

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

Issue: Consistency Revisions for Residuals

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: This agenda item has been developed to incorporate consistency revisions for residual tranches and residual security interests. Over the last couple of years, a variety of revisions have been incorporated for residual interests. These began with revisions to clarify the reporting on Schedule BA (instead of Schedule D-1) along with the residual definition and guidance within each investment SSAP to highlight that residuals shall be captured on Schedule BA. Although these revisions were necessary to immediately address the reporting of residuals, the discussion that accompanied these revisions have noted that conforming revisions would be needed coinciding with the effective date of the principles-based bond definition guidance to have consistency of guidance location, terminology and definitions.

With the revisions to *SSAP No. 21R—Other Admitted Assets* to provide the accounting and reporting for residuals, all residuals, regardless of investment structure, shall follow the guidance detailed in SSAP No. 21R and be reported on Schedule BA.

To ensure consistency in definitions and guidance, this agenda item proposes to centralize the guidance in SSAP No. 21R and use a consistent approach in the other investment SSAPs to exclude residuals from scope and direct to SSAP No. 21R.

Existing Authoritative Literature: - Key references **bolded** for emphasis.

- ***SSAP No. 21R—Other Admitted Assets (Effective 2025) – Adopted March 16, 2024***

Residual Tranches or Interests/Loss Positions

28. A residual interest or a residual security tranche (collectively referred to as residuals) exists in investment structures that issue one or more classes of debt securities created for the primary purpose of raising debt capital backed by collateral assets. The primary source of debt repayment is derived through rights to the cash flows of a discrete pool of collateral assets. These designs could be backed directly or indirectly through a feeder fund. The collateral assets generate cash flows that provide interest and principal payments to debt holders through a contractually prescribed distribution methodology (e.g., waterfall dictating the order and application of all collateral cash flows). Once those contractual requirements are met, the remaining cash flows generated by (or with the sale of) the collateral assets are provided to the holder of the residual security/residual interest holder. When an asset within the discrete pool of assets does not perform as expected, it impacts the extent to which cash flows will be generated and distributed. The residual holders in the structure continue to receive payments from the collateral so long as there are cash flows in excess of the debt obligations. The payments to the residual holder may vary significantly, both in timing and amount, based on the underlying collateral performance.

29. The structural design of a residual interest or residual security tranche can vary, but the overall concept is that they receive the remaining cash flows after all debt holders receive contractual interest and principal payments. Determining whether an investment in a structure reflects a residual interest or tranche shall be based on the substance of the investment held rather than its legal form. Common characteristics of residual interests/residual security tranches include the items noted below, but the presence or absence of any of these factors should not be definitive in determination. Classification as a residual should be based on the substance

of the investment and how cash flows to the holder are determined. Additionally, it would be expected that the equity position in an ABS Issuer, as defined in SSAP 26R, would be classified as a residual tranche.

- a. Residuals often do not have contractual principal or interest.
- b. Residuals may be structured with terms that appear to be stated principal or interest but that lack substance, and result in receiving the residual cash flows of the underlying collateral. The terms allow for significant variation in the timing and amount of cash flows without triggering a default of the structure.
- c. Residuals do not have credit ratings or NAIC assigned designations. Rather, they are first loss positions that provide subordination to support the credit quality of the typically rated debt tranches.
- d. Residuals may provide payment throughout the investment duration (and not just at maturity), but the payments received continue to reflect the residual amount permitted after debt tranche holders receive contractual principal and interest payments.
- e. Frequently, there are contractual triggers that divert cash flows from the residual holders to the debt tranches if the structure becomes stressed.

30. Residual tranches or interests do not qualify for bond reporting. Residuals shall follow the accounting and admittance guidance within this statement and are required to be reported on Schedule BA: Other Long-Term Invested Assets.

31. As stated in paragraph 22, residuals are permitted to be admitted assets if debt securities from the same structure qualify (or would qualify) as admitted assets. If the debt security from a structure is (or would be) nonadmitted due to the requirements under paragraph 22, then any residual interests or first loss positions held from the same structure also do not qualify as admitted assets and shall be reported as nonadmitted assets.

