Statutory Accounting Principles (E) Working Group

**Maintenance Agenda Submission Form**

**Form A**

## **Issue:** Accounting and Reporting of Credit Tenant Loans

**Check (applicable entity):**

P/C Life Health

Modification of Existing SSAP

New Issue or SSAP

Interpretation

Description of Issue:

This agenda item intends to clarify the reporting of credit tenant loans (CTL) for statutory accounting. Although this is an investment (that if meeting certain criteria) may have been historically captured in *SSAP No. 43R—Loan-Backed and Structured Securities*, due to recent discussions at the Valuation of Securities (E) Task Force, in order to provide timely guidance, it was identified that this issue needs to considered separately outside of the substantive SSAP No. 43R project. As the SSAP No. 43R project is a substantive assessment, with various aspects being considered, it is noted that the conclusion of that project may extend beyond the timeframe for which clarity on CTLs is needed.

This agenda item focuses on credit tenant loans. There are other variations of similar investments that should also be specifically named / addressed in the AP&P Manual. These include ground lease financings as well as other lease-backed (non-ABS) securities. NAIC staff recommends that the Working Group first consider CTLs, with separate subsequent consideration of other structures.

Pursuant to guidance in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office*:

Mortgage loans that are made primarily in reliance on the credit standing of a major tenant, structured with an assignment of the rental payments to the lender with real property pledged as collateral in the form of a first lien, are referred to as a Credit Tenant Loan. *(Staff Note – This overall definition also matches the NAIC Model 280: Investments of Insurers Model Act (Defined Limits Version).*

**Credit Tenant Loan (CTL)** – A CTL is a mortgage loan made primarily in reliance on the credit standing of a major tenant, structured with an assignment of the rental payments to the lender with real property pledged as collateral in the form of a first lien. This Manual identifies four categories of CTLs as eligible for reporting on Schedule D conditioned on an SVO determination that the transaction meets the criteria specified by the VOS/TF for Schedule D treatment. A transaction that purports to be a Credit Tenant Loan, including one that is assigned a credit rating by an NAIC CRP, is not eligible for Schedule D reporting unless the SVO confirms that the transaction is eligible for Schedule D reporting and assigns the transaction an NAIC Designation.

It has been long-standing practice for CTLs to be filed with the NAIC SVO for review and assessment. If the SVO identified that the CTL qualifies under the SVO’s legal and structural analysis (which reflects bond characteristics) and meets certain other criteria (such as minimal residual real-estate risk), then it has been granted special treatment and reported in scope of SSAP No. 43R on schedule D. If the CTL did not qualify under the SVO provisions or if it was not filed with the SVO, it would not qualify to be reported as a bond. These CTLs are often referred to as “non-conforming CTLs.” It has been presumed that a non-conforming CTL would be considered a mortgage loan and reported in scope of *SSAP No. 37—Mortgage Loans.*

The Valuation of Securities (E) Task Force has recently been discussing CTLs as it was identified that CTLs that were not submitted to the SVO and/or did not qualify under the SVO’s structural and legal analysis were being reported on Schedule D with filing exempt designations. Although this identification resulted with discussion at the Task Force on the existing process, it was also noted that the overall statutory accounting guidance is not clear. The following elements have been identified as potential accounting and reporting issues:

1. There is no clear guidance in the *Accounting Practices & Procedures Manual* that SVO-identified conforming CTLs are in scope of SSAP No. 43R. It is noted that the CTL structure does not qualify within the SSAP No. 43R definition of a loan-backed and structured security (LBSS), and all that is currently included in SSAP No. 43R is a generic reference to “credit-tenant loans” as an example of an “all other” loan-backed and structured security. This reference is in paragraph 27.b of SSAP No. 43 in the section that addresses “designation guidance.”
2. It is presumed that non-SVO-identified CTLs would have historically been reported as mortgage loans. However, SSAP No. 37 explicitly excludes “securities” from the scope of the standard. Due to the structure of CTLs, and as they have CUSIPs, there is a question whether they are a “security” which would then specifically exclude CTL’s from the mortgage loan guidance.
3. It has been identified that if non-conforming CTLs are reported as mortgage loans, the RBC calculation may be considered punitive for these specific designs. This is because the assessment of a CTL is based on the credit quality of the major tenant, whereas the RBC calculation factors for mortgage loans is a loan-to-value (LTV) assessment. As the RBC calculation does not have an alternative process for CTL structures, under the LTV process, these loans receive high RBC charges.
4. If the non-conforming CTLs are not reported on schedule D and not reported as mortgage loans, they would be captured on Schedule BA – Other Long-Term Invested Assets. Although there are certain classes of assets that could be reported with NAIC designations on Schedule BA, assets with underlying characteristics of mortgage loans do not currently have this capability. As such, if reported under this Schedule BA category under current provisions, these items would receive a 20% RBC for property/casualty and health filers and would receive a 30% charge for life filers. Even if provisions were incorporated to permit NAIC designations for this class of asset (or direct reporting within a different reporting line), this would only allow life insurers to receive a reduction in RBC. There would be no benefit for property/casualty and health filers under existing RBC provisions.

