity was not accruing the liability to the third-party funding agent, asserting that the payments to the funding agent were theoretically avoidable until the policy had passed the anniversary year-end date.

The accounting issue is whether levelized commission arrangements that are linked to traditional elements (such as premium payments and policy persistency) requires the establishment of a liability for the full amount of the unpaid principal and accrued interest which is payable to a third party related to levelized commissions.

Persistency Commission

Also, in the noted example, the reporting entity was also asserting that the levelized commission obligations related to policy persistency commission were not required to be accrued until the policy anniversary year end had been passed. The reporting entity asserts that the liability is not required until the persistency commission was fully earned by the agent and therefore unavoidable.

The accounting issue is if the persistency commission expense should be accrued proportionately over the policy period to which the commission relates, or if it is accrued only when fully earned and unavoidable.

Existing Authoritative Literature:

*Preamble* provides the following (bolding added for emphasis):

37. Liabilities require recognition as they are incurred. Certain statutorily mandated liabilities may also be required to arrive at conservative estimates of liabilities and probable loss contingencies (e.g., interest maintenance reserves, asset valuation reserves, and others).

38. Revenue should be recognized only as the earnings process of the underlying underwriting or investment business is completed. Accounting treatments which tend to defer expense recognition do not generally represent acceptable SAP treatment.

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

Liabilities

2. A liability is defined as certain or probable1 future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or to provide services to other entities in the future as a result of a past transaction(s) or event(s).

3. A liability has three essential characteristics: (a) it embodies a present duty or responsibility to one or more other entities that entails settlement by probable1 future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand, (b) the duty or responsibility obligates a particular entity, leaving it little or no discretion to avoid the future sacrifice, and (c) the transaction or other event obligating the entity has already happened. This includes, but is not limited to, liabilities arising from policyholder obligations (e.g., policyholder benefits, reported claims and reserves for incurred but not reported claims). Liabilities shall be recorded on a reporting entity’s financial statements when incurred.

4. Estimates (e.g., loss reserves) are required in financial statements for many ongoing and recurring activities of a reporting entity. The mere fact that an estimate is involved does not of itself constitute a loss contingency. For example, estimates of losses utilizing appropriate actuarial methodologies meet the definition of liabilities as outlined above and are not loss contingencies.

Loss Contingencies or Impairments of Assets

6. For purposes of implementing the statutory accounting principles of loss contingency or impairment of an asset described below, the following additional definitions shall apply:

a. Probable—The future event or events are likely to occur;

b. Reasonably Possible—The chance of the future event or events occurring is more than remote but less than probable;

c. Remote—The chance of the future event or events occurring is slight.

7. A loss contingency or impairment of an asset is defined as an existing condition, situation, or set of circumstances involving uncertainty as to possible loss to an enterprise that will ultimately be resolved when one or more future event(s) occur or fail to occur (e.g., collection of receivables).

8. An estimated loss from a loss contingency or the impairment of an asset shall be recorded by a charge to operations if both of the following conditions are met:

a. Information available prior to issuance of the statutory financial statements indicates that it is probable that an asset has been impaired or a liability has been incurred at the date of the statutory financial statements. It is implicit in this condition that it is probable that one or more future events will occur confirming the fact of the loss or incurrence of a liability; and

b. The amount of loss can be reasonably estimated.

*SSAP No. 71—Policy Acquisition Costs and Commissions* provides the following (bolding added for emphasis):

SUMMARY CONCLUSION

2. Acquisition costs are those costs that are incurred in the acquisition of new and renewal insurance contracts and include those costs that vary with and are primarily related to the acquisition of insurance contracts (e.g., agent and broker commissions, certain underwriting and policy issue costs, and medical and inspection fees). Acquisition costs and commissions shall be expensed as incurred. Determination of when acquisition costs and commissions have been incurred shall be made in accordance with SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets.

