

**Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A**

Issue: ASU 2021-04 - *Issuer's Accounting for Certain Modifications or Exchanges of Freestanding Equity-Classified Written Call Options*

Check (applicable entity):

	P/C	Life	Health
Modification of Existing SSAP	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
New Issue or SSAP	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Interpretation	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Description of Issue: In May 2021, the Financial Accounting Standards Board (FASB) issued *Accounting Standard Update (ASU) 2021-04, Earnings Per Share (Topic 260), Debt—Modifications and Extinguishments (Subtopic 470-50), Compensation—Stock Compensation (Topic 718), and Derivatives and Hedging—Contracts in Entity's Own Equity (Subtopic 815-40)—Issuer's Accounting for Certain Modifications or Exchanges of Freestanding Equity-Classified Written Call Options*. The amendments in this ASU impact all entities that issue freestanding written call options, that are then modified in connection with either an equity issuance, debt origination or a debt modification.

The amendments affect those entities for when a freestanding equity-classified written call option is modified, or exchanged, and the instrument remains classified as equity after the modification or exchange. This topic is discussed in *SSAP No. 72—Surplus and Quasi-Reorganization*, paragraph 10. If the warrant is modified as part of a debt modification and the warrant is held by the creditor involved in the debt modification, the issuer would treat the warrant's change in value as a fee to or from the creditor, based on if it is an increase or a decrease. If the modification of the warrant is connected to a debt modification where the debt is held by a third-party, the increase in fair-value of the warrant will be treated as third-party cost, and any decreases would be disregarded. Guidance for debt issuance costs is in *SSAP No. 15—Debt and Holding Company Obligations*.

The main provisions of this ASU are:

1. An entity should treat a modification of the terms or conditions or an exchange of a freestanding equity-classified written call option that remains equity classified after modification or exchange as an exchange of the original instrument for a new instrument.
2. An entity should measure the effect of a modification or an exchange of a freestanding equity-classified written call option that remains equity classified after modification or exchange as follows:
 - a. For a modification or an exchange that is a part of or directly related to a modification or an exchange of an existing debt instrument or line-of-credit or revolving-debt arrangements (hereinafter, referred to as a "debt" or "debt instrument"), as the difference between the fair value of the modified or exchanged written call option and the fair value of that written call option immediately before it is modified or exchanged.
 - b. For all other modifications or exchanges, as the excess, if any, of the fair value of the modified or exchanged written call option over the fair value of that written call option immediately before it is modified or exchanged.
3. An entity should recognize the effect of a modification or an exchange of a freestanding equity-classified written call option that remains equity classified after modification or exchange on the basis of the substance of the transaction.

An entity should recognize the effect of a modification or an exchange of a freestanding equity-classified written call option to compensate for goods or services in accordance with the guidance in Topic 718, Compensation—Stock Compensation. In a multiple-element transaction (for example, one that includes both debt financing and equity financing), the total effect of the modification should be allocated to the respective elements in the transaction.

Existing Authoritative Literature: The guidance for the issuance of stock purchase warrants is in *SSAP No. 72—Surplus and Quasi-Reorganization*, paragraph 10, and guidance for debt issuance costs is included in *SSAP No. 15—Debt and Holding Company Obligations*, paragraph 5.

SSAP No. 72:

10. Stock purchase warrants issued in return for cash shall be credited to gross paid-in and contributed surplus. When debt instruments are issued with conversion features, no value shall be assigned to the conversion features unless the conversion feature is clearly separable from the debt obligation in the form of a detachable stock purchase warrant. In such instances the relative fair value of the detachable stock purchase warrant at time of issue shall be credited to gross paid-in and contributed surplus. For instances in which a reporting entity has issued puttable warrants or mandatorily redeemable warrants, such items shall be reflected as liabilities as the warrants obligate the reporting entity to ultimately transfer cash or other assets to the holder in order to repurchase the shares.

SSAP No. 15:

5. Debt issuance costs (e.g., loan fees and legal fees) do not meet the definition of an asset as defined in SSAP No. 4—Assets and Nonadmitted Assets. Accordingly, these costs shall be charged to operations in the period incurred.

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): None.

Staff Review Completed by: Jake Stultz -NAIC staff, September 2021

Staff Recommendation:

NAIC staff recommends that the Working Group move this item to the active listing and expose revisions to *SSAP No. 72—Surplus and Quasi-Reorganization* to reject ASU 2021-04 for statutory accounting. However, NAIC staff recommends that the FASB guidance related to accounting for the changes in fair value regarding the exchange of a free-standing equity-classified written call option be incorporated into SSAP No. 72.

Proposed revisions to SSAP No. 72:

10. Stock purchase warrants issued in return for cash shall be credited to gross paid-in and contributed surplus. An entity shall treat a modification of the terms or conditions or an exchange of a freestanding equity-classified written call option as an exchange of the original instrument for a new instrument. In substance, the entity repurchases the original instrument by issuing a new instrument. The total effect of the modification or exchange shall be allocated to the respective elements in the transaction. When debt instruments are issued with conversion features, no value shall be assigned to the conversion features unless the conversion feature is clearly separable from the debt obligation in the form of a detachable stock purchase warrant. In such instances the relative fair value of the detachable stock purchase warrant at time of issue shall be credited to gross paid-in and contributed surplus. For instances in which a reporting entity has issued puttable warrants or mandatorily redeemable warrants, such items shall be reflected as liabilities

as the warrants obligate the reporting entity to ultimately transfer cash or other assets to the holder in order to repurchase the shares.

29. This statement also rejects *Accounting Research Bulletin No. 43, Restatement and Revision of Accounting Research Bulletins*, “Chapter 1, Prior Opinions,” paragraph 12 of APB 10, and *FASB Technical Bulletin No. 85-6, Accounting for a Purchase of Treasury Shares at a Price Significantly in Excess of the Current Market Price of the Shares and the Income Statement Classification of Costs Incurred in Defending against a Takeover Attempt* [and Accounting Standard Update \(ASU\) 2021-04, Earnings Per Share \(Topic 260\), Debt—Modifications and Extinguishments \(Subtopic 470-50\), Compensation—Stock Compensation \(Topic 718\), and Derivatives and Hedging—Contracts in Entity’s Own Equity \(Subtopic 815-40\)—Issuer’s Accounting for Certain Modifications or Exchanges of Freestanding Equity-Classified Written Call Options.](#)

Status:

On December 11, 2021, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions, as illustrated above, to incorporate guidance related to the accounting for the changes in fair value when exchanging equity-classified written call options, while rejecting the remainder of ASU 2021-04 in SSAP No. 72.

<https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/NationalMeetings/A.NationalMeetingMaterials/2021/13.FallNationalMeeting/Exposures/21-27-ASU2021-04-ModificationsofFreestandingEquityOptions.docx>