Statutory Accounting Principles (E) Working Group

**Maintenance Agenda Submission Form**

**Form A**

## **Issue:** Clarification Edits - Mortgage Loan Participations

**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 propose clarification edits to the statutory accounting guidance for a participation in mortgage loans. In summary, questions have been raised regarding the scope of “financial rights and obligations” that a reporting entity lender should possess via a participation agreement and if these extend beyond the right to receive contractual cash flows. Specifically, whether these rights should include items beyond the attachment to cash flows, such as the ability to independently take legal action against the borrower, participate with other lenders in determining whether legal action should be taken, or under normal circumstances, communicate directly with borrower.

As historical info:

* In agenda item 2016-39, guidance was adopted to clarify the types of investments in scope of SSAP *No. 37—Mortgage Loans*, and confirmed that a reporting entity mortgage loan lending arrangements via a participation agreement and co-lending arrangements (e.g., single mortgage with more than one lender) are in scope of SSAP No. 37. With these structures, the insurer would acquire the mortgage loan via an assignment, syndication or participation agreement between the selling (originating) lender and any co-lenders. This guidance identified that reporting entity lenders through a participation agreement or co-lending situation shall have financial rights and obligations that are similar to those in the direct loan. This action resulted with the following footnote in SSAP No. 37:

Reporting entity has a “participation agreement” to invest in mortgages issued by another entity. Although the reporting entity is not named on the original mortgage loan agreement, the original issuer sells a portion of the mortgage loan to an incoming participant lender (co-lender) and the sale is documented by an assignment or participation agreement between the selling lender and the co-lender. With these agreements, the co-lender acquires an undivided participation interest in the loan and will receive direct interest in the amount of their participation in the right to repayment of the loan and the collateral given to secure the loan. The financial rights and obligations of the lenders in these agreements shall be similar to those in a direct loan.

* In agenda item 2018-22, guidance was adopted to clarify the provisions of reporting entity lenders through participation agreements. (This guidance was captured in this agenda item per a regulator request). These revisions further expanded the “participation agreement” footnote provisions, but the provisions for financial rights and obligations was retained. Revised SSAP No. 37 footnote:

Reporting entity has a “participation agreement” to invest in a single mortgage loan. The reporting entity is not the lender or record named as a payee on the mortgage loan, but the lender of record sells a portion of the mortgage loan to the reporting entity through an assignment or participation interest under the participation agreement. Under a participation agreement, the reporting entity acquires an undivided interest in the single mortgage loan proceeds to be received by the lender of record. Under a participation agreement, single mortgage loan proceeds include the periodic mortgage loan principal and interest payments received by the lender of record, and all rights and proceeds received in the foreclosure of a mortgage, deed of trust, deed in lieu of foreclosure, or other similar proceeding by the lender of record. The amount of the proceeds to be received by the reporting entity is based on the ratio of its participation interest to the then-outstanding single mortgage loan balance. To qualify as a mortgage loan under the scope of this statement, the reporting entity must have a signed participation agreement with the lender of record named in the mortgage loan, the financial rights and obligations of the reporting entity under the participation agreement are the same as the lender of record, the reporting entity’s participation interest in the single mortgage loan proceeds must be pari-passu with the lender of record named on the mortgage loan agreement, and the participation agreement must be properly and promptly recorded on the lender or record’s books and records.

NAIC staff believes that the reference to“rights and obligations” generally reflects the participant’s right to be paid when the borrower pays. As the participant’s relationship is generally with the original lender, they typically cannot sue the borrower, institute foreclosure independent of the other lenders, or under normal circumstances, communicate directly with the borrower.

State regulators have noted mortgage participation agreements which do not provide loan participants the same rights to pursue legal action as the lender of record. Rather, the participants possess equal rights to proceeds – regardless if received in the normal course of business or through legal proceedings. NAIC staff has received questions regarding if the inability to independently pursue legal recourse diminishes the rights of the participant to such a level that it is not on the pari-passu footing of the original lender as required by SSAP No. 37.

NAIC staff believe that if SSAP No. 37 were to require a participant to have the ability to independently pursue legal action against the obligor (separately from the direct lender), or require the ability to communicate directly with the borrower (under normal circumstances), most participation agreements would not qualify within scope of SSAP No. 37. (NAIC SVO staff has also indicated that a participant’s legal relationship is only with the original lender and the participant’s ability to operate independent of the original lender is not a common business practice.) It is anticipated that the provisions of the SSAP footnote guidance were intended to ensure that the reporting entity lender had the rights to foreclosure proceeds via their participation agreement, but it was not anticipated that the reporting entity lender would be able to separately engage in foreclosure actions outside of the direct lender (and other participants) via the provisions of their participation agreement.