3. Contingent commission liabilities shall be determined in accordance with the terms of each individual commission agreement. Commission liabilities determined on the basis of a formula that relates to loss experience shall be established for the earned portion. Assumptions used to calculate the contingent commission liability shall be consistent with the terms of the policy contract and with the assumptions made in recording other assets and liabilities necessary to reflect underwriting results of the reporting entity such as retrospective premium adjustments and loss reserves, including incurred but not reported.

4. Levelized commissions occur in situations where agents receive normal (non-level) commissions with payments made by a third party. It is intended, but not necessarily guaranteed, that the amounts paid to the agents by the third party would ultimately be repaid (with interest explicit or implied) to the third party by levelized payments (which are less than the normal first year commissions but exceed the normal renewal commissions) from the reporting entity. These transactions are, in fact, funding agreements between a reporting entity and a third party. The continuance of the stream of payments specified in the levelized commission contract is a mechanism to bypass recognition of those expenses which are ordinarily charged to expense in the first year of the contract. Consequently, the normal link between the persistency of the policy, the continuance of the premium payment or the maintenance of the agent's license with the reporting entity is not maintained with respect to the payment stream.

5. The use of an arrangement where commission payments are not linked to traditional elements such as premium payments and policy persistency, but rather are linked to the repayment of an advance amount requires the establishment of a liability for the full amount of the unpaid principal and accrued interest which is payable to a third party related to levelized commissions.

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

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

**Convergence with International Financial Reporting Standards (IFRS):** Not applicable

Staff Review Completed by:

Robin Marcotte, NAIC Staff – July 2019

Staff Recommendation:

NAIC Staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to SSAP No. 71 as illustrated below. NAIC Staff recommends that revisions to the guidance clarify the following:

1. A levelized commission arrangement (whether linked to traditional or nontraditional elements) require the establishment of a liability for the full amount of the unpaid principal and accrued interest payable to a third party at the time the policy is issued.

1. The persistency commission is accrued proportionately over the policy period in which the commission relates to and is not deferred until fully earned.

These recommendations are consistent with the original intent of SSAP No. 71 as well as the Statutory Statement of Concepts focusing on Recognition (excerpts from Preamble, paragraphs 37 and 38):

* Liabilities require recognition as they are incurred.
* Accounting treatments which tend to defer expense recognition do not generally represent acceptable SAP treatment.

July 2019 Proposed Revisions to SSAP No. 71:

SUMMARY CONCLUSION

2. Acquisition costs are those costs that are incurred in the acquisition of new and renewal insurance contracts and include those costs that vary with and are primarily related to the acquisition of insurance contracts (e.g., agent and broker commissions, certain underwriting and policy issue costs, and medical and inspection fees). Acquisition costs and commissions shall be expensed as incurred. Determination of when acquisition costs and commissions have been incurred shall be made in accordance with SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets. The recognition of commission expense for new and renewal insurance contracts meets the definition of a liability under SSAP No. 5R when the policy is issued or renewed. The issuance of the policy is the obligating event under SSAP No. 5R.

3. Contingent commission liabilities shall be determined in accordance with the terms of each individual commission agreement. Commission liabilities determined on the basis of a formula that relates to loss experience shall be established for the earned portion. Assumptions used to calculate the contingent commission liability shall be consistent with the terms of the policy contract and with the assumptions made in recording other assets and liabilities necessary to reflect underwriting results of the reporting entity such as retrospective premium adjustments and loss reserves, including incurred but not reported. Commission contracts that include persistency (or other such components) shall not use these clauses to defer recognition of commission expense. If a commission is based on annual policy persistency (or similar components), the commission is accrued based on experience to date for the policy period (it is inappropriate to wait until the amount is fully earned and/or unavoidable). Actual policy cancellation would reverse the accrual of the related persistency commission.

4. Levelized commissions occur in situations where agents receive normal (non-level) commissions with payments made by a third party. It is intended, but not necessarily guaranteed, that the amounts paid to the agents by the third party would ultimately be repaid (with interest explicit or implied) to the third party by levelized payments (which are less than the normal first year commissions but exceed the normal renewal commissions) from the reporting entity. These transactions are, in fact, funding agreements between a reporting entity and a third party. The continuance of the stream of payments specified in the levelized commission contract is a mechanism to bypass recognition of those expenses which are ordinarily charged to expense in the first year of the contract. Consequently, the normal link between the persistency of the policy, the continuance of the premium payment or the maintenance of the agent's license with the reporting entity is not maintained with respect to the payment stream.

