Statutory Accounting Principles (E) Working Group

**Maintenance Agenda Submission Form**

**Form A**

## **Issue: Updating the SCA Review Process**

**Check (applicable entity):**

 P/C Life Health

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

New Issue or SSAP [ ]  [ ]  [ ]

Interpretation [ ]  [ ]  [ ]

Description of Issue:

This agenda item has been drafted to update part of the SCA filing review process in *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*. In addition to these revisions, minor clarification revisions have also been proposed. In summary, the SCA filing review process begins when a filer submits an SCA filing in VISION and concludes when NAIC staff emails the filer and domiciliary state a review letter with its final approved value.

Current SCA Review Process

The SCA filing review process begins when a filer submits an SCA filing in VISION. NAIC staff will review the filing and verify the information claimed in the filing is validated with appropriate supporting documentation. After the filing has been reviewed and has been issued a completion code to initiate billing, the review has been finalized. Upon completion of the review, a file with the final validated information is available under the “Export State Information” in VISION. NAIC staff will open this and copy the final review information into a NAIC letter template for the relevant type of filing (i.e. Sub 1 filing, Sub 2 filing, Sub 2 Appeal filing, etc.). This letter is then saved, and the review process concludes when NAIC staff emails both the filer and domiciliary state regulator duplicate copies of the review letter. During calendar year 2019, NAIC staff reviewed over 825 filings, the creation of these review letters and correspondence to the both filers and regulators amounts to weeks’ worth of administrative work.

Proposed Updates

NAIC staff propose updating the SCA filing process by eliminating some of the manual steps in the process. VISION was designed to allow filers to have more control and access to their filing information, including the final review results. As such, filers should be responsible for pulling their own finalized review information from VISION, which will eliminate the need for NAIC staff to manually insert this information into a template and email it to them. NAIC staff will continue to export this information for regulators and will send them the review information in an email on a monthly basis. Regulators will benefit by receiving only one, monthly correspondence of all applicable SCA reviews – as opposed to a communication for every review.

Existing Authoritative Literature:

SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities

## EXHIBIT A – SCA REPORTING PROCESS

1. SCA entities, except for domestic SCA insurance company investments accounted for under paragraph 8.b.i, in which the reporting entity has an equity interest (common or preferred stock), are required to be filed with the NAIC. Nonadmitted assets are not required to be filed in a Sub 2 as long as they were nonadmitted, or had a zero value, for the full reporting period (all interim and annual reporting). Immaterial asset SCAs do not have an automatic exclusion from filing, as immaterially of an SCA will be ascertained by the state of domicile of the insurance reporting entity, but companies are allowed to request an exemption from the domiciliary state to not file an SCA on the basis that it is immaterial. The filing process does not include investments within the scope of SSAP No. 48*.*
2. Except for domestic SCA insurance company investments accounted for under paragraph 8.b.i, all SCA investments within the scope of this statement, purchased during any one calendar year, shall be reported to the NAIC on a Sub 1 form within 90 days of the acquisition or formation of the investment; this includes nonadmitted, zero-valued and immaterial SCAs. The NAIC will process that filing in the same year but will not at that time approve or disapprove a value for the SCA investment. By August 31 of the following year, the insurance company shall submit a Sub 2 filing for the previously purchased SCA investment reported on a Sub 1 form and later that year, the NAIC will approve a value for the transaction. For SCAs that routinely receive their audit reports after the August 31 deadline, a filing deadline of one month after the audit date shall be applied. The value approved by the NAIC at the conclusion of the Sub 2 form filing is reported by the insurance company on its financial statement blank. If the insurance company has reported a value for the SCA investment on its financial statement blank that differs from the value approved by the NAIC, the insurer is required to adjust the reported value in its next quarterly financial statement blank unless otherwise directed by the insurer's state of domicile.
3. Insurance companies shall use one of the valuation methods described in paragraph 8 to calculate the value of their investments in insurance and non-insurance SCA companies. An insurance company shall calculate the value of its investments in foreign insurance and all non-insurance company SCA entities and report the value to the NAIC no later than August 31, or one month after the audit report date for SCAs that routinely receive their audits after August 31 for existing SCA investments, and within 90 days of the acquisition or formation of a new SCA investment.

