Statutory Accounting Principles (E) Working Group

**Maintenance Agenda Submission Form**

**Form A**

## **Issue:** SSAP No. 43R – Credit Tenant Loans - Scope

**Check (applicable entity):**

P/C Life Health

Modification of Existing SSAP

New Issue or SSAP

Interpretation

Description of Issue: On July 15, 2021, the Valuation of Securities (E) Task Force adopted revisions to the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual) to clarify that the definition of a credit tenant loan (CTL), which defines CTLs as mortgage loans, is specific to “mortgage loans in scope of SSAP No. 37.” This limited amendment to the P&P Manual was suggested by the chair and vice chair of the Statutory Accounting Principles (E) Working Group to clarify that the application of the structural assessment to identify CTLs is limited to direct mortgage loans and relates to the potential reclassification of investments from Schedule B (Mortgage Loans) to Schedule D (Bonds) for qualifying investments. The amendment also clarifies that security structures, which are excluded from SSAP No. 37, are not subject to the P&P Manual CTL structural assessments and should be captured for accounting and reporting in accordance with the applicable SSAP within the *NAIC* *Accounting Practices and Procedures Manual*. With this Task Force discussion, it was highlighted that there is a current Working Group project to define principal concepts for bond reporting.

With the adoption of the Task Force guidance, NAIC staff has assessed whether *INT 20-10: Reporting Nonconforming CTLs* should be nullified and whether other revisions should be incorporated into SSAP No. 43R prior to the adoption of guidance in advance of the principle-based bond proposal project.

Review of INT 20-10:

INT 20-10 was adopted Dec. 28, 2020, to provide reporting exceptions for year-end 2020. This interpretation permitted continued reporting on Schedule D for nonconforming CTLs (and other structures which met the characteristics of a CTL) if they had been filed for an SVO-assigned designation by Feb. 15, 2021. Although an SVO-assigned designation was not required to be received before filing the statutory financial statements, reporting entities were required to disclose the nonconforming CTLs captured on Schedule D with a CRP rating in Note 1. Once the SVO-assigned designation was received, then the reporting entity would begin reporting the SVO-assigned designation (instead of the CRP rating) and the Note 1 disclosure would no longer be required. This interpretation also clarified that there would be no requirement to move investments to Schedule D (and file them with the SVO) if they had previously been reported on a different schedule (such as Schedule B or Schedule BA). This interpretation was set to expire Oct. 1, 2021. This limited effective date was set to allow for further review and consideration of these structures prior to year-end 2021 reporting.

Assessment of INT 20-10:

With the adoption of the Task Force edits, which clarify that security structures shall be assessed for accounting and reporting in accordance with the provisions in SSAP No. 26R and SSAP No. 43R, NAIC staff does not believe there is a need to retain INT 20-10 as the reporting exception provided within would no longer be necessary for security structures. (The identification of nonconforming CTLs as of year-end 2020 solely encompassed security structures with underlying real estate risk and did not include any direct mortgage loans that had been reclassified from Schedule B to Schedule D without meeting the SVO structural analysis.) With the nullification of INT 20-10 and Task Force clarifications, only direct mortgage loans would be assessed for reclassification from mortgage loans to bonds under the CTL structural provisions. With the limited focus on these specific structures, there is no perceived need to reconsider the current structural provisions that need to be met (namely the 5% residual risk threshold) for those investments to be reclassified from mortgage loans to bonds. With the nullification of INT 20-10, the following guidance would be applicable:

* Mortgage loans in scope of SSAP No. 37 will continue past practice, with reporting entities having the ability to file the structures with the SVO for a structural assessment to determine whether the mortgage loan can be reclassified from Schedule B to Schedule D as a CTL.
* Security structures that have underlying real estate risk, whether they are referred to as CTLs or by another named (e.g., lease-backed securities) that qualify in scope of *SSAP No. 26R—Bonds* or *SSAP No. 43R—Loan-Backed and Structured Securities* shall follow the accounting and reporting provisions of those SSAPs. Investments that qualify within these SSAPs are reported on Schedule D-1: Long-Term Bonds. This is consistent with past intent of the SSAPs as the highest level of the statutory hierarchy (pursuant to Section V – Statutory Hierarchy of the Preamble to the AP&P Manual) as well as guidance in the *NAIC Policy Statement on Coordination of the AP&P Manual and the P&P Manual*. Per that guidance, obtaining an NAIC designation does not change in investment’s applicable SSAP, annual or quarterly statement reporting schedule or override other SSAP guidance required for an investment to be an admitted asset. That guidance identifies that there are limited instances in which a SSAP specifically identifies within its scope, the inclusion of specific SVO-Identified investments based on structural assessments (such as SVO-Identified Bond ETFs in scope of SSAP No. 26R). However, that guidance is specific to the inclusion of qualifying investments into the scope of a specific SSAP and does not provide the ability to remove investments from a specific SSAP that qualify under the SSAP’s scope provisions.

Assessment of SSAP No. 43R:

NAIC staff has recognized that the scope guidance of SSAP No. 43R does not name mortgage loans that qualify as CTLs after an SVO structural assessment. Furthermore, it has been identified that there are examples of securities in paragraph 27.b that have been cited as structures that are in scope of SSAP No. 43R. Paragraph 27 is not a scope paragraph but is in the section of the SSAP that addresses determination of the designation based on whether the investment is subject to the financial modeling guidance. (The original source of these examples were in a paragraph that identified investments that would not be financially modeled or that did not receive CRP ratings subject to the “modified filing exempt” provisions. Since the “MFE” concept was removed in 2020, SSAP No. 43 investments are either financially modeled or captured as an “all other loan-backed or structured security.”) With the removal of the MFE guidance, paragraph 27.b is now applicable to all securities not subject to financial modeling, but these examples are still included. *(Note: NAIC staff has an impression that there could be industry concern with removing these examples as it will cause questions on whether they can be reported in scope of SSAP No. 43R.)*

Although there is current “bond project” to establish principal concepts in determining whether an investment qualifies as a bond, the finalization and implementation of that project is expected to take time to complete. To address immediate issues with regards to clarifying the reporting of mortgage loan CTLs and other securities, NAIC staff proposes nonsubstantive revisions to remove the examples from paragraph 27.b and explicitly incorporate applicable provisions in the scope paragraphs of SSAP No. 43R.

Existing Authoritative Literature:

1. This statement establishes statutory accounting principles for investments in loan-backed securities, structured securities and mortgage-referenced securities. In accordance with *SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, retained beneficial interests from the sale of loan-backed securities and structured securities are accounted for in accordance with this statement. Items captured in scope of this statement are collectively referred to as loan-backed securities.

### 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 P&P Manual provides detailed guidance. A general description of the processes is as follows:
2. Financial Modeling: Pursuant to the P&P Manual, theNAICidentifies select 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. As specified in the P&P Manual, securities where modeling results in zero expected loss in all scenarios and that would be equivalent to an NAIC designation and NAIC designation category of NAIC 1 and NAIC 1.A. respectively, if the filing exemption process in the P&P Manual was applied, are automatically considered to have a final NAIC designation of NAIC 1 and NAIC designation category of NAIC 1.A., 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 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. The final designation is mapped to an NAIC designation category according to the instructions in the P&P Manual. This final NAIC designation shall be applicable for statutory accounting and reporting purposes and the NAIC designation category will be used for investment schedule reporting and establishing RBC and AVR charges. The final NAIC 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 securities not subject to paragraph 27.a. (financial modeling) follow the established designation procedures according to the appropriate section of the P&P Manual. 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 paragraph 26. **Examples of these securities include, but are not limited to equipment trust certificates, credit tenant loans (CTL), 5\*/6\* securities, interest only (IO) securities, securities with CRP ratings (excluding RMBS/CMBS), loan-backed and structured securities, and mortgage-referenced securities with SVO assigned NAIC designations.**

