Statutory Accounting Principles (E) Working Group

**Maintenance Agenda Submission Form**

**Form A**

## **Issue:** SSAP No. 32R – Permitted Valuation Methods

**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’s primary purpose is to propose minor revisions to SSAP No. 32R to clarify the applicable measurement methods for preferred stock. For a brief historical context, in July 2020, the Working Group adopted *Issue Paper No. 164—Preferred Stock* and substantively revised *SSAP No. 32R—Preferred Stock.* The substantively revised SSAP No. 32R was effective January 1, 2021, however in October 2020, agenda item 2020-31, permitted early application of the newly revised standard.

As described in Issue Paper No. 164, paragraph 17, the historical guidance in SSAP No. 32 captured different accounting and reporting provisions based on whether the preferred stock was classified as redeemable or perpetual, and whether the reporting entity maintained an Asset Valuation Reserve. Although these classifications were still considered appropriate, in 2020, the Statutory Accounting Principles (E) Working Group reviewed the permissible valuation methods for redeemable preferred stock – specifically the prior guidance in SSAP No. 32 that permitted “historical cost” as an applicable measurement method. During the development of SSAP No. 32R, and consistent with prior conclusions from U.S. GAAP, the Working Group concluded that “historical cost” is generally not an acceptable measurement method for this type of instrument. However, during the implementation of SSAP No. 32R, it was discovered that a lingering reference to “cost” being a permissible reporting value remained in the authoritative literature.

This agenda item has been drafted to 1) remove lingering references which indicate that cost is a permissible valuation method, and 2) remove descriptive language regarding redeemable preferred stock to ensure consistency with other identical edits made when SSAP No. 30 was substantively revised.

Existing Authoritative Literature: The primary outstanding reference to “cost” is found in paragraph 11 of SSAP No. 32R - relevant items have been bolded for emphasis.

### Balance Sheet Amount

11. Preferred stock shall be valued based on (a) the underlying characteristics (redeemable, perpetual or mandatory convertible), (b) the quality rating expressed as an NAIC designation, and (c) whether an asset valuation reserve (AVR) is maintained by the reporting entity:

1. For reporting entities that do not maintain an AVR:
2. Highest-quality or high-quality redeemable preferred stocks (NAIC designations 1 and 2), which have characteristics of debt securities, shall be **valued at cost** or amortized cost. All other redeemable preferred stocks (NAIC designations 3 to 6) shall be **reported at the lower of cost**, amortized cost, or fair value.
3. Perpetual preferred stock and publicly traded preferred stock warrants shall be reported at fair value, not to exceed any currently effective call price.
4. Mandatory convertible preferred stocks (regardless if the preferred stock is redeemable or perpetual) shall be reported at fair value, not to exceed any currently effective call price, in the periods prior to conversion. Upon conversion to common stock, these securities shall be in scope of SSAP No. 30R.
5. For preferred stocks reported at fair value, unrealized gains and losses shall be recorded as a direct credit or charge to unassigned funds (surplus)
6. For reporting entities that maintain an AVR:
7. Highest-quality, high-quality or medium quality redeemable preferred stocks (NAIC designations 1 to 3) shall be valued at amortized cost. All other redeemable preferred stocks (NAIC designations 4 to 6) shall be reported at the lower of amortized cost or fair value.
8. Perpetual preferred stock and publicly preferred stock warrants shall be valued at fair value, not to exceed any currently effective call price.
9. Mandatory convertible preferred stocks (regardless if the preferred stock is redeemable or perpetual) shall be reported at fair value, not to exceed any currently effective call price, in the periods prior to conversion. Upon conversion to common stock, these securities shall be in scope of SSAP No. 30R.
10. For preferred stocks reported at fair value, the accounting for unrealized gains and losses shall be in accordance with *SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve.*

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): In addition to the previous activity that was summarized in the “Description of Issue” section, in Aug. 2021, the Working Group adopted revisions from agenda item 2021-10: SSAP No. 32R – Clarification of Effective Call Price. Adopted revisions clarified that the “effective call price” valuation limitation for instruments with outstanding call provisions shall only apply if the call is currently exercisable by the issuer or if the issuer has announced that the instrument will be redeemed/called.

**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. 32R—Preferred Stock* to remove lingering references indicating that cost is an allowable valuation method. Note that the additional proposed edits in SSAP No. 32R, paragraph 11.a.i., regarding removing the reference to “characteristics of debt securities” was proposed to ensure consistency with prior approved edits to yield what is now SSAP No. 32R, paragraph 11.b.i.

### Proposed edits to SSAP No. 32R:

### Balance Sheet Amount

11. Preferred stock shall be valued based on (a) the underlying characteristics (redeemable, perpetual or mandatory convertible), (b) the quality rating expressed as an NAIC designation, and (c) whether an asset valuation reserve (AVR) is maintained by the reporting entity:

1. For reporting entities that do not maintain an AVR:
2. Highest-quality or high-quality redeemable preferred stocks (NAIC designations 1 and 2), shall be valued at amortized cost. All other redeemable preferred stocks (NAIC designations 3 to 6) shall be reported at the lower of amortized cost or fair value.
3. Perpetual preferred stock and publicly traded preferred stock warrants shall be reported at fair value, not to exceed any currently effective call price.
4. Mandatory convertible preferred stocks (regardless if the preferred stock is redeemable or perpetual) shall be reported at fair value, not to exceed any currently effective call price, in the periods prior to conversion. Upon conversion to common stock, these securities shall be in scope of SSAP No. 30R.
5. For preferred stocks reported at fair value, unrealized gains and losses shall be recorded as a direct credit or charge to unassigned funds (surplus)
6. For reporting entities that maintain an AVR:
7. Highest-quality, high-quality or medium quality redeemable preferred stocks (NAIC designations 1 to 3) shall be valued at amortized cost. All other redeemable preferred stocks (NAIC designations 4 to 6) shall be reported at the lower of amortized cost or fair value.
8. Perpetual preferred stock and publicly preferred stock warrants shall be valued at fair value, not to exceed any currently effective call price.
9. Mandatory convertible preferred stocks (regardless if the preferred stock is redeemable or perpetual) shall be reported at fair value, not to exceed any currently effective call price, in the periods prior to conversion. Upon conversion to common stock, these securities shall be in scope of SSAP No. 30R.
10. For preferred stocks reported at fair value, the accounting for unrealized gains and losses shall be in accordance with *SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve.*

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

**Status:**

On October 25, 2021, in response to an e-vote to expose, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to *SSAP No. 32R—Preferred Stock* to remove lingering references which indicate that cost is an allowable valuation method for redeemable preferred stock.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/Maintenance/Active Form A's/2021/21-17 - SSAP No. 32R - Permitted Valuation Methods.docx