In order to fully assess the proper accounting and reporting, this agenda item presents the following key characteristics of CTLs:

* A CTL generally is long-term in nature in comparison to a commercial mortgage. So, whereas a commercial mortgage loan may be between 5-10 years, a CTL could be between 15-40 years of fixed payments that correspond to the term of the lease and the loan.
* The CTL is structured based on the credit-quality of the corporate tenant which is obligated to pay rent regardless of property casualty, condemnation or obsolescence and to pay all expenses associated with the property, such as taxes, maintenance and utilities. The investment, however, is secured with collateral through a mortgage on the property. With this structure, the reporting entity receives a steady cash flow stream with the additional protection of real estate collateral.
* Conforming CTLs are generally structured to be fully amortized over the term of the loan and lease; however, they are illiquid investments. This principal amortizing component is a key element of the requirements in determining whether a CTL meets the SVO requirements in support of bond classification / NAIC designation. (Technically, if the structure is not substantively amortized over the term, then it is not a Schedule D eligible CTL, per the P&P Manual. However, the phrase “non-conforming CTL” is used to describe the general structure of the transaction.) To provide simple examples (ignoring investment returns or interest payments):
  + Example 1: If a CTL investment reflected $1,500,000, with the investor receiving $100,000 in annual cash payments over a 15-year lease/loan term, at conclusion of the investment, the principal balance would have been returned to the investor. Although the underlying property would have been provided as collateral as part of the CTL agreement, with the structure of the investment, there is little risk that the property would be transferred to the reporting entity at maturity to satisfy a remaining principal amount due. This is referred to as “residual risk.” The SVO parameters permit a slight amount of residual risk (e.g., 5%) in conforming CTLs. If the investment retains a greater amount of residual risk, then additional mitigation elements must be included in the structure for an SVO “conforming CTL” designation.
  + Example 2: If a CTL investment reflected $1,500,000, with the investor receiving $600,000 in annual cash payments over a 15-year lease/loan term, at conclusion of the investment, the reporting entity investor would be due $900,000. If the structure was not renewed or refinanced with the tenant (or a new tenant), then the reporting entity investor would receive ownership of the building in lieu of the remaining principal amount owed. The reporting entity investor would then have to sell the building to recoup their investment. This structure reflects a level of residual risk that has been historically deemed unacceptable for bond reporting under the SVO parameters. Rather, this structure has been historically considered to reflect a mortgage loan at inception, with reclassification as real estate if the reporting entity received the property at the conclusion of the investment maturity.

The focus of this agenda item is to inquire whether the conforming CTLs (such as example 1) should be captured in scope of SSAP No. 43R or whether these investments should be captured in *SSAP No. 21R—Other Admitted Assets*. This agenda item is not proposing that structures that do not conform to current requirements (such as example 2) be considered in scope of SSAP No. 43R. This agenda item also inquires whether structures that are not conforming CTLs (such as example 2) should be reported as mortgage loans or whether these structures should be captured in SSAP No. 21R. This agenda item is not proposing to reconsider the existing SVO guidelines in determining whether a CTL is “conforming” and in determining what is considered to be a suitable amount of “residual risk.” If there is a desire to reassess these provisions, NAIC staff would recommend a separate project with the Task Force, after concluding on desired reporting location and governing SSAP, to review these parameters.