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): Previous activity was summarized above, in the ‘Description of Issue’ section. A prior agenda item 2020-24: Accounting and Reporting of Credit Tenant Loans in response to a Task Force referral was also developed

**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 take the following action:

1. Nullify INT 20-10 as no longer applicable. (If preferred, rather than nullifying immediately, this INT could continue and expire automatically on Oct. 1, 2021, without consideration of further extension.)
2. Dispose agenda item 2020-24: Accounting and Reporting of Credit Tenant Loans without statutory revisions. This agenda item had two exposures regarding CTLs prior to the development of INT 20-10 and the SVO adoption that clarified the definition of CTLs.
3. Expose revisions to *SSAP No. 43R—Loan-Backed and Structured Securities* to explicitly identify the SVO-Identified CTLs in scope of SSAP No. 43R. These revisions also propose to delete the examples of “other LBSS” in paragraph 27.b If there are concerns that this deletion inadvertently removes any specific investment from the scope of SSAP No. 43R, those comments are requested to be shared during the exposure period.

It is noted that these modifications are intended to simply clarify current guidance prior to the adoption of bond proposal.

*Proposed edits to SSAP No. 43R:*

1. This statement establishes statutory accounting principles for investments in loan-backed securities, structured securities and mortgage-referenced securities. In accordance with *SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, retained beneficial interests from the sale of loan-backed securities and structured securities are accounted for in accordance with this statement. In addition, mortgage loans in scope of SSAP No. 37 that qualify under a SVO structural assessment are in scope of this statement as credit tenant loans (CTLs). Items captured in scope of this statement are collectively referred to as loan-backed securities

### 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 P&P Manual provides detailed guidance. A general description of the processes is as follows:
2. Financial Modeling: Pursuant to the P&P Manual, theNAICidentifies select 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. As specified in the P&P Manual, securities where modeling results in zero expected loss in all scenarios and that would be equivalent to an NAIC designation and NAIC designation category of NAIC 1 and NAIC 1.A. respectively, if the filing exemption process in the P&P Manual was applied, are automatically considered to have a final NAIC designation of NAIC 1 and NAIC designation category of NAIC 1.A., 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 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. The final designation is mapped to an NAIC designation category according to the instructions in the P&P Manual. This final NAIC designation shall be applicable for statutory accounting and reporting purposes and the NAIC designation category will be used for investment schedule reporting and establishing RBC and AVR charges. The final NAIC 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 securities not subject to paragraph 27.a. (financial modeling) follow the established designation procedures according to the appropriate section of the P&P Manual. 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 paragraph 26.

Staff Review Completed by: Julie Gann, NAIC Staff – July 2021

**Status:**

On August 26, 2021, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed the following:

1. Revisions to *SSAP No. 43R—Loan-Backed and Structured Securities*, as illustrated above,to explicitly identify the SVO-Identified CTLs are in scope of SSAP No. 43R. These revisions also propose to delete the examples of “other loan-backed and structured securities” in paragraph 27.b. Comments are requested if this deletion is perceived to remove investments from the scope of SSAP No. 43R.
2. Request for comment on the Working Group’s intent to nullify INT 20-10. (This INT nullifies automatically on Oct. 1, 2021, but it is anticipated that the explicit nullification will identify the revisions adopted by the VOSTF for historical reference.)
3. Disposal of agenda item 2020-24: Accounting and Reporting of Credit Tenant Loans without statutory revisions. This was the agenda item in response to the initial VOSTF referral and is no longer applicable with the adopted Task Force edits to clarify that CTLs are mortgage loans in scope of SSAP No. 37.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2021/9. August 26/Exposures/21-11 - SSAP No. 43R - CTL 2021.docx