Statutory Accounting Principles (E) Working Group

**Maintenance Agenda Submission Form**

**Form A**

## **Issue: SSAP No. 97 – Valuation of Foreign Insurance SCAs**

**Check (applicable entity):**

 P/C Life Health

Modification of existing SSAP [x]  [x]  [x]

New Issue or SSAP [ ]  [ ]  [ ]

Interpretation [ ]  [ ]  [ ]

Description of Issue:

In March 2020, agenda item 2018-26 – SCA Loss Tracking – Accounting Guidance adopted guidance in *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities* to state that reported equity method losses of an investment in a subsidiary controlled or affiliated entity (SCA) would not create a negative value in a SCA investment, thus equity method losses would stop at zero. However, the agenda item also clarified that to the extent there was a financial guarantee or commitment, it would require appropriate recognition under *SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets.*

In November 2020, the Working Group adopted agenda item 2020-18 - SSAP No. 97 Update and removed a lingering, superseded reference regarding negative equity method loss valuations.

However guidance in SSAP No. 97 also requires specific adjustments to 8.b.ii (insurance related SCA) and 8.b.iv (foreign insurance SCA) entities. These long-standing adjustments require the non-admission of certain assets to achieve a limited statutory basis of accounting. The adjustments have typically been viewed as necessary in order to prevent assets being held by SCA receiving more favorable treatment than had the assets been held directly by the insurer. (e.g., requiring the nonadmittance of certain assets per *SSAP No. 20—Nonadmitted Assets*). Per SSAP No. 97, an equity method of accounting for 8.b.ii and 8.b.iv entities would be a beginning point which would then be adjusted by the provisions of SSAP No. 97, paragraph 9 (see “authoritative literature section”). It is important to note the outcome of these adjustments can result in a negative equity valuation of the investment. Again, this is so assets held by an SCA aren’t reported at a higher value than had they been held directly by the insurer.

During the discussion of agenda item 2020-18, industry comments requested consideration of whether 8.b.iv entities should be subject to the provisions of SSAP No. 97, specifically that paragraph 9 adjustments may result in a negative equity valuation. While stating many positions, industry’s primary response that foreign insurance operations are subject to foreign jurisdiction and should be allowed to stand independently of a domestic insurer – thus in the absence of a guarantee or commitment, equity valuation should not go negative and thus stop at zero. Comments were received from industry noted that the circumstances that would cause a foreign insurance reporting entity to record negative equity is not prevalent, however indicated the potential to arise in the future.

At the direction of the NAIC staff have drafted this agenda item to determine if further edits to SSAP No. 97 are required, specifically if the required statutory adjustments to 8.b.iv entities should no longer be able to result in a negative equity valuation.

One note, NAIC staff reviewed all SCA filings for the last 3 years, noting that less than 7% of all SCA filings were 8.b.iv entities. It was further noted that there was not a single instance of an 8.b.iv in a negative equity situation.

Existing Authoritative Literature:

Paragraph 9 of SSAP No. 97 details the modifications that are necessary to adjust audited U.S .Generally Accepted Accounting Principle (GAAP) financial statements to a limited statutory basis of accounting. These long-standing adjustments ensure that assets held by an SCA are not accounted for in a more favorable manner than had the assets been held directly by the insurer.

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

1. **The limited statutory basis of accounting for investments in noninsurance SCA entities, subject to paragraph 8.b.ii. and foreign insurance SCA entities, subject to paragraph 8.b.iv., shall be adjusted for the following:**

a. Nonadmit assets pursuant to the following statutory accounting principles as promulgated by the NAIC in the *Accounting Practices and Procedures Manual*;

1. *SSAP No. 6—Uncollected Premium Balances, Bills Receivable for Premiums, and Amounts Due From Agents and Brokers*
2. *SSAP No. 16R—Electronic Data Processing Equipment and Software*
3. *SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements*
4. *SSAP No. 20—Nonadmitted Assets*
5. *SSAP No. 21R—Other Admitted Assets* (e.g., collateral loans secured by assets that do not qualify as investments are nonadmitted under SAP)
6. *SSAP No. 29—Prepaid Expenses*
7. *SSAP No. 105R—Working Capital Finance Investments*

b. Expense costs that are capitalized in accordance with GAAP but are expensed pursuant to statutory accounting as promulgated by the NAIC in the *Accounting Practices and Procedures Manual* (e.g., deferred policy acquisition costs, preoperating, development and research costs, etc.);

c. Adjust depreciation for certain assets in accordance with the following statutory accounting principles:

1. *SSAP No. 16R—Electronic Data Processing Equipment and Software*
2. *SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements*
3. *SSAP No. 68—Business Combinations and Goodwill*

d. Nonadmit the amount of goodwill of the SCA in excess of 10% of the audited U.S. GAAP equity of the SCA’s last audited financial statements.

e. Nonadmit amount of the net deferred tax assets (DTAs) of the SCA in excess of 10% of the audited U.S. GAAP equity of the SCA’s last audited financial statements.

f. Nonadmit any surplus notes held by the SCA issued by the reporting entity.

g. Adjust the U.S. GAAP annuity account value reserves of a foreign insurance SCA, with respect to the business it wrote directly, using the commissioners' annuity reserve valuation method (CARVM) as defined in paragraphs 14 and 15 of Appendix A-820 (including the reserving provisions in the various Actuarial Guidelines which support CARVM). The valuation interest rate and mortality tables to be used in applying CARVM should be that prescribed by the foreign insurance SCA's country of domicile. If the Foreign SCA’s country of domicile does not prescribe the necessary tables and/or rates, no reserve adjustment shall be made.

**Note that the outcome of these adjustments, can result in a negative equity valuation of the investment.**

**SSAP No. 97, Exhibit C:**

7. **Q – Is it possible for an SCA investment valued using an equity method to be reported as a negative value?**

7.1 **A –** Yes, the equity method noninsurance SCA could have a negative equity. For example, SSAP No. 97, paragraph 8.b.ii., relating to noninsurance SCA entities, may require some assets to be reported as a negative value (nonadmitted) in paragraph 9. In this example, a paragraph 8.b.ii. SCA subsidiary that is only holding furniture, which is nonadmitted, would be reflected with negative equity to the extent the value of the nonadmitted asset(s) exceed(s) reported equity. It should be noted that although SSAP No. 97, paragraph 13.e., discusses some situations in which the equity method should be discontinued, this does not apply to SCA entities, which meet the requirements of paragraph 8.b.ii. In addition, SSAP No. 97, paragraph 13.e., lists some situations where the equity method for 8.b.ii and 8.b.iv entities would result in a valuation that is less than zero.

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): Agenda items 2018-26 – SCA Loss Tracking – Accounting Guidance and 2020-18 – SSAP No. 97 Update were previously adopted. Agenda item 2018-26 resulted in revisions to *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets* and *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities* stating that equity losses of an SCA would not go negative (thus stopping at zero), however the guaranteed liabilities would be reported to the extent there is a financial guarantee or commitment. Agenda item 2020-18 resulted in revisions with clarifying edits to Exhibit C, question 7, in SSAP No. 97, as well as removed a superseded statement that guarantees or commitments from the insurance reporting entity to the SCA could result in a negative equity valuation of the SCA.

**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 the intent to move this item to the disposal listing without statutory edits. Per staff’s review of SCA Sub 2 filings filed with an 8b(iv) valuation method, there were no noted instances of negative value SCAs, therefore we do not recommend revisions to the existing guidance. This exposure will allow industry to determine if they are aware of any prevalent examples of a negative equity valuation in a foreign insurance SCA (8.b.iv) and provide detailed information to NAIC staff for assessment.

NAIC staff highlights that if such an event (negative equity due to nonadmitted assets) was to actually occur at some point, and the company was to question whether the negative equity in the SCA should be reported, that this should be addressed directly with the state of domicile. With this approach, the domiciliary state would be able to assess the limited statutory edits that were performed, the extent to which assets are held in the SCA that would be nonadmitted if held directly by the insurer, and how the SCA obtained those assets.

Staff Review Completed by: Fatima Sediqzad - NAIC Staff

February 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 the intent to move this agenda item to the disposal listing without statutory edits. Industry is requested submit comments on any prevalent examples of a negative equity valuation in a foreign insurance subsidiary, controlled or affiliated (SCA) investment with detailed information for assessment.

On May 20, 2021, the Statutory Accounting Principles (E) Working Group exposed revisions to *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies* and *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*, as shown below,to indicate that the equity method valuation referenced in SSAP No. 97 can result in a negative equity valuation and to limit the statutory adjustments in SSAP No. 97, paragraph 9. The exposure includes proposed guidance based on comments received, which propose that foreign insurance SCAs shall stop at zero (and thus not be subject to negative equity valuations) when applying paragraph 9 adjustments in cases where the foreign insurance subsidiary is not engaged in providing services to, or holdings assets on behalf of, U.S. insurers.

Exposed Revisions:

**SSAP No. 97, paragraph 9**

1. The limited statutory basis of accounting for investments in noninsurance SCA entities, subject to paragraph 8.b.ii. and foreign insurance SCA entities, subject to paragraph 8.b.iv., shall be adjusted for the following:

a. Nonadmit assets pursuant to the following statutory accounting principles as promulgated by the NAIC in the *Accounting Practices and Procedures Manual*;

1. *SSAP No. 6—Uncollected Premium Balances, Bills Receivable for Premiums, and Amounts Due From Agents and Brokers*
2. *SSAP No. 16R—Electronic Data Processing Equipment and Software*
3. *SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements*
4. *SSAP No. 20—Nonadmitted Assets*
5. *SSAP No. 21R—Other Admitted Assets* (e.g., collateral loans secured by assets that do not qualify as investments are nonadmitted under SAP)
6. *SSAP No. 29—Prepaid Expenses*
7. *SSAP No. 105R—Working Capital Finance Investments*

b. Expense costs that are capitalized in accordance with GAAP but are expensed pursuant to statutory accounting as promulgated by the NAIC in the *Accounting Practices and Procedures Manual* (e.g., deferred policy acquisition costs, preoperating, development and research costs, etc.);

c. Adjust depreciation for certain assets in accordance with the following statutory accounting principles:

1. *SSAP No. 16R—Electronic Data Processing Equipment and Software*
2. *SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements*
3. *SSAP No. 68—Business Combinations and Goodwill*

d. Nonadmit the amount of goodwill of the SCA in excess of 10% of the audited U.S. GAAP equity of the SCA’s last audited financial statements.

e. Nonadmit amount of the net deferred tax assets (DTAs) of the SCA in excess of 10% of the audited U.S. GAAP equity of the SCA’s last audited financial statements.

f. Nonadmit any surplus notes held by the SCA issued by the reporting entity.

g. Adjust the U.S. GAAP annuity account value reserves of a foreign insurance SCA, with respect to the business it wrote directly, using the commissioners' annuity reserve valuation method (CARVM) as defined in paragraphs 14 and 15 of Appendix A-820 (including the reserving provisions in the various Actuarial Guidelines which support CARVM). The valuation interest rate and mortality tables to be used in applying CARVM should be that prescribed by the foreign insurance SCA's country of domicile. If the Foreign SCA’s country of domicile does not prescribe the necessary tables and/or rates, no reserve adjustment shall be made.

Note that the outcome of these adjustments can result in a negative equity valuation of the investment for all paragraph 8.b.ii. entities. For a paragraph 8.b.iv. entity, the application of these adjustments will stop at zero, and will not result in negative equity valuation unless the 8.b.iv entity provides services to the reporting entity or its affiliates or holds assets on behalf of the reporting entity. If such services, including reinsurance transactions, are occurring, the adjustments required in this paragraph can result in a negative equity valuation. (See additional equity method application guidance in paragraph 13.e. regarding guarantees and financial support.)

**SSAP No. 48, paragraph 6**

6. Investments in these ventures, except for joint ventures, partnerships and limited liability companies with a minor ownership interest, shall be reported using an equity method as defined in *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*, paragraphs 8.b.i. through 8.b.iv. (The equity method calculation may result with a negative valuation of the investment, therefore the SSAP No. 97 equity method calculation shall occur regardless of whether the investment is supported by an audit and the reporting entity will nonadmit the investment.) A reporting entity whose shares of losses in a SSAP No. 48 entity exceeds its investment in the SSAP No. 48 entity shall disclose the information required by SSAP No. 97, paragraph 35.a.

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