Although it is understood that historical practice has permitted certain SVO verified CTLs that meet legal and structural analyses to be reported on Schedule D, there is a question whether these investments reflect bonds or securitized assets that should be included on the bond schedule. If preferred by the Working Group, revisions can be considered to remove these items from potential Schedule D reporting and instead capture these investments in scope of SSAP No. 21R. Some elements to consider in determining whether SSAP No. 21R would be more appropriate:

* If captured in scope of SSAP No. 21R, all CTLs will be reported in the same schedule, regardless of whether they are considered “conforming” or “non-conforming” CTLs. (In other words, the same reporting schedule would occur regardless of the NAIC SVO assessment.) This reporting process would likely result with improved identification and assessment of CTL investments in the financial statements. Under the current process, since CTLs are bifurcated across reporting schedules, it is not possible to identify the full extent an insurer is invested in CTLs (regardless if confirming or non-conforming).
* If captured in scope of SSAP No. 21R, CTLs could still be filed with the NAIC SVO for the legal and structural analysis and, if qualifying, to obtain an NAIC designation. For these “conforming” CTLs, revisions could be incorporated to permit the NAIC designation to be reported on Schedule BA. This NAIC designation could be used by life insurers to obtain an improved RBC designation. (Although the improved RBC is not an option under the current RBC formula for non-life entities, from information gathered, most CTL holders are life insurers.)
* Reporting CTLs in scope of SSAP No. 21R would be consistent with previous decisions of the SAPWG to not report non-bond items as bonds simply for RBC purposes. It would also be consistent with the policy statement that obtaining an NAIC designation does not direct statutory accounting or reporting. Pursuant to this policy statement, obtaining an NAIC designation does not change an investment’s applicable SSAP, annual or quarterly reporting schedule or override other SSAP guidance required for the investment to be an admitted asset. This policy statement does identify that there are limited situations in which an SVO-listing could be used for classification purposes that focuses on the underlying structure of the investment. If conforming CTL investments are retained in SSAP No. 43R (and not moved to SSAP No. 21R), it would be recommended that CTLs that meet the SVO structural analysis be captured on a listing that could be referred to in the scope section of SSAP No. 43R. It is noted that the recent issues involving non-conforming CTLs seem to originate from an interpretation that obtaining a CRP rating would allow entities to report these structures as bonds on Schedule D through the filing exemption process. This assessment is incorrect under existing statutory accounting guidance and the existing policy statement.
* Reporting CTLs in scope of SSAP No. 21R would seemingly be consistent with the decision made for structured settlements in 2018. Although structured settlements and CTLs are vastly different investments, they both represent an investment, that is not a bond, but reflects an investment in a cash flow stream that is subject to the underlying credit quality of the payer.

On May 29, 2020, the Valuation of Securities (E) Task Force submitted a referral to the Working Group to permit non-conforming CTLs that receive an NAIC designation from the SVO to be considered in scope of SSAP No. 43R. Excerpts of this referral have been provided below:

The Task Force is referring this memo and proposed amendment to the Statutory Accounting Principles (E) Working Group and **requesting the Working Group affirm that they would consider these Non-conforming CTLs to have the characteristics of a bond if assigned an NAIC Designation by the SVO staff**. Like the referral from earlier this year on GLFs, these Non-conforming Credit Tennant Loan (CTL) Transactions have historically been reported under the Accounting Practices & Procedures Manual’s SSAP No. 43R – Loan-Backed and Structured Securities under Paragraph 27, b as a type of CTL. The SVO staff recommends affirming that treatment only if the SVO staff can assign an NAIC Designation.

The edits noted in the Task Force referral are revisions to the *Purposes and Procedures Manual* (P&P) to affirm the Task Force’s role in making all decisions on the use of CRP ratings and provides guidance to insurance company filers on what to do if they are uncertain about the filing procedure for a particular security or class of securities.

NAIC staff highlights that it would be inconsistent with the *Policy Statement on Coordination of the AP&P Manual and the P&P Manual of the NAIC IAO* to permit CTLs to be classified as a bond simply in accordance with an NAIC designation / CRP rating. However, the provisions in the Policy Statement does identify that such classifications can occur based on an SVO structural assessment of an investment. NAIC SAPWG staff has confirmed with the SVO staff that the review and assignment of an NAIC designation for CTLs requires a structural assessment, and they only receive an NAIC designation if the CTL possess bond characteristics.

Existing Authoritative Literature:

*SSAP No. 37—Mortgage Loans*

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[[1]](#footnote-1). Investments that reflect “participating mortgages,” “mortgage loan fund,” “bundled mortgage loans[[2]](#footnote-2)” 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.