5. The use of an arrangement where commission payments are not linked to traditional elements such as premium payments and policy persistency, but rather are linked to the repayment of an advance amount requires the establishment of a liability for the full amount of the unpaid principal and accrued interest which is payable to a third party related to levelized commissionsFN.

New Footnote – The guidance in this paragraph does not imply that levelized commissions that are linked to traditional elements do not require establishment of a liability. Rather, such levelized commissions are captured in paragraphs 3-4.

Status:

On August 3, 2019, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to *SSAP No. 71—Policy Acquisition Costs and Commissions*, as illustrated above, to clarify levelized commissions guidance and provide additional direction regarding commissions that are based on policy persistency. The revisions also clarify that the recognition of commission expense is based on experience to date.

For Fall 2019 Discussion NAIC staff has proposed updates for exposure.

Paragraph 2 - Removed previously exposed revisions as unneeded.

Paragraph 3 - Added clarifying phrases regarding persistency commission accrual. The concept is that normal persistency commission is accrued for the period it relates to unless the policy is cancelled.

Paragraph 4 - Added two clarifying phrases to assist with identifying levelized commission funding agreements.

Paragraph 5 - Added clarifying phrases regarding funding agreements.

Footnote 1 - Redrafted to remove double negative wording.

Fall 2019 Proposed Revisions to SSAP No. 71:

SUMMARY CONCLUSION

2. Acquisition costs are those costs that are incurred in the acquisition of new and renewal insurance contracts and include those costs that vary with and are primarily related to the acquisition of insurance contracts (e.g., agent and broker commissions, certain underwriting and policy issue costs, and medical and inspection fees). Acquisition costs and commissions shall be expensed as incurred. Determination of when acquisition costs and commissions have been incurred shall be made in accordance with SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets.

3. Contingent commission liabilities shall be determined in accordance with the terms of each individual commission agreement. Commission liabilities determined on the basis of a formula that relates to loss experience shall be established for the earned portion. Assumptions used to calculate the contingent commission liability shall be consistent with the terms of the policy contract and with the assumptions made in recording other assets and liabilities necessary to reflect underwriting results of the reporting entity such as retrospective premium adjustments and loss reserves, including incurred but not reported. Commission contracts that include persistency (or other such components) shall not use these clauses to defer recognition of commission expense. If a commission is based on annual policy persistency (or other similar components), the commission shall be accrued based on experience to date for the policy period that the commission relates. In regard to persistency commission, it is inappropriate to wait until the amount is fully earned and/or unavoidable to accrue experience to date commission expenses. Actual policy cancellation would reverse the accrual of the related persistency commission.

4. Levelized commissions occur in situations where agents receive normal (non-level) commissions with payments made by a third party. It is intended, but not necessarily guaranteed, that the amounts paid to the agents by the third party would ultimately be repaid (with interest explicit or implied) to the third party by levelized payments (which are less than the normal first year commissions but exceed the normal renewal commissions) from the reporting entity. (Note: levelized repayments made by the reporting entity extend the repayment period but might not be a straight-line repayment.) These transactions are, in fact, funding agreements between a reporting entity and a third party, regardless of how the payment to the third party is characterized. The continuance of the stream of payments specified in the levelized commission contract is a mechanism to bypass recognition of those expenses which are ordinarily charged to expense in the first year of the contract. Consequently, the normal link between the persistency of the policy, the continuance of the premium payment or the maintenance of the agent's license with the reporting entity is not maintained with respect to the payment stream.

5. The use of an arrangement such as a levelized commission arrangement where commission payments are not linked to traditional elements such as premium payments and policy persistency, but rather are linked to the repayment of an advance amount paid by a third party to the agents requires the establishment of a liability by the reporting entity for the full amount of the unpaid principal and accrued interest which is payable to a third party related to levelized commissionsFN.

