Statutory Accounting Principles (E) Working Group

**Maintenance Agenda Submission Form**

**Form A**

## **Issue:** Inclusion of Cash / Liquidity Pools - Cash Equivalents as defined in SSAP No. 2R.

**Check (applicable entity):**

 P/C Life Health

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

New Issue or SSAP [ ]  [ ]  [ ]

Interpretation [ ]  [ ]  [ ]

Description of Issue: **Cash pooling, also known as liquidity bundling or liquidity pools, is a special form of liquidity management in which groups combine resources in order to make a more efficient use of idle cash. A cash pool is typically a structure in which several entities’ cash accounts are aggregated for numerous purposes, including optimizing earned interest, accessing additional short-term investments markets, and improving liquidity management. The investment goal is to optimize financial results by increasing investment access and lower transaction costs that would be incurred by each individual pool participant.**

**Contributed cash is typically placed in short-term investments, which may not have been previously available to a single affiliated reporting entity that possesses a lower cash balance. Affiliates with lower cash balances can leverage the financial strength of other related affiliates in order to access certain markets that contain significant initial investment requirements. Additionally, by pooling resources and making fewer (and larger) investments, transaction costs are reduced, thus giving the participants a more efficient use of cash resources.**

**In general, pooling is restricted to groups in which several companies are organized under the management of a single corporate entity. Individual participating companies may be legally independent, however the group acts as a strategic unit, for the purposes of cash management.**

**Cash pooling structures are not a new market development; however, their potential uses and organizational structures can vary significantly. Under certain pool structures, positive cash balances of one member could cover the deficit cash balance of another member. In this type of structure, surplus funds are physically concentrated into a single account in order to maximize investment return while deficit accounts are covered by transfers from the cash pool. Within these structures, individual participants lose economic independence as the cash is managed centrally and may not be available to the extent desired by the participating entity. Pooling structures have also been formed for internal financing purposes as “sharing of cash” can be used to reduce reliance on external borrowing for short-term working capital needs, again potentially reducing the cash available by certain participants.**

**This agenda item recommends revisions to allow specific structures that strictly hold cash, cash equivalents and short-term investments and other certain criteria, but do not meet the current requirements for cash equivalent reporting, to be reported as cash equivalents under *SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments.***

Existing Authoritative Literature:

*SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments*

### Cash Equivalents

1. Cash equivalents are short-term, highly liquid investments that are both (a) readily convertible to known amounts of cash, and (b) so near their maturity that they present insignificant risk of changes in value because of changes in interest rates. Only investments with original maturities[[1]](#footnote-1) of three months or less qualify under this definition, with the exception of money market mutual funds, as detailed in paragraph 7. Regardless of maturity date, derivative instruments shall not be reported as cash equivalents and shall be reported as derivatives on Schedule DB. Securities with terms that are reset at predefined dates (e.g., an auction-rate security that has a long-term maturity and an interest rate that is regularly reset through a Dutch auction) or have other features an investor may believe results in a different term than the related contractual maturity shall be accounted for based on the contractual maturity at the date of acquisition, except where other specific rules within the statutory accounting framework currently exist.
2. Money market mutual funds registered under the Investment Company Act of 1940 and regulated under rule 2a-7 of the Act shall be accounted for and reported as cash equivalents for statutory accounting. Investments in money market mutual funds shall be valued at fair value or net asset value (NAV) as a practical expedient. For reporting entities required to maintain an asset valuation reserve (AVR), the accounting for unrealized capital gains and losses shall be in accordance with *SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve*. For reporting entities not required to maintain an AVR, unrealized capital gains and losses shall be recorded as a direct credit or charge to surplus. Sales/reinvestments in money market mutual funds are excluded from the wash sale disclosure in SSAP No. 103R.

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): A question regarding cash pools was raised under the proposed short-term rolling provisions captured in agenda item 2019-20. With this question, it was noted that cash pools are not specifically addressed in *SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments*. This agenda item proposes to incorporate specific guidance for these instruments. If revisions are adopted to clarify cash pools in scope of SSAP No. 2R, it is anticipated that revisions will also be proposed to exclude cash pools from the short-term rolling provisions, allowing qualifying cash pools to be continually reported as cash equivalents.

**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 Recommendation:

NAIC Staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to *SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments* to specify the types of cash pooling organization structures and the investments they are required to maintain in order to qualify as cash equivalents.