*SSAP No. 43R—Loan-Backed and Structured Securities*

*(Excerpts from scope guidance)*

1. Loan-backed securities are defined as securitized assets not included in structured securities, as defined below, for which the payment of interest and/or principal is directly proportional to the payments received by the issuer from the underlying assets, including but not limited to pass-through securities, lease-backed securities, and equipment trust certificates.
2. Structured securities are defined as loan-backed securities which have been divided into two or more classes for which the payment of interest and/or principal of any class of securities has been allocated in a manner which is not proportional to payments received by the issuer from the underlying assets.
3. Loan-backed securities are issued by special-purpose corporations or trusts (issuer) established by a sponsoring organization. The assets securing the loan-backed obligation are acquired by the issuer and pledged to an independent trustee until the issuer’s obligation has been fully satisfied. The investor only has direct recourse to the issuer’s assets, but may have secondary recourse to third parties through insurance or guarantee for repayment of the obligation. As a result, the sponsor and its other affiliates may have no financial obligation under the instrument, although one of those entities may retain the responsibility for servicing the underlying assets. Some sponsors do guarantee the performance of the underlying assets.
   1. In determining whether a loan-backed structure is a related party investment, consideration shall be given to the substance of the transaction, and the parties whose action or performance materially impacts the insurance reporting entity holding the security. For example, although a loan-backed security may be acquired from a non-related issuer, if the assets held in trust predominantly[[3]](#footnote-3) reflect assets issued by affiliates of the insurance reporting entity, and the insurance reporting entity only has direct recourse to the assets held in trust, the transaction shall be considered an affiliated investment, and the transaction shall also subject to the accounting and reporting provisions in *SSAP No. 25—Affiliates and Other Related Parties*.
4. Mortgage-referenced securities do not meet the definition of a loan-backed or structured security but are explicitly captured in scope of this statement. In order to qualify as a mortgage-referenced security, the security must be issued by a government sponsored enterprise[[4]](#footnote-4) in the form of a “credit risk transfer” in which the issued security is tied to a referenced pool of mortgages. These securities do not qualify as “loan-backed securities” as the pool of mortgages are not held in trust and the amounts due under the investment are not backed or secured by the mortgage loans. Rather, these items reflect instruments in which the payments received are linked to the credit and principal payment risk of the underlying mortgage loan borrowers captured in the referenced pool of mortgages. For these instruments, reporting entity holders may not receive a return of their full principal as principal repayment is contingent on repayment by the mortgage loan borrowers in the referenced pool of mortgages. Unless specifically noted, the provisions for loan-backed securities within this standard apply to mortgage-referenced securities.
5. Investments within the scope of this statement are also subject to the provisions and disclosure requirements of SSAP No. 25 if the SSAP No. 43R transaction is a related party arrangement[[5]](#footnote-5). Loan-backed and structured securities meet the definition of assets as defined in SSAP No. 4—Assets and Nonadmitted Assets and are admitted assets to the extent they conform to the requirements of this statement and SSAP No. 25.
6. The scope of this statement encompasses all types of loan-backed and structured securities, including, but not limited to, the following:
7. Loan-backed and structured securities acquired at origination,
8. Loan-backed and structured securities acquired subsequent to origination for which it is probable, at acquisition, that the reporting entity will be able to collect all contractually required payments receivable, and are accounted for at acquisition under SSAP No. 103R,
9. Loan-backed and structured securities for which it is probable, either known at acquisition or identified during the holding period[[6]](#footnote-6), that the reporting entity will be unable to collect all contractually required payments receivable, and
10. Transferor’s beneficial interests in securitization transactions that are accounted for as sales under SSAP No. 103R and purchased beneficial interests in securitized financial assets[[7]](#footnote-7).