New Footnote – The guidance in this paragraph notes that levelized commissions which use a third party to pay agents that are linked to traditional elements require establishment of a liability for the amounts that have been paid to the agents and any interest accumulated to date.

On December 7, 2019, the Statutory Accounting Principles (E) Working Group exposed revisions to *SSAP No. 71—Policy Acquisition Costs and Commissions*, as illustrated above, to include additional NAIC staff modifications regarding persistency commission and levelized commission arrangements to address certain comments received and to allow for further discussion. With this exposure, the Working Group directed a notification of the exposure to be sent to the Life Actuarial (A) Task Force.

On March 18, 2020, the Statutory Accounting Principles (E) Working Group deferred discussion of this item for a subsequent call or meeting.

On July 30, 2020, the Statutory Accounting Principles (E) Working Group exposed revisions to *SSAP No. 71—Policy Acquisition Costs and Commissions*, as illustrated below. Exposed revisions clarify existing levelized commissions guidance which requires full recognition of the funding liabilities incurred to date for commission expenses prepaid on behalf of an insurer. The exposed revisions are consistent with the 2019 Fall National Meeting exposure, with the inclusion of guidance to clarify that reporting entities that have not complied with the original intent shall reflect the change as a correction of an error, in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*, in the year-end 2020 financial statements.

July 30, 2020 Exposed Revisions to SSAP No. 71:

SUMMARY CONCLUSION

2. Acquisition costs are those costs that are incurred in the acquisition of new and renewal insurance contracts and include those costs that vary with and are primarily related to the acquisition of insurance contracts (e.g., agent and broker commissions, certain underwriting and policy issue costs, and medical and inspection fees). Acquisition costs and commissions shall be expensed as incurred. Determination of when acquisition costs and commissions have been incurred shall be made in accordance with SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets.

3. Contingent commission liabilities shall be determined in accordance with the terms of each individual commission agreement. Commission liabilities determined on the basis of a formula that relates to loss experience shall be established for the earned portion. Assumptions used to calculate the contingent commission liability shall be consistent with the terms of the policy contract and with the assumptions made in recording other assets and liabilities necessary to reflect underwriting results of the reporting entity such as retrospective premium adjustments and loss reserves, including incurred but not reported. Commission contracts that include persistency (or other such components) shall not use these clauses to defer recognition of commission expense. If a commission is based on annual policy persistency (or other similar components), the commission shall be accrued based on experience to date for the policy period that the commission relates. In regard to persistency commission, it is inappropriate to wait until the amount is fully earned and/or unavoidable to accrue experience to date commission expenses. Actual policy cancellation would reverse the accrual of the related persistency commission.

4. Levelized commissions occur in situations where agents receive normal (non-level) commissions with payments made by a third party. It is intended, but not necessarily guaranteed, that the amounts paid to the agents by the third party would ultimately be repaid (with interest explicit or implied) to the third party by levelized payments (which are less than the normal first year commissions but exceed the normal renewal commissions) from the reporting entity. (Note: levelized repayments made by the reporting entity extend the repayment period but might not be a straight-line repayment.) These transactions are, in fact, funding agreements between a reporting entity and a third party, regardless of how the payment to the third party is characterized. The continuance of the stream of payments specified in the levelized commission contract is a mechanism to bypass recognition of those expenses which are ordinarily charged to expense in the first year of the contract. Consequently, the normal link between the persistency of the policy, the continuance of the premium payment or the maintenance of the agent's license with the reporting entity is not maintained with respect to the payment stream.

5. The use of an arrangement such as a levelized commission arrangement where commission payments are not linked to traditional elements such as premium payments and policy persistency, but rather are linked to the repayment of an advance amount paid by a third party to the agents requires the establishment of a liability by the reporting entity for the full amount of the unpaid principal and accrued interest which is payable to a third party related to levelized commissions FN.

New Footnote – The guidance in this paragraph notes that levelized commissions which use a third party to pay agents that are linked to traditional elements require establishment of a liability for the amounts that have been paid to the agents and any interest accumulated to date.

### Effective Date and Transition

7. This statement is effective for years beginning January 1, 2001. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*. The nonsubstantive revisions adopted \_\_\_\_\_\_\_ regarding levelized commission intend to clarify the original intent of this statement. Reporting entities that have not complied with the original intent of the statement shall reflect the change as a correction of an error (as a mistake in the application of an accounting principle) pursuant to SSAP No. 3 in the December 31, 2020 financial statements. In accordance with SSAP No. 3, correction of all accounting errors in previously issued financial statements, for which an amended financial statement was not filed, shall be reported as an adjustment to unassigned funds (surplus) in the period in which the error was detected. Disclosure shall also occur in accordance with SSAP No. 3.

On October 15, 2020, the Statutory Accounting Principles (E) Working Group held a hearing to receive comments, resulting in updated exposed revisions to *SSAP No. 71—Policy Acquisition Costs and Commissions*, as illustrated below. The updated exposed revisions clarify existing levelized commissions guidance, which requires full recognition of funding agreement liabilities incurred for commission expenses obligated when an insurance policy is written. (This guidance clarifies that writing the insurance policy is the obligating event for initial sales commission.) The exposed revisions have the following key changes from the prior exposure:

1. Improved description of the funding agreements in paragraphs 4 and 5.
2. Deletes the previously proposed revisions in paragraph 3 regarding other types of commission to address the comments received regarding unintended impacts on traditional renewal commission.
3. Modifies the revisions in paragraph 7 to remove the language on correction of an error.
4. Proposes the nonsubstantive revisions apply to contracts in effect on Jan. 1, 2021.

For ease of review the following pages illustrate the October 15, 2020 exposed revisions in two formats:

1. Exposure reflecting tracked revisions to Existing SSAP No. 71
2. October 2020 (new) Shaded Revisions to prior July exposure

Oct. 2020 Exposure of Tracked Revisions to Existing SSAP No. 71

2. Acquisition costs are those costs that are incurred in the acquisition of new and renewal insurance contracts and include those costs that vary with and are primarily related to the acquisition of insurance contracts (e.g., agent and broker commissions, certain underwriting and policy issue costs, and medical and inspection fees). Acquisition costs and commissions shall be expensed as incurred. Determination of when acquisition costs and commissions have been incurred shall be made in accordance with SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets.

3. Contingent commission liabilities shall be determined in accordance with the terms of each individual commission agreement. Commission liabilities determined on the basis of a formula that relates to loss experience shall be established for the earned portion. Assumptions used to calculate the contingent commission liability shall be consistent with the terms of the policy contract and with the assumptions made in recording other assets and liabilities necessary to reflect underwriting results of the reporting entity such as retrospective premium adjustments and loss reserves, including incurred but not reported.

4. Levelized commissions occur in situations where agents receive normal (non-level) commissions with payments made by a third party. It is intended, but not necessarily guaranteed, that the amounts paid to the agents by the third party would ultimately be repaid (with interest explicit or implied) to the third party by levelized payments (which are less than the normal first year commissions but exceed the normal renewal commissions) from the reporting entity. (Note: levelized repayments made by the reporting entity extend the repayment period but might not be a straight-line repayment.) These transactions are, in fact, funding agreements between a reporting entity and a third party, regardless of how the payment to the third party is characterized. The continuance of the stream of payments specified in the levelized commission contract is a mechanism which attempts to bypass recognition of those expenses which are ordinarily charged to expense in the first year of the contract. Consequently, the normal link between the persistency of the policy, the continuance of the premium payment or the maintenance of the agent's license with the reporting entity is not maintained with respect to the payment stream.