**NAIC staff is aware a circumstance where a Limited Liability Company was used as the primary structure for a Cash / Liquidity Pool. However, NAIC staff is not proposing changes to *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies* as the legal structure of such pools will vary. Comments are requested regarding the need for a Cash / Liquidity Pool reference in SSAP No. 48.**

*Proposed Revisions to SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments*

### Cash Equivalents

1. Cash equivalents are short-term, highly liquid investments that are both (a) readily convertible to known amounts of cash, and (b) so near their maturity that they present insignificant risk of changes in value because of changes in interest rates. Only investments with original maturities of three months or less qualify under this definition, with the exception of cash pools that meet the requirements of paragraph 8 and money market mutual funds described in paragraph 7. Regardless of maturity date, derivative instruments shall not be reported as cash equivalents and shall be reported as derivatives on Schedule DB. Securities with terms that are reset at predefined dates (e.g., an auction-rate security that has a long-term maturity and an interest rate that is regularly reset through a Dutch auction) or have other features an investor may believe results in a different term than the related contractual maturity shall be accounted for based on the contractual maturity at the date of acquisition, except where other specific rules within the statutory accounting framework currently exist.
2. Money market mutual funds registered under the Investment Company Act of 1940 and regulated under rule 2a-7 of the Act shall be accounted for and reported as cash equivalents for statutory accounting. Investments in money market mutual funds shall be valued at fair value or net asset value (NAV) as a practical expedient. For reporting entities required to maintain an asset valuation reserve (AVR), the accounting for unrealized capital gains and losses shall be in accordance with *SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve*. For reporting entities not required to maintain an AVR, unrealized capital gains and losses shall be recorded as a direct credit or charge to surplus. Sales/reinvestments in money market mutual funds are excluded from the wash sale disclosure in SSAP No. 103R.
3. Cash pooling is a technique, utilized by some companies under common control by which several entities’ cash accounts are aggregated for numerous purposes, including liquidity management, optimizing interest or investment returns and reducing investment or banking transaction fees. Cash pools can have numerous functions and structures, however only those that have obtained domiciliary regulator approval and meet the requirements may look through the ownership structure to report the assets held as cash equivalents.
	1. Members or participants in the pool are limited to affiliated entities as defined in SSAP No. 25.
	2. Investments held by the pool are limited to non-affiliated investments.
	3. The pool must permit each participant to withdraw, at any time, cash up to the amount it has contributed to the pool. Each participant must own an undivided interest in the underlying assets of the pool in proportion to the aggregate amount of cash contributed. All affiliates’ interests in the pool shall be of the same class, with equal rights, preferences and privileges. All membership interests shall be fully paid and non-assessable and shall have no preemptive, conversion or exchange rights. The liability of a participant’s debts and obligations of the pool shall be limited to the amount of its contributions and no participant shall be obligated to contribute money to the pool for any reason other than to participate in the pool’s investments. Additionally, participants shall not cover the debits or credits of another participant (commonly referred to as notional cash pooling).
	4. An audited U.S. GAAP annual report of the cash pool and schedules showing each affiliate’s prorated share of investments shall be provided annually to each participant as of December 31. The reporting entity shall determine if the investments would have qualified as cash, cash equivalents or short-term investments had the entity independently acquired the investments. To the extent the pool holds investments that do not meet the definition of cash, cash equivalents, short-term investments, or if the cash pool is not supported by an audited statement, the pool does not quality within scope of this statement.

### Disclosures

1. The following disclosures shall be made for short-term investments in the financial statements:
2. Fair values in accordance with *SSAP No. 100R—Fair Value*;
3. Concentrations of credit risk in accordance with *SSAP No. 27—Off-Balance-Sheet and Credit Risk Disclosures*;
4. Basis at which the short-term investments are stated.
5. The items in the scope of this statement are also subject to the annual audited disclosures in *SSAP No. 26R—Bonds*, paragraph 30.f.
6. The financial statements shall disclose the reporting entity’s share of the cash pool by asset type (cash, cash equivalents, or short-term investments).

For brevity, the remaining paragraphs of SSAP No. 2R have been omitted but will be renumbered accordingly.

Staff Review Completed by:

**NAIC Staff – Jim Pinegar, September 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, as illustrated above, to *SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments* to specify that cash pooling structures that meet specified criteria qualify as cash equivalents.

On March 18, 2020, the Statutory Accounting Principles (E) Working Group exposed this agenda item, with revisions to *SSAP No. 2R—Cash, Cash Equivalents, Drafts and Short-Term Investments*, as illustrated below, with revisions from the prior exposure shaded in gray, to reflect that certain cash / liquidity pools, meeting defined criteria, may be reported as cash, cash equivalents, or short-term investments. This item has a shortened comment period deadline ending May 1, 2020.