32. Residuals shall be initially reported at cost, or allocated cost (using proportional fair values if acquired along with debt tranches from the securitization). Subsequent to initial acquisition, residuals shall be reported at either 1) the lower of amortized cost or fair value under the Allowable Earned Yield method detailed in paragraphs 33-34, with temporary reductions in fair value reported as an unrealized loss, or 2) at the calculated practical expedient method detailed in paragraph 35.

33. For purposes of this statement for residuals only, amortized cost shall be defined as the cost to acquire the residual reduced for distributions in excess of the Allowable Earned Yield and other-then-temporary impairments (OTTI). The Allowable Earned Yield shall be established at acquisition as the discount rate that equates the initial best estimate of the residual's cash flows to its acquisition cost. The Allowable Earned Yield is not to be updated after acquisition.

34. Interest income shall be recorded under the effective yield method using the Allowable Earned Yield, capped by the amount of cash distributions received. To the extent that the Allowable Earned Yield, applied to the current amortized cost, exceeds the cash distributions received, such unrecognized interest income may be carried forward to future periods to be recognized when sufficient cash distributions are received. To the extent cash distributions exceed the Allowable Earned Yield (including any unrecognized interest carried forward), the amortized cost shall be reduced by the excess. As a result of this method, the amortized cost shall not be increased unless there is a subsequent investment (i.e., an additional purchase with additional consideration remitted).

35. Reporting entities may elect a practical expedient in lieu of the Allowable Earned Yield detailed in paragraphs 33-34 and calculate Book/Adjusted Carrying Value (BACV) such that all distributions received are treated as a reduction in BACV. With this approach, the reporting entity will not recognize any interest or investment income until the residual tranche has a BACV of zero. Once the residual has a zero BACV, distributions received shall be recognized as interest income.

- a. Reporting entities applying the practical expedient shall continue to report residuals on Schedule BA, including those with a zero BACV. Any subsequent distributions shall be reported as interest income until the structure matures/terminates, is unwound, or no longer meets the definition of a residual.
- b. Reporting entities are required to apply the practical expedient to all residuals held.
- c. Reporting entities that wish to discontinue use of the practical expedient approach and move towards the Allowable Earned Yield method are required to specify and disclose an explicit transition date, and only apply the Allowable Earned Yield method to residuals acquired after that date. Residuals held prior to the disclosed accounting method transition date shall continue to follow the practical expedient until those residuals mature/terminate or are unwound.

36. Residuals shall be assessed for other-than-temporary impairment (OTTI) on an ongoing basis, with required assessment anytime that fair value is less than the reported value.

- a. For residuals measured using the Allowable Earned Yield method, as detailed in paragraphs 33-34, an OTTI shall be considered to have occurred if the present value of expected cash flows discounted by the Allowable Earned Yield, is less than amortized cost. Upon identification of an OTTI, the reporting entity shall recognize a realized loss equal to the difference between the amortized cost and the present value of expected cash flows, with the present value of expected cash flows becoming the new amortized cost to which the Allowable Earned Yield is applied. After the OTTI is recognized, distributions received from the residual shall continue to be recorded in accordance with paragraphs 33-34. Subsequent recoveries in cash flows shall not result in increases to the amortized cost.
- b. For residuals measured under the practical expedient, as detailed in paragraph 35, an OTTI shall be considered to have occurred if the fair value of the residual is less than the BACV. The reporting entity shall recognize a realized loss equal to the difference between the fair value and the BACV, with the fair value becoming the new BACV. After the OTTI is recognized, distributions received from the residual shall continue to be recorded in accordance with paragraph 35. Subsequent recoveries in cash flows shall not result in increases to the BACV.