5. The use of an arrangement such as a levelized commission arrangement where commission payments are not linked to traditional elements such as premium payments and policy persistency, but rather are linked to the repayment of an advance amount paid by a third party to the direct selling agents requires the establishment of a liability by the reporting entity for the full amount of the unpaid principal and accrued interest which is payable to a third party related to levelized commissions ~~FN~~ .Arrangements that use a third party to pay agents who write policies for the reporting entity and the insured can be an attempt to de-link the relationship between the insurer and those agents and defer or levelize the acquisition commissions. The insurance reporting entity is required to recognize the full amount of earned commission costs to the direct policy writing agents even if those costs are paid indirectly to the agents by a third party through the use of levelized commission, or similar arrangement, which is in substance a funding arrangement. Having a third party pay commission costs to the selling agent is strong evidence of a potential funding arrangement which shall be recognized as a liability because the substance of the arrangement indicates that repayment is reasonable and probable, even if a contingency has been incorporated into the funding arrangement, unless the underlying policy has been cancelled. A third-party structure cannot recharacterize (e.g. by referencing policy persistency) and delay recognition of liabilities for initial sales commission owed from the writing of policies regardless of how a third-party arrangement is structured with regards to the timing of payment from the insurer. The amount owed for full initial sales commission shall be recognized immediately as the writing of an insurance contract is the event that obligates the insurer, and such action shall occur consistently among insurers. As such, this recognition is required regardless if the insurer owes a selling agent directly or if a third-party has been contracted to provide payment to the selling agent.

### Effective Date and Transition

7. This statement is effective for years beginning January 1, 2001. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*. The nonsubstantive revisions adopted \_\_\_\_\_\_\_ regarding levelized commission are to clarify the original intent of this statement and are effective January 1, 2021.

October 2020 (new) Shaded Revisions to prior July exposure

2. Acquisition costs are those costs that are incurred in the acquisition of new and renewal insurance contracts and include those costs that vary with and are primarily related to the acquisition of insurance contracts (e.g., agent and broker commissions, certain underwriting and policy issue costs, and medical and inspection fees). Acquisition costs and commissions shall be expensed as incurred. Determination of when acquisition costs and commissions have been incurred shall be made in accordance with SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets.

3. Contingent commission liabilities shall be determined in accordance with the terms of each individual commission agreement. Commission liabilities determined on the basis of a formula that relates to loss experience shall be established for the earned portion. Assumptions used to calculate the contingent commission liability shall be consistent with the terms of the policy contract and with the assumptions made in recording other assets and liabilities necessary to reflect underwriting results of the reporting entity such as retrospective premium adjustments and loss reserves, including incurred but not reported.

4. Levelized commissions occur in situations where agents receive normal (non-level) commissions with payments made by a third party. It is intended, but not necessarily guaranteed, that the amounts paid to the agents by the third party would ultimately be repaid (with interest explicit or implied) to the third party by levelized payments (which are less than the normal first year commissions but exceed the normal renewal commissions) from the reporting entity. (Note: levelized repayments made by the reporting entity extend the repayment period but might not be a straight-line repayment.) These transactions are, in fact, funding agreements between a reporting entity and a third party, regardless of how the payment to the third party is characterized. The continuance of the stream of payments specified in the levelized commission contract is a mechanism which attempts to bypass recognition of those expenses which are ordinarily charged to expense in the first year of the contract. Consequently, the normal link between the persistency of the policy, the continuance of the premium payment or the maintenance of the agent's license with the reporting entity is not maintained with respect to the payment stream.

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### Effective Date and Transition

7. This statement is effective for years beginning January 1, 2001. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*. The nonsubstantive revisions adopted \_\_\_\_\_\_\_ regarding levelized commission are to clarify the original intent of this statement and are effective January 1, 2021.

On November 12, 2020, the Statutory Accounting Principles (E) Working Group held a hearing to receive comments. The Working Group took the following actions:

* **Re-exposed** the prior version of SSAP #71 with shaded edits reflected below. – (1) the proposed effective date of Jan.1, 2021 was changed to be effective upon adoption, and (2) the revised text made explicit that the proposed revisions will apply to contracts in effect as of the date of adoption. Comments due by Jan. 11, 2021.

* Determined that the revisions to SSAP #71 had met the due process for **either a substantive or a non-substantive revision but concluded to keep the revision classified as nonsubstantive**. The Working Group reiterated that it is not the impact of a change on an individual entity that determines whether a change is substantive or non-substantive, but whether the revision is in line with the original intent of the SSAP. The Working group noted that this is a clarification of existing guidance consistent with original intent. Commissioner Donelon noted an objection to the classification as non-substantive.

* **Directed NAIC Staff to draft an Issue Paper** to document the discussion on this topic for historical purposes. The issue paper will be exposed for comment before considered for adoption by the Working Group.

Nov. 12, 2020 Exposed shaded SSAP No. 71 revisions are new from prior exposure.

2. Acquisition costs are those costs that are incurred in the acquisition of new and renewal insurance contracts and include those costs that vary with and are primarily related to the acquisition of insurance contracts (e.g., agent and broker commissions, certain underwriting and policy issue costs, and medical and inspection fees). Acquisition costs and commissions shall be expensed as incurred. Determination of when acquisition costs and commissions have been incurred shall be made in accordance with SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets.

3. Contingent commission liabilities shall be determined in accordance with the terms of each individual commission agreement. Commission liabilities determined on the basis of a formula that relates to loss experience shall be established for the earned portion. Assumptions used to calculate the contingent commission liability shall be consistent with the terms of the policy contract and with the assumptions made in recording other assets and liabilities necessary to reflect underwriting results of the reporting entity such as retrospective premium adjustments and loss reserves, including incurred but not reported.

4. Levelized commissions occur in situations where agents receive normal (non-level) commissions with payments made by a third party. It is intended, but not necessarily guaranteed, that the amounts paid to the agents by the third party would ultimately be repaid (with interest explicit or implied) to the third party by levelized payments (which are less than the normal first year commissions but exceed the normal renewal commissions) from the reporting entity. (Note: levelized repayments made by the reporting entity extend the repayment period but might not be a straight-line repayment.) These transactions are, in fact, funding agreements between a reporting entity and a third party, regardless of how the payment to the third party is characterized. The continuance of the stream of payments specified in the levelized commission contract is a mechanism which attempts to bypass recognition of those expenses which are ordinarily charged to expense in the first year of the contract. Consequently, the normal link between the persistency of the policy, the continuance of the premium payment or the maintenance of the agent's license with the reporting entity is not maintained with respect to the payment stream.

5. The use of an arrangement such as a levelized commission arrangement where commission payments are not linked to traditional elements such as premium payments and policy persistency, but rather are linked to the repayment of an advance amount paid by a third party to the direct selling agents requires the establishment of a liability by the reporting entity for the full amount of the unpaid principal and accrued interest which is payable to a third party related to levelized commissions ~~FN~~ .Arrangements that use a third party to pay agents who write policies for the reporting entity and the insured can be an attempt to de-link the relationship between the insurer and those agents and defer or levelize the acquisition commissions. The insurance reporting entity is required to recognize the full amount of earned commission costs to the direct policy writing agents even if those costs are paid indirectly to the agents by a third party through the use of levelized commission, or similar arrangement, which is in substance a funding arrangement. Having a third party pay commission costs to the selling agent is strong evidence of a potential funding arrangement which shall be recognized as a liability because the substance of the arrangement indicates that repayment is reasonable and probable, even if a contingency has been incorporated into the funding arrangement, until the underlying policy has been cancelled. A third-party structure cannot recharacterize (e.g. by referencing policy persistency) and delay recognition of liabilities for initial sales commission owed from the writing of policies regardless of how a third-party arrangement is structured with regards to the timing of payment from the insurer. The amount owed for full initial sales commission shall be recognized immediately as the writing of an insurance contract is the event that obligates the insurer, and such action shall occur consistently among insurers. As such, this recognition is required regardless if the insurer owes a selling agent directly or if a third-party has been contracted to provide payment to the selling agent.

### Effective Date and Transition

7. This statement is effective for years beginning January 1, 2001. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*. The nonsubstantive revisions adopted TBD date regarding levelized commission are to clarify the original intent of this statement and apply to existing contracts in effect on the date of adoption of the revisions .

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