### Designation Guidance

1. For RMBS/CMBS securities within the scope of this statement, the initial NAIC designation used to determine the carrying value method and the final NAIC designation for reporting purposes is determined using a multi-step process. The *Purposes and Procedures Manual of the NAIC Investment Analysis Office* provides detailed guidance. A general description of the processes is as follows:
2. Financial Modeling: TheNAICidentifies securities where financial modeling must be used to determine the NAIC designation. NAIC designation based on financial modeling incorporates the insurers’ carrying value for the security. For those securities that are financially modeled, the insurer must use NAIC CUSIP specific modeled breakpoints provided by the modelers in determining initial and final designation for these identified securities. Securities where modeling results in zero expected loss in all scenarios are automatically considered to have a final NAIC designation of NAIC 1, regardless of the carrying value. The three-step process for modeled securities is as follows:

i. Step 1: Determine Initial Designation –The current amortized cost (divided by remaining par amount) of a loan-backed or structured security is compared to the modeled breakpoint values assigned to the six (6) NAIC designations for each CUSIP to establish the **initial** NAIC designation.

ii. Step 2: Determine Carrying Value Method – The carrying value method, either the amortized cost method or the lower of amortized cost or fair value method, is then determined as described in paragraph 26 based upon the initial NAIC designation from Step 1.

iii. Step 3: Determine Final Designation –The final NAIC designation that shall be used for investment schedule reporting is determined by comparing the carrying value (divided by remaining par amount) of a security (based on paragraph 27.a.ii.) to the NAIC CUSIP specific modeled breakpoint values assigned to the six (6) NAIC designations for each CUSIP. This final NAIC designation shall be applicable for statutory accounting and reporting purposes (including establishing the AVR charges). The final designation is not used for establishing the appropriate carrying value method in Step 2 (paragraph 27.a.ii.).

1. All Other Loan-Backed and Structured Securities: For loan-backed and structured securities not subject to paragraphs 27.a. (financial modeling) follow the established designation procedures according to the appropriate section of the *Purposes and Procedures Manual of the NAIC Investment Analysis Office*. The NAIC designation shall be applicable for statutory accounting and reporting purposes (including determining the carrying value method and establishing the AVR charges). The carrying value method is established as described in paragraph26. **Examples of these securities include, but are not limited to**, mortgage-referenced securities, equipment trust certificates, **credit tenant loans (CTL)**, 5\*/6\* securities, interest only (IO) securities, securities with CRP ratings (excluding RMBS/CMBS), and loan-backed and structured securities with SVO assigned NAIC designations.

*Note: This is the only reference to credit tenant loans in the AP&P Manual.*

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 following items are noted as recent actions / projects by the Working Group:

* In agenda items 2018-22 and 2016-39, the Working Group clarified the scope guidance in SSAP No. 37. With these revisions (reflected in the cited guidance), the Working Group has clarified that the focus of SSAP No. 37 is on direct, single mortgage loan agreements that are not securities. These revisions have clarified that the scope of the SSAP does not include funds, securitizations, or “bundles” of mortgage loans.
* The Working Group has a current project to substantively review and revise SSAP No. 43R. Pursuant to agenda item 2019-21, the original focus was on “equity” related items (such as collateralized fund obligations), but the scope of the project has been expanded to include a complete review of SSAP No. 43R. The initial discussion draft issue paper was exposed in March 2020 with a comment period ending July 31, 2020. This initial exposure focused initial review of broad groupings of assets and did not address investments addressed in the *Purposes and Procedures Manual*. The issue paper noted that these VOSTF-related items were pending development and would be addressed in subsequent exposures.

**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, initially categorized as nonsubstantive and expose the agenda item to solicit comment before directing NAIC staff on the desired guidance for CTLs. There are two general options:

* Option 1: SSAP No. 43R for Conforming CTLs (this includes CTLs With SVO-Identified Bond Characteristics Acquired Prior to Jan. 1, 2020 as detailed in the P&P Manual) – With this option, statutory accounting will continue with historical application and keep CTLs that are identified to have bond characteristics, after review by the SVO, in scope of SSAP No. 43R and reported on Schedule D as bonds. If selecting this option, the Working Group should also advise if they would prefer for the nonqualifying CTLs to be in scope of *SSAP No. 37—Mortgage Loans* and reported on Schedule B, or if they want these investments to be considered an “other invested asset” under SSAP No. 21 and reported on Schedule BA. (Note: The SVO will only review non-conforming CTLs held prior to Jan. 1, 2020 for bond characteristics. As such all non-conforming CTLs acquired after Jan. 1, 2020 will not be in scope of SSAP No. 43R.)

If selecting this option, NAIC staff will propose edits to SSAP No. 43R to explicitly include in scope CTLs that are included on an SVO-Identified listing based on a structural analysis. Furthermore, revisions will be proposed to either SSAP No. 37 or *SSAP No. 21R—Other Invested Assets* to capture CTL type structures that are not on the SVO identified listing.

Option 2: SSAP No. 21 for All CTLs – With this option, statutory accounting revisions will be proposed to capture all CTLs in scope of *SSAP No. 21—Other Invested Assets* and reported on Schedule BA. With this approach, all CTLs will be reported on the same schedule, and revisions will be proposed to allow CTLs that are reviewed and approved by the NAIC SVO to be reported with an NAIC designation. This process will be similar to the existing approach for other non-bond items reported on Schedule BA that have underlying characteristics of fixed income instruments. With this approach, there will be no need to reference an SVO-Identified listing of qualifying CTLs in SSAP No. 21R. Pursuant to the *Purposes and Procedures Manual,* CTLs will not qualify as filing exempt, and a CTL would need an SVO-provided NAIC designation if there was a desire to obtain a more favorable RBC. (Only CTLs the SVO determines qualify to receive an NAIC designation will be assigned one and will be identified on a separate listing maintained and published by the SVO.)  (Under existing RBC parameters, the ability for a more favorable RBC on Schedule BA based on NAIC designation is only permitted for life entities.)

In addition to exposing a direction, NAIC staff recommends notifying the Valuation of Securities (E) Task Force of this agenda item in response to their referral. With this notification, NAIC staff will request further confirmation that an SVO-Listing could be developed to capture the CTLs that meet the SVO’s structural and legal analysis and possess bond characteristics.

Staff Review Completed by:

Julie Gann - NAIC Staff

June 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 this agenda item with a request for comments on the two general options for the accounting treatment of credit tenant loans (CTL). Notification will also be sent to the Valuation of Securities (E) Task Force of this agenda item in response to their referral. With this notification, NAIC staff will request further confirmation that a SVO-Listing could be developed to capture the CTLs that meet the SVO’s structural and legal analysis and possess bond characteristics.

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

   a. 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.

   b. 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. [↑](#footnote-ref-1)
2. The scope of this SSAP is limited to single mortgage loan agreements. Although single mortgage loan agreements can potentially have more than one lender (e.g., co-lenders/participations) and more than one borrower (such as in a tenancy-in-common arrangement), the concept of a “single mortgage loan” does not include arrangements in which a reporting entity acquires more than one mortgage loan in a sole transaction. (For example, if a reporting entity was to acquire an interest in a “bundle” of mortgage loans with various unrelated borrowers and collateral, this agreement would be outside of the scope of this SSAP. However, a bundle of mortgage loans does not include a “bulk purchase” where the reporting entity’s interest in each mortgage loan is legally separate and divisible and the purchase just facilitates the acquisitions of multiple single mortgage loan agreements.) [↑](#footnote-ref-2)
3. In applying this guidance, a reporting entity is not required to complete a detailed review of the assets held in trust to determine the extent, if any, the assets were issued by related parties. Rather, this guidance is a principle concept intended to prevent situations in which related party transactions (particularly those involving affiliates) is knowingly captured in a SSAP No. 43R structure and not identified as a related party transaction (or not reported as an affiliated investment on the investment schedule) because of the involvement of a non-related trustee or SSAP No. 43R security issuer. As identified in *SSAP No. 25—Affiliates and Other Related Parties*, it is erroneous to conclude that the inclusion of a non-related intermediary, or the presence of non-related assets in a structure predominantly comprised of related party investments, eliminates the requirement to identify and assess the investment transaction as a related party arrangement. [↑](#footnote-ref-3)
4. Currently, only Fannie Mae and Freddie Mac are the government sponsored entities that issue qualifying mortgage-referenced securities. However, this guidance would apply to mortgage-referenced securities issued by any other government sponsored entity that subsequently engages in the transfer of residential mortgage credit risk. [↑](#footnote-ref-4)
5. As discussed in paragraph 4.a. of this statement, a SSAP No. 43R security may still be considered a related party transaction even if the asset trustee or security issuer is a non-related party. [↑](#footnote-ref-5)
6. Securities classified within the type of paragraph 7.a. or 7.b. may be required to change classification to type 6.c. when it becomes probable that the reporting entity will be unable to collect all contractually required payments receivable. [↑](#footnote-ref-6)
7. The accounting requirements related to these types of securities included in paragraphs 22-25 shall be determined at acquisition or initial transfer. [↑](#footnote-ref-7)