This agenda item intends to clarify the provisions to ensure consistency in practice. As NAIC staff believes the intent was to include participation mortgages in scope of SSAP No. 37, the proposed edits have clarified that direct communication and unilateral ability to foreclose are not required elements in the reference for “financial rights and obligations.” However, comments are requested as to whether these provisions were anticipated to be required. If these provisions were intended, all mortgage loan participations that do not provide this capability would be scoped out of SSAP No. 37 and would need to be captured on Schedule BA.

Existing Authoritative Literature:

SSAP No. 37 defines participating mortgages that are in scope. Applicable guidance has been bolded for emphasis.

SUMMARY CONCLUSION

2. A mortgage loan is defined as a debt obligation that is not a security, which is secured by a mortgage on real estate. In addition to mortgage loans directly originated, a mortgage loan also includes mortgage loans acquired or obtained through assignment, syndication or participation (footnote 1). Investments that reflect “participating mortgages,” “mortgage loan fund,” “bundled mortgage loans” or the “securitization of assets” are not considered mortgage loans within scope of this SSAP.

1. A security is a share, participation, or other interest in property or in an entity of the issuer or an obligation of the issuer that has all of the following characteristics:

i. It is either represented by an instrument issued in bearer or registered form, or if not represented by an instrument, is registered in books maintained to record transfers by or on behalf of the issuer.

ii. It is of a type commonly dealt in on securities exchanges or markets or, when represented by an instrument, is commonly recognized in any area in which it is issued or dealt in as a medium for investment.

iii. It either is one of a class or series or by its terms is divisible into a class or series of shares, participations, interests, or obligations.

Footnote 1 -Examples of agreements intended to be captured within this statement:

1. Reporting entity is a “co-lender” in a single mortgage loan agreement that identifies more than one lender (which includes the reporting entity) with the real estate collateral securing all lenders identified in the agreement. For these single-mortgage loan agreements, each lender is incorporated directly into the loan documents. The key differentiating characteristic of a mortgage loan provided under a group “mortgage loan co-lending agreement” rather than a solely owned mortgage loan is that no one lender of the lending group may unilaterally foreclose on the mortgage. With these agreements, the lenders must foreclose on the mortgage loan as a group.
2. Reporting entity has a “participation agreement” to invest in a single-mortgage loan. The reporting entity is not the lender of record named as a payee on the mortgage loan, but the lender of record sells a portion of the mortgage loan to the reporting entity through an assignment or participation interest under the participation agreement. **Under a participation agreement, the reporting entity acquires an undivided interest in the single mortgage loan proceeds to be received by the lender of record. Under a participation agreement, single mortgage loan proceeds include the periodic mortgage loan principal and interest payments received by the lender of record, and all rights and proceeds received in the foreclosure of a mortgage, deed of trust, deed in lieu of foreclosure, or other similar proceeding by the lender of record.** The amount of the proceeds to be received by the reporting entity is based on the ratio of its participation interest to the then-outstanding single mortgage loan balance. **To qualify as a mortgage loan under the scope of this statement, the reporting entity must have a signed participation agreement with the lender of record named in the mortgage loan, the financial rights and obligations of the reporting entity under the participation agreement are the same as the lender of record, the reporting entity’s participation interest in the single mortgage loan proceeds must be pari-passu with the lender of record named on the mortgage loan agreement, and the participation agreement must be properly and promptly recorded on the lender or record’s books and records.**

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):

The historical information is included in the summary of issue.

**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 clarify the requirements for participation loans in *SSAP No. 37—Mortgage Loans*. Revisions clarify that a participant’s financial rights may include the right to take legal action against the borrower (or participate in the determination of legal action), but do not require that the participant have the right to solely initiate legal action, foreclosure, or under normal circumstances, require the ability to communicate directly with the borrower.

SUMMARY CONCLUSION

2. A mortgage loan is defined as a debt obligation that is not a security, which is secured by a mortgage on real estate. In addition to mortgage loans directly originated, a mortgage loan also includes mortgage loans acquired or obtained through assignment, syndication or participation (footnote 1). Investments that reflect “participating mortgages,” “mortgage loan fund,” “bundled mortgage loans” or the “securitization of assets” are not considered mortgage loans within scope of this SSAP.

1. A security is a share, participation, or other interest in property or in an entity of the issuer or an obligation of the issuer that has all of the following characteristics:

i. It is either represented by an instrument issued in bearer or registered form, or if not represented by an instrument, is registered in books maintained to record transfers by or on behalf of the issuer.

ii. It is of a type commonly dealt in on securities exchanges or markets or, when represented by an instrument, is commonly recognized in any area in which it is issued or dealt in as a medium for investment.

iii. It either is one of a class or series or by its terms is divisible into a class or series of shares, participations, interests, or obligations.

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Staff Review Completed by: Jim Pinegar, 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. 37—Mortgage Loans*, as shown above, to clarify that a participant’s financial rights may include the right to take legal action against the borrower (or participate in the determination of legal action), but do not require that the participant have the right to solely initiate legal action, foreclosure, or under normal circumstances, require the ability to communicate directly with the borrower.

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