Cash Equivalents

1. Cash equivalents are short-term, highly liquid investments that are both (a) readily convertible to known amounts of cash, and (b) so near their maturity that they present insignificant risk of changes in value because of changes in interest rates. Only investments with original maturities of three months or less qualify under this definition, with the exception of cash pools that meet the requirements of paragraph 8 and money market mutual funds described in paragraph 7. Regardless of maturity date, derivative instruments shall not be reported as cash equivalents and shall be reported as derivatives on Schedule DB. Securities with terms that are reset at predefined dates (e.g., an auction-rate security that has a long-term maturity and an interest rate that is regularly reset through a Dutch auction) or have other features an investor may believe results in a different term than the related contractual maturity shall be accounted for based on the contractual maturity at the date of acquisition, except where other specific rules within the statutory accounting framework currently exist.
2. Money market mutual funds registered under the Investment Company Act of 1940 and regulated under rule 2a-7 of the Act shall be accounted for and reported as cash equivalents for statutory accounting. Investments in money market mutual funds shall be valued at fair value or net asset value (NAV) as a practical expedient. For reporting entities required to maintain an asset valuation reserve (AVR), the accounting for unrealized capital gains and losses shall be in accordance with *SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve*. For reporting entities not required to maintain an AVR, unrealized capital gains and losses shall be recorded as a direct credit or charge to surplus. Sales/reinvestments in money market mutual funds are excluded from the wash sale disclosure in SSAP No. 103R.
3. Cash pooling is a technique, utilized by some companies under common control by which several entities’ cash accounts are aggregated for numerous purposes, including liquidity management, optimizing interest or investment returns and reducing investment or banking transaction fees. Cash pools can have numerous functions and structures, however only those that have obtained domiciliary regulator approval and meet the requirements may look through the ownership structure to report the assets held as cash, cash equivalents, or short-term investments.
	1. Members or participants in the pool are limited to affiliated entities as defined in SSAP No. 25.
	2. Investments held by the pool are limited to non-affiliated investments.
	3. The pool must permit each participant to withdraw, at any time, cash up to the amount it has contributed to the pool. Each participant must own an undivided interest in the underlying assets of the pool in proportion to the aggregate amount of cash contributed. All affiliates’ interests in the pool shall be of the same class, with equal rights, preferences and privileges. All membership interests shall be fully paid and non-assessable and shall have no preemptive, conversion or exchange rights. The liability of a participant’s debts and obligations of the pool shall be limited to the amount of its contributions and no participant shall be obligated to contribute money to the pool for any reason other than to participate in the pool’s investments. Additionally, participants shall not cover the debits or credits of another participant (commonly referred to as notional cash pooling).
	4. A reporting entity shall receive an annual report from the pool manager, which identifies the participant’ investment (share) in the cash pool and the dollar value of its share of cash, cash equivalents and short-term investments. The reporting entity shall report their total balances in the cash pool on the schedule which represents a majority of the held assets (For example, a qualifying cash pool that contains 20% cash, 70% cash equivalents, and 10% short-term investments, the reporting entity would report their entire balance invested as a cash equivalent.) The reporting entity shall independently determine if the investments would have qualified as cash, cash equivalents or short-term investments had the entity independently acquired the investments. To the extent the pool holds investments that do not meet the definition of cash, cash equivalents, short-term investments, the pool does not quality within scope of this statement.
	5. Valuation of the assets in the pool shall remain consistent with the valuations required by reported asset type as stipulated in SSAP No. 2R.

### Disclosures

1. The following disclosures shall be made for short-term investments in the financial statements:
2. Fair values in accordance with *SSAP No. 100R—Fair Value*;
3. Concentrations of credit risk in accordance with *SSAP No. 27—Off-Balance-Sheet and Credit Risk Disclosures*;
4. Basis at which the short-term investments are stated.
5. The items in the scope of this statement are also subject to the annual audited disclosures in *SSAP No. 26R—Bonds*, paragraph 30.f.
6. The financial statements shall disclose the reporting entity’s share of the cash pool by asset type (cash, cash equivalents, or short-term investments).

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1. Original maturity means original maturity to the entity holding the investment. For example, both a three-month U.S. Treasury bill and a three-year Treasury note purchased three months from maturity qualify as cash equivalents. However, a Treasury note purchased three years ago does not become a cash equivalent when its remaining maturity is three months. [↑](#footnote-ref-1)