### Initial Reporting of SCA Investments

1. Reporting the acquisition or formation of a new investment is accomplished by submitting a completed Sub 1 form for each investment, disclosing (i) the valuation reported or to be reported by the insurance company on its latest or next quarterly financial statement blank, (ii) which method of those described in paragraph 8 was used to arrive at the valuation, (iii) the factual context of the transaction and (iv) economic and business motivations for the transaction. The submission will be processed by the NAIC only if the NAIC determines it has been provided with all material information with respect to all SCA companies of the reporting insurance company that require valuation.
2. The purpose of a Sub 1 filing is to determine whether the value claimed is reasonable. If the NAIC determines that the reported transaction meets the tests specified, it will complete the filing in the VISION database. If the NAIC determines that the transaction does not meet the tests specified, it shall not complete the filing in the VISION database and instead notify the reporting insurance company and the state of domicile in writing of its determination.

### Subsequent Reporting of SCA Investments

1. By August 31 or one month after the audit report date of the year following the acquisition or formation, and reporting of an SCA investment on the Sub 1 form, the insurance company shall submit a Sub 2 form filing, with all supporting documentation for foreign SCAs provided in English, for the same SCA investment. Additionally, by August 31 or one month after the audit report date of each year, any insurance company that has made a Sub 2 form filing in a previous year must update the information by filing an updated Sub 2 form filing.
2. Each year the NAIC shall compile a list of all SCA investments (excluding insurance company SCAs (paragraph 8.b.i.) nonadmitted and zero-value SCAs) reported as Sub 1 form filings for which a Sub 2 form filing has not yet been received. For these transactions, the NAIC will notify the responsible reporting insurance company and its state of domicile that it has not received a Sub 2 filing for the SCA investment.
3. The purpose of the Sub 2 filing is to determine whether the value calculated by the reporting insurance company for the SCA investment is appropriate and to approve that or some other value for reporting on the insurer's financial statement blank.
4. An insurance company that concludes an SCA transaction at year-end may be unable to file a Sub 1 form prior to the time it would be required to file a Sub 2 form. Where this is the case, the NAIC is authorized to accept and review a Sub 1 filing from such an insurance company and to accept and review the Sub 2 filing after the Sub 1 filing review has been completed.
5. No filing of an investment in a domestic SCA insurance company valued under paragraph 8.b.i. shall be required to be made with the NAIC.

### Consistency in Application of Chosen Valuation Method

1. The valuation method used for a specific SCA company shall be determined by the guidance in paragraph 8. If a reporting insurance company previously selected the Market Valuation Method and wished to change to an Equity Method (or vice versa), they may only do so with the approval of the domiciliary commissioner. Once the approval of the domiciliary commissioner has been obtained, the reporting insurance company shall provide the NAIC with evidence of that approval as part of the Sub 1 or Sub 2 filing.
2. For reporting insurance companies that use the Market Valuation Method, the reporting insurance company shall obtain the discount rate to be applied from the NAIC. The discounts identified in Exhibit E are minimum discounts. The NAIC calculation may result in discounts in market value higher than those shown in Exhibit E.

### Assessment and Review of Sub 1 Form

1. Upon receipt of the reporting insurance company's Sub 1 filing, the NAIC shall conduct an assessment in the following manner:
2. If the NAIC is aware of any broad regulatory concerns or issues affecting the reporting insurance company or the reported SCA investment, it shall determine whether such concerns or issues are relevant to valuation of the SCA investment. If so, the NAIC shall take such action as seems appropriate under the circumstances.
3. The NAIC shall ensure that the value reported by the insurance company on a Sub 1 form has been arrived at by application of one of the permitted valuation methods described in paragraph 8. If a reporting insurance company submits a Sub 1 form filing that reports a value calculated under an inappropriate method, the NAIC shall contact the insurer to resolve the discrepancy or it shall recalculate the value of the SCA investment under the most appropriate valuation method and notify the reporting insurance company of such action.
4. The NAIC shall review the factual, business and economic context of the transaction to determine whether (i) the SCA investment appears to be an arms-length business arrangement with a reasonable economic value to the reporting insurance company, (ii) the valuation method chosen is reasonable in view of the factual, business and economic context of the transaction, (iii) the transaction is reasonable in the context of all the known facts surrounding the insurance company and its operations and (iv) the value reported appropriately reflects economic value to the insurance company. The NAIC may consider other factors that appear relevant from the context of the transaction including:
5. The specific tax, accounting or other regulatory treatment sought.
6. Whether the transaction effects a legally effective, binding and permanent transfer of the risks and rewards of ownership.
7. The effect of the SCA valuation on the solvency of the insurer.
8. The degree of affiliation between the insurer and the party from whom such company was acquired, the form of the consideration (cash, property or the exchange of stock), evidence of ability to recover cost and whether the acquisition price represented the result of arms-length dealing between economic equals.
9. The right to dividends or other payments from the SCA and any limitations thereto.
10. The nature, extent and demonstrable financial value of the business operations of the SCA.
11. The value of the assets owned by the SCA.

If the NAIC determines that the transaction does not seem to present economic value to the insurance company, or that the transaction tends to obscure issues that might be relevant to an NAIC member or that the information provided is insufficient or unreliable as a basis upon which to make a determination, then the NAIC shall notify the reporting insurance company and the NAIC member of the reporting insurance company's state of domicile and request guidance.

1. The NAIC shall review whether the reporting insurance company has correctly applied the correct valuation guidance under paragraph 8 and made adjustments, if applicable, under paragraph 9.
2. If the SCA investment reported on the Sub 1 form filing is deemed to meet the assessment and reviews described in paragraph 62, the NAIC shall complete the filing in the VISION database. A completed filing will be a Sub 1 filing where the reported SCA investment meets the tests described above. The completed filing will be revised to a value if and when the filer submits a Sub 2 form on the same transaction and the NAIC approves a final value based on the information provided. (Assignment of completion to an SCA investment does not mean, and shall not be interpreted to mean, that the NAIC is expressing an opinion as to the value claimed by the reporting insurance company for the reported SCA investment. The completion implies only that, based on the information provided, the NAIC has determined that the SCA investment meets the tests described in paragraph 62.)

### Assessment and Review of Sub 2 Form

1. By August 31 or one month after the audit report date of each year, the NAIC shall initiate a review of all SCA investments for which new Sub 2 form filings have been received as well as an annual update review of Sub 2 SCA investments already logged in the VISION database. The NAIC review shall encompass a review of the most recent annual statutory reporting by the parent insurance company's Schedule Y (to ascertain the identity of the members of the holding company system and to ensure that information for all SCA companies has been submitted), a review of the parent's financial statement blank to review the last reported value for the SCA investments and a review of the VISION database to determine whether SCA debt and SCA preferred securities have been assigned NAIC designations. As part of its analysis, the NAIC shall review the portion of the bond investments carried by the parent or a subsidiary insurer with a Z notation. If the NAIC determines that the portion of the Z bonds shown on the documentation is significant, the NAIC shall not process the Sub 2 filing until the insurance company reports the bonds to permit removal of the Z notation. Beginning with year-end 2019, two new suffixes will apply: YE and IF. YE means that the security is a properly filed annual update that the SVO has determined will not be assigned an NAIC designation by the close of the year-end reporting cycle. The symbol YE is assigned by the SVO pursuant to the carryover administrative procedure described in Part One, Section 3 f) (iii) of the *Purposes and Procedures Manual of the NAIC Investment Analysis Office*. When the SVO assigns the symbol YE it also assigns the NAIC designation in effect for the previous reporting year. IF means that the security is an initial filing that has been properly filed with the SVO but which the SVO has determined will not be assigned an NAIC designation by the close of the year-end reporting cycle. The symbol IF is assigned by the SVO and communicates that the insurer should self-designate the security for year-end and identify it with the symbol IF. IF, therefore, also communicates to the regulator that the NAIC designation reported by the insurance company was not derived by or obtained from the SVO, but has been determined analytically by a reporting insurance company.
2. Upon completion of the procedures described above, the NAIC will determine whether the value reported by the insurance company on the current SCA filing was calculated in accordance with the instructions for the valuation method chosen and verify that the filed value reflects the adjustments required by paragraph 9.
3. Upon approval of a value (including making necessary adjustments), the NAIC will complete the Sub 2 filing with the approved value in the status field of the VISION database.
4. The NAIC shall report its determination to the insurance company. If a significant discrepancy exists between the value claimed by the reporting insurance company and the value approved by the NAIC, the NAIC shall communicate the discrepancy with the company. If the NAIC cannot come to a conclusion based on the support provided, the filing can be rejected in VISION, and written notification will be provided to the reporting insurance company and the company's state of domicile of this action.

### Additional Reporting Instructions

1. A reporting entity that has direct ownership of shares of an upstream intermediate or ultimate parent owns an interest in itself and is required to reduce the value of those shares from the value of the reporting entity. This is referred to as elimination of reciprocal ownership.
2. If the shares of the parent are owned indirectly by a reporting entity, for example, because the reporting entity owns a downstream SCA entity that directly owns shares in the parent, the entity that owns the parent’s shares must reduce its value by the value of the shares in the parent. This is referred to as elimination of the reciprocal ownership.
3. Any parent reporting entity that owns an interest in itself via either direct or indirect ownership of a down-stream affiliate, which in turn owns shares of the parent reporting entity, shall eliminate its proportionate interest in these shares from the valuation of such affiliate.
4. Pursuant to paragraph 22, in lieu of separate GAAP audits of SCA entities of the downstream holding company, the insurer can choose to have a GAAP audit performed at the holding company level with a consolidating balance sheet showing GAAP equity of all the SCA entities. The consolidating balance sheet shall then be adjusted for GAAP to SAP differences of the insurance entities as described in this statement. This adjusted amount would then be the reported value of the investment in downstream holding company at the higher-level insurance company.

Investments in the surplus notes of an SCA shall be accounted for in accordance with the provisions of SSAP No. 41R. If the reporting entity also holds an investment in preferred stock or surplus notes, refer to paragraphs 28-32 of this statement.

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): N/A**

Staff Recommendation:

Staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities* to provide clarification updates to the SCA review process. Revisions to the “Updating SCA Review Process – Sub 1 filing” and “Updating SCA Review Process – Sub 2 filing” procedural documents update parts of the SCA filing process.

Proposed Revisions:

*Due to the length of Exhibit A, only paragraphs with proposed revisions have been copied below.*

SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities

## EXHIBIT A – SCA REPORTING PROCESS

1. SCA entities, except for domestic SCA insurance company investments accounted for under paragraph 8.b.i, in which the reporting entity has an equity interest (common or preferred stock), are required to be filed with the NAIC. Nonadmitted assets are not required to be filed in a Sub 2 as long as they were nonadmitted, or had a zero value, for the full reporting period (all interim and annual reporting). Immaterial asset SCAs do not have an automatic exclusion from filing, as immateriality of an SCA will be ascertained by the state of domicile of the insurance reporting entity, but companies are allowed to request an exemption from the domiciliary state to not file an SCA on the basis that it is immaterial. The filing process does not include investments within the scope of SSAP No. 48*.*
2. Except for domestic SCA insurance company investments accounted for under paragraph 8.b.i, all SCA investments within the scope of this statement, purchased during any one calendar year, shall be reported to the NAIC on a Sub 1 form within 90 days of the acquisition or formation of the investment; this includes nonadmitted, zero-valued and immaterial SCAs. The NAIC will process that filing in the same year but will not at that time approve or disapprove a value for the SCA investment. By August 31 of each year, the insurance company shall submit a Sub 2 filing for the previously purchased SCA investment reported on a Sub 1 form and later that year, the NAIC will approve a value for the transaction. For SCAs that routinely receive their audit reports after the August 31 deadline, a filing deadline of one month after the audit date shall be applied. Filers must provide previous years’ audit reports to verify an audit report dated after August 31 in order to not be charged a late fee for a Sub 2 filing that is filed after the August 31 deadline. The value approved by the NAIC at the conclusion of the Sub 2 form filing is reported by the insurance company on its financial statement blank. If the insurance company has reported a value for the SCA investment on its financial statement blank that differs from the value approved by the NAIC, the insurer is required to adjust the reported value in its next quarterly financial statement blank unless otherwise directed by the insurer's state of domicile.
3. The purpose of a Sub 1 filing is to gather basic information about the SCA. If the NAIC determines that the reported transaction meets the tests specified, it will complete the filing in the VISION database. If the NAIC determines that the transaction does not meet the tests specified, it shall not complete the filing in the VISION database and instead notifies the reporting insurance company and the state of domicile in writing of its determination.

### Subsequent Reporting of SCA Investments

1. By August 31 or one month after the audit report date of each year, and subsequent to the reporting of an SCA investment on the Sub 1 form, the insurance company shall submit a Sub 2 form filing, with all supporting documentation for foreign SCAs provided in English, for the same SCA investment. Additionally, by August 31 or one month after the audit report date of each year, any insurance company that has made a Sub 2 form filing in a previous year must update the information by filing an updated Sub 2 form filing.
2. The NAIC shall report its determination to the insurance company. If a significant discrepancy exists between the value claimed by the reporting insurance company and the value approved by the NAIC, the NAIC shall communicate the discrepancy with the company. If the NAIC cannot come to a conclusion based on the support provided, the filing can be rejected in VISION, and written notification will be provided to the reporting insurance company and the company's state of domicile of this action. This correspondence will be sent to the domiciliary state. Filers are able to download their review information from the NAIC filing system.

Staff Review Completed by:

**Fatima Sediqzad - NAIC Staff**

**April 2020**

**Status:**

On July 30, 2020, the Statutory Accounting Principles (E) Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*, as shown above, to provide updated descriptive language regarding SCA reviews. Additionally, this agenda item proposes a more streamlined method for communicating SCA review results.

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