Statutory Accounting Principles (E) Working Group

**Maintenance Agenda Submission Form**

**Form A**

## **Issue:** ASU 2020-08 – Premium Amortization on Callable Debt Securities

**Check (applicable entity):**

 P/C Life Health

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

New Issue or SSAP [ ]  [ ]  [ ]

Interpretation [ ]  [ ]  [ ]

Description of Issue: In October 2020, the Financial Accounting Standards Board (FASB) issued *ASU 2020-08, Codification Improvements to Subtopic 310-20, Receivables – Nonrefundable Fees and Other Costs* to clarify the amortization of premium associated with callable debt securities. In summary, ASU 2020-08 requires that to the extent the amortized cost basis of a callable debt security exceeds the amount repayable by the issuer, any associated premium (above the call price) is to be amortized to the next effective call price/date. For example, if a reporting entity held a bond at $104 in which could be called at $102 in a year, the $2 excess premium would be amortized over that particular year. Once amortized to $102, the reporting entity would then reassess for any excess premium to the next effective call price/date. If there is no remaining premium or further call dates, the effective yield is reset using the payment terms of the debt security.

Existing Authoritative Literature: The amortization of premiums related to debt securities is referenced in *SSAP No. 26R—Bonds.* While the requirements in ASU 2020-08 are very similar to statutory accounting guidance, SSAP No. 26R also requires the application of a yield-to-worst concept. With this concept, premium is amortized in a manner to produce the lowest asset value. Relevant guidance has been bolded below.

### Amortized Cost

1. **Amortization of bond premium or discount shall be calculated using the scientific (constant yield) interest method taking into consideration specified interest and principal provisions over the life of the bond. Bonds containing call provisions (where the issue can be called away from the reporting entity at the issuer’s discretion), except “make-whole” call provisions, shall be amortized to the call or maturity value/date which produces the lowest asset value (yield-to-worst).** Although the concept for yield-to-worst shall be followed for all callable bonds, make-whole call provisions, which allow the bond to be callable at any time, shall not be considered in determining the timeframe for amortizing bond premium or discount unless information is known by the reporting entity indicating that the issuer is expected to invoke the make-whole call provision.

### Application of Yield-to-Worst

1. For callable bonds, the first call date after the lockout period (or the date of acquisition if no lockout period exists) shall be used as the “effective date of maturity” for reporting in Schedule D, Part 1. Depending on the characteristics of the callable bonds, the yield-to-worst concept in paragraph 9 shall be applied as follows:
2. For callable bonds with a lockout period, premium in excess of the next call price (subsequent to acquisition and lockout period) shall be amortized proportionally over the length of the lockout period. **After each lockout period (if more than one), remaining premium shall be amortized to the call or maturity value/date which produces the lowest asset value.**
3. **For callable bonds without a lockout period, the book adjusted carrying value (at the time of acquisition) of the callable bonds shall equal the lesser of the next call price (subsequent to acquisition) or cost. Remaining premium shall then be amortized to the call or maturity value/date which produces the lowest asset value.**
4. For callable bonds that do not have a stated call price, all premiums over par shall be immediately expensed. For callable bonds with a call price at par in advance of the maturity date, all premiums shall be amortized to the call date.

### Balance Sheet Amount

1. Bonds, as defined in paragraph 3, shall be valued and reported in accordance with this statement, the *Purposes and Procedures Manual of the NAIC Investment Analysis Office*, and the designation assigned in the NAIC *Valuations of Securities* product prepared by the NAIC Securities Valuation Office (SVO).
2. Bonds, except for mandatory convertible bonds: **For reporting entities that maintain an asset valuation reserve (AVR), the bonds shall be reported at amortized cost, except for those with an NAIC designation of 6, which shall be reported at the lower of amortized cost or fair value. For reporting entities that do not maintain an AVR, bonds that are designated highest-quality and high-quality (NAIC designations 1 and 2, respectively) shall be reported at amortized cost; all other bonds (NAIC designations 3 to 6) shall be reported at the lower of amortized cost or fair value**.
3. Mandatory convertible bonds: Mandatory convertible bonds are subject to special reporting instructions and are not assigned NAIC designations or unit prices by the SVO. The balance sheet amount for mandatory convertible bonds shall be reported at the lower of amortized cost or fair value during the period prior to conversion. This reporting method is not impacted by NAIC designation or information received from credit rating providers (CRPs). Upon conversion, these securities will be subject to the accounting guidance of the statement that reflects their revised characteristics. (For example, if converted to common stock, the security will be in scope of *SSAP No. 30R—Unaffiliated Common Stock*, if converted to preferred stock, the security will be in scope of *SSAP No. 32R—Preferred Stocks*.)

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:

NAIC staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to *SSAP No. 26R—Bonds* to reject ASU 2020-08 for statutory accounting. While ASU 2020-08 closely mimics existing guidance in SSAP No. 26R (amortizing applicable debt premium to the next effective call price), it does preclude statutory accounting’s yield-to-worst concept, which requires amortizing premiums to the call or the maturity value/date in which produces the lowest asset value. There may be scenarios, for statutory accounting, in which premiums amortized to the maturity value/date will yield a lower asset value than simply amortizing applicable premium to the next effective call date (as is required in ASU 2020-08).

Proposed Revisions to SSAP No. 26R

33.          This statement rejects the GAAP guidance for debt securities, which is contained in *ASU 2020-08, Codification Improvements to Subtopic 310-20, Receivables – Nonrefundable Fees and Other Costs*,  *ASU 2018-03, Recognition and Measurement of Financial Assets and Financial Liabilities, ASU 2017-08, Premium Amortization on Purchased Callable Debt* Securities, ASU *2016-01, Financial Instruments – Overall*, *FASB Statement No. 115,* *Accounting for Certain Investments in Debt and Equity Securities,* *FASB Statement No. 91,* *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases, FASB Emerging Issues Task Force No. 89-18, Divestitures of Certain Investment Securities to an Unregulated Commonly Controlled Entity under FIRREA,* and *FASB Emerging Issues Task Force No. 96-10, Impact of Certain Transactions on Held-to-Maturity Classifications Under FASB Statement No. 115*

Staff Review Completed by: Jim Pinegar, NAIC Staff – January 2021

**Status:**

On March 15, 2021, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to *SSAP No. 26R—Bonds* to reject *ASU 2020-08, Codification Improvements to Subtopic 310-20, Receivables – Nonrefundable Fees and Other Costs* for statutory accounting. While ASU 2020-08 closely mimics existing guidance in SSAP No. 26R (amortizing applicable debt premium to the next effective call price), it does preclude statutory accounting’s yield-to-worst concept, which requires amortizing premiums to the call or the maturity value/date which produces the lowest asset value. There may be scenarios, for statutory accounting, in which premiums amortized to the maturity value/date will yield a lower asset value than simply amortizing applicable premium to the next effective call date (as is required in ASU 2020-08).

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