37. Residuals recognized on Schedule BA as of December 31, 2024, and accounted for under a different SSAP, shall follow the following measurement transition guidance as of January 1, 2025:

- a. Reporting entity shall determine whether they will follow the Allowable Earned Yield method detailed in paragraphs 33-34, or the practical expedient detailed in paragraph 35, for all residuals.
- b. Residuals previously accounted for under SSAP No. 26R or SSAP No. 43R shall prospectively apply the Allowable Earned Yield measurement method elected under this Statement using the amortized cost as of December 31, 2024 as the starting point in the calculation. Residuals that will follow the practical expedient shall be recognized on January 1, 2025 at the lower of amortized cost or fair value as of December 31, 2024, realizing any unrealized loss existing at that date.
- c. Residuals reported under the equity method or fair value as of December 31, 2024 (as they were previously captured in scope of SSAP No. 30R, 32R or 48) with unrealized gains or losses recognized, shall recognize any unrealized position as realized, with the reported value as of December 31, 2024 becoming the January 1, 2025 cost basis for subsequent measurement under this statement.

Effective Date and Transition

40. This statement is effective for years beginning January 1, 2001. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with SSAP No. 3—*Accounting Changes and Corrections of Errors*. The guidance for structured settlements when the reporting entity acquires the legal right to receive payments is effective December 31, 2018.

41. Revisions adopted March 16, 2024, to add guidance for “Debt Securities That Do Not Qualify as Bonds” and for “Residual Tranches or Interests/Loss Positions” are initially effective Jan. 1, 2025, to correspond with

the effective date of the principles-based bond definition. The guidance for residual tranches is permitted for early application. Reporting entities that apply this guidance in 2024 shall continue to follow the transition guidance in paragraph 37 using the modified dates that correspond to the reporting entity's application date.

- ***SSAP No. 26R—Bonds (Effective 2025)***

4. This statement excludes:

- a. Mortgage loans and other real estate lending activities made in the ordinary course of business. These investments are addressed in *SSAP No. 37—Mortgage Loans* and *SSAP No. 39—Reverse Mortgages*.
- b. Investments that qualify within the principles-based definition as an ABS. These investments shall follow the guidance in *SSAP No. 43R—Asset-Backed Securities*.
- c. Securities that provide varying principal or interest based on underlying equity appreciation or depreciation, an equity-based derivative, real estate or other non-debt variable, as described in paragraph 6.d.
- d. Securities that do not qualify as bonds pursuant to the principles-based bond definition, including first loss positions that lack contractual payments or substantive credit enhancement. These investments shall follow the appropriate guidance in *SSAP No. 21R— Other Admitted Assets*.
- e. Replication (synthetic asset) transactions addressed in *SSAP No. 86—Derivatives*. The admissibility, classification and measurement of a replication (synthetic asset) transactions are not preemptively determined by the principles-based bond definition and should be evaluated in accordance with the guidance on replication (synthetic asset) transactions within *SSAP No. 86*.
- f. Investments that are captured specifically within other SSAPs. For example, reporting entity acquired structured settlements are captured in scope of *SSAP No. 21R—Other Admitted Assets*, held surplus notes are captured in scope of *SSAP No. 41R—Surplus Notes* and working capital finance investments are captured in scope of *SSAP No. 105—Working Capital Finance Investments*. Investments captured in scope of other SSAPs are subject to the measurement and admittance provisions of those SSAPs. Furthermore, investments that have specific reporting lines on dedicated schedules (such as with both surplus notes and WCFI) shall be reported on their dedicated lines.

10. The holder of a debt instrument issued by an ABS Issuer is in a different economic position than if the holder owned the ABS Issuer's assets directly. The holder of the debt instrument is in a different economic position if such debt instrument benefits from substantive credit enhancement through guarantees (or other similar forms of recourse), subordination and/or overcollateralization.

- a. **Substantive Credit Enhancement:** The intent of the criteria requiring the holder to be in a different economic position is to distinguish qualifying bonds from instruments with equity-like characteristics or where the substance of the transaction is more closely aligned with that of the underlying collateral. To qualify as an ABS under this standard, there is a requirement that there are substantive credit enhancements within the structure that absorb losses before the debt instrument being evaluated would be expected to absorb losses. This is inherent in the context of an issuer credit obligation in scope of *SSAP No. 26R* as the owners of the equity in the operating entity are the first to absorb any variability in performance of the operating entity. The same concept applies to asset-backed securities. If substantive credit enhancement did not exist, the substance of the debt instrument being evaluated would be more closely aligned with that of the underlying collateral than that of a bond. Credit enhancement that is merely nominal or lacks economic substance does not put a holder in a different economic position. The substantive credit enhancement required to be in a different economic position is specific to each transaction; determined at origination; and

refers to the level of credit enhancement a market participant (i.e., knowledgeable investor transacting at arm's length) would conclude is substantive.

- b. The first loss position may be issued as part of a securitization in the form of a debt or equity interest, or it may be retained by the sponsor and not issued as part of the securitization. If the first loss position (or a more senior position(s), if the first loss position(s) lacks contractual payments along with a substantive credit enhancement) is issued as part of the securitization, and does not have contractual principal and interest payments along with substantive credit enhancement and is held by a reporting entity, the investment(s) does not qualify for reporting as a bond and shall be reported on Schedule BA: Other Long-Term Invested Assets at the lower of amortized cost or fair value consistent with the treatment for residuals. (These items are further addressed in SSAP No. 21R—Other Admitted Assets.)**

- ***SSAP No. 30R—Unaffiliated Common Stock***

1. This statement establishes statutory accounting principles for common stocks.
2. Investments in common stock of subsidiaries, controlled or affiliated entities (investments in affiliates) are not within the scope of this statement. They are addressed in SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities.
- 3. Investments in the form of common stock that are in substance residual interests or a residual security tranche, as defined in SSAP No. 43R or SSAP No. 48, shall be reported on Schedule BA: Other Long-Term Assets in the dedicated reporting lines for residuals.**

- ***SSAP No. 32R—Preferred Stock***

1. This statement establishes statutory accounting principles for preferred stock.
2. Investments in preferred stock of entities captured in SSAP No. 97—*Investments in Subsidiaries, Controlled or Affiliated Entities* or SSAP No. 48—*Joint Ventures, Partnerships and Limited Liability Companies* as well as preferred stock interests of certified capital companies per INT 06-02: *Accounting and Reporting for Investments in a Certified Capital Company* (CAPCO) are included within the scope of this statement. The requirement to file investments in preferred stock of certain subsidiaries, controlled or affiliated entities with the NAIC pursuant to SSAP No. 97 does not affect the application of the accounting, valuation or admissibility under this statement. In addition to the provisions of this statement, preferred stock investments in SCAs are also subject to the provisions of SSAP No. 25—*Affiliates and Other Related Parties* and SSAP No. 97—*Investments in Subsidiary, Controlled and Affiliated Entities*.
- 3. Investments in the form of preferred stock that are in substance residual interests or a residual security tranche, as defined in SSAP No. 43R or SSAP No. No. 48, shall be reported on Schedule BA: Other Long-Term Assets in the dedicated reporting lines for residuals.**

- ***SSAP No. 43R—Asset-Backed Securities (Effective 2025)***

4. This statement excludes:
 - a. Securities captured in scope of SSAP No. 26R—*Bonds*.
 - b. Mortgage loans in scope of SSAP No. 37—*Mortgage Loans* that qualify under an SVO structural assessment as SVO-Identified Credit Tenant Loans. These investments are excluded as these are captured as issuer credit obligations under SSAP No. 26R.
 - c. Securities that do not qualify as Asset-Backed Securities per the bond definition in SSAP No. 26R—Bonds. This exclusion includes residual or interests, as well as first loss positions, that do not have contractual payments or substantive credit enhancement. Debt**

securities that do not qualify and residual interests shall follow guidance in SSAP No. 21R—Other Admitted Assets.

11. After initial recognition, the carrying value shall be determined in accordance with the reported NAIC designation. The determination of NAIC designations shall be in accordance with the requirements detailed in the Purposes and Procedures Manual of the NAIC Investment Analysis Office (P&P Manual):

- a. For reporting entities that maintain an Asset Valuation