Statutory Accounting Principles (E) Working Group

**Maintenance Agenda Submission Form**

**Form A**

## **Issue:** Surplus Notes – Enhanced Disclosures

**Check (applicable entity):**

 P/C Life Health

Modification of Existing SSAP [x]  [x]  [x]

New Issue or SSAP [ ]  [ ]  [ ]

Interpretation [ ]  [ ]  [ ]

Description of Issue:

Surplus notes are unique statutory accounting items which have the characteristics of both debt and equity addressed in *SSAP No. 41R—Surplus Notes*. Surplus notes are debt instruments that are required to be subordinated to policyholders, claimants and all other creditors; with interest and principal repayments requiring approval by the domiciliary commissioner. As such, surplus notes are reported as equity for statutory accounting purposes. (This treatment is specific to statutory accounting. Surplus notes are reported as debt under U.S. GAAP.) Pursuant to the requirements of SSAP No. 41R, proceeds received by the issuer of a surplus note must be in the form of cash or other admitted assets meeting both value and liquidity requirements of the state of domicile’s commissioner.

In conjunction with agenda item 2018-07, originally a referral from the Reinsurance (E) Task Force, the Statutory Accounting Principles (E) Working Group has been discussing surplus notes where an “associated” asset is received by the surplus note issuer. These discussions have questions whether a surplus note that does not result with an exchange of cash flows (as the cash flows of offset with an associated asset), shall be considered surplus notes under SSAP No. 41R. Although the discussion on how to treat these surplus notes will occur in agenda item 2018-07, the Working Group has directed that additional disclosures shall be captured in SSAP No. 41R. The intent of this agenda item is to consider new disclosures involving surplus notes to better identify these situations in the statutory financial statements.

Existing Authoritative Literature:

Authoritative guidance is detailed in *SSAP No. 41R—Surplus Notes.* Current guidance does not require disclosure if a surplus note has been issued with the structure as described where little or no actual cashflows are exchanged.

Current Surplus Note Disclosures under SSAP No 41R:

### Disclosures

1. The notes to the financial statements of a reporting entity that issues surplus notes shall disclose the following as long as the surplus notes are outstanding:
2. Date issued;
3. Description of the assets received;
4. Holder of the note or if public the names of the underwriter and trustee;
5. Amount of note;
6. Carrying value of note;
7. The rate at which interest accrues;
8. Maturity dates or repayment schedules, if stated;
9. Unapproved interest and/or principal;
10. Interest and/or principal paid in the current year;
11. Total interest and/or principal paid on surplus notes;
12. Subordination terms;
13. Liquidation preference to the reporting entity’s common and preferred shareholders;
14. The repayment conditions and restrictions.

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): Discussions on linked surplus notes is occurring within agenda item 2018-07. The Working Group directed NAIC staff to collect information via a data-call on “linked” surplus notes as of Sept. 30, 2019. This information is requested by Dec. 31, 2019. Improved disclosures on surplus notes in SSAP No. 41R will reduce the need for subsequent data-call collection.

**Information or issues (included in *Description of Issue*) not previously contemplated by the Working Group:**

None

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

Staff Recommendation:

NAIC staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to SSAP No. 41R to provide enhanced disclosures to identify when a surplus note has been issued in which anticipated or typical cashflows have been partially or fully offset through the terms of the asset provided by the note holder.

### Disclosures

1. The notes to the financial statements of a reporting entity that issues surplus notes shall disclose the following as long as the surplus notes are outstanding:
2. Date issued;
3. Description and fair value of the assets received;
4. Holder of the note or if public, the names of the underwriter and trustee, with identification on whether the holder of the surplus note is a related party per SSAP No. 25;
5. Original issue amount of note;
6. Carrying value of note;
7. The rate at which interest accrues;
8. Maturity dates or repayment schedules, if stated;
9. Unapproved interest and/or principal;
10. Life-to-date and current year approved interest and/or principal recognized as “paid” with identification of the amount of approved interest and/or principal remitted to the holder of the surplus note (actual transfer of cash / assets) and the amount of approved interest and/or principal not remitted to the holder of the surplus note (no transfer of cash / assets).
11. Information regarding a 3rd party liquidity source including name, identification if a related party, cost of the liquidity guarantee, and maximum amount available should a triggering event occur.
12. Subordination terms;
13. Liquidation preference to the reporting entity’s common and preferred shareholders;
14. The repayment conditions and restrictions.
15. If a reporting entity is not remitting actual cash or assets to the holder of the surplus note for approved interest or principal (as reported under paragraph 18.h), because the reporting entity is offsetting the amount owed under the surplus note with an amount receivable from a reported asset, the following information shall be disclosed regarding the offsetting asset:
16. Identification of asset, including the investment schedule where the asset is reported and reported NAIC designation.
17. Book/ adjusted carrying value of asset and interest income recognized in the current year.
18. Amount of principle return and interest income from the asset not received by the reporting entity as the amounts were offset with approved amounts owed by the reporting entity’s issued surplus note.
19. In addition to the above, a reporting entity shall identify all affiliates that hold any portion of a surplus debenture or similar obligation (including an offering registered under the Securities Act of 1933 or distributed pursuant to rule 144A under the Securities Act of 1933), and any holder of 10% or more of the outstanding amount of any surplus note registered under the Securities Act of 1933 or distributed pursuant to Rule 144A under the Securities Act of 1933.

Updates to the Blanks are proposed as a result of the SSAP No. 41R revisions. For readability and due to the amount of proposed changes, both the current and proposed Blanks revisions are detailed below.

Current Blanks Disclosures:

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| Date Issued | Interest Rate | Par Value (Face Amount of Notes) | Carrying Value of Note | Interest And / Or Principal Paid Current Year | Total Interest And / Or Principal Paid | Unapproved Interest And / Or Principal | Date of Maturity |
|  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |
| 1311999 Total |  |  |  |  |  | XXX |

Proposed Blanks Disclosures:

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Date Issued | Interest Rate | Original Issue Amount of Note | Fair Value of Assets Received Upon Issuance | Type of Assets Received Upon Issuance | Carrying Value of Note Prior Year | Carrying Value of Note Current Year | Unapproved Interest And / Or Principal | Approved Interested Recognized Current Year | Life-To-Date Interest Remitted (Actual Transfer of Cash/Assets)  | Life-To-Date Principal (Actual Transfer of Cash/Assets) Remitted  | Date of Maturity |
|  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |
| 1311999 Total |  |  |  |  |  |  |  |  |  | XXX |

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| Current Year Approved Interested Remitted (Actual Transfer of Cash/Assets)  | Current Year Approved Principal Remitted (Actual Transfer of Cash/Assets) | Current Year Approved Interest Not Remitted Since Issuance (No Transfer of Cash/Assets) \* | Current Year Approved Principal Not Remitted Since Issuance (No Transfer of Cash/Assets) \* | Is Non-Remitted Interest or Principal Offset with Amounts Owed from Surplus Note Holder? (Y/N) | Does Remitted Interest or Principal Payments Result with Acquisition of a Source of Liquidity Through the Surplus Note Holder? (Y/N) | Is Surplus Note Holder a Related Party (Y/N) |

*\* Include amounts offset with amounts owed from the holder of the surplus note.*

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| Name of 3rd Party Liquidity Source Acquired  | Is Liquidity Source a Related Party to the Surplus Note Issuer? | Current Year Total Cost of Liquidity Source | Current Year Cost of Liquidity Source Reported as Surplus Note Interest  | Total Cost of Liquidity Source Since Acquisition | Total Cost of Liquidity Source Reported as Surplus Note Interest Since Acquisition | Maximum Amount Surplus Note Issuer Can Receive from Liquidity Source |

**Staff Review Completed by: Jim Pinegar, October 2019**

**Status:**

On December 7, 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. 41—Surplus Notes* to provide enhanced disclosures to identify when an issued surplus note’s anticipated or typical cash flows have been partially or fully offset through an asset held by the surplus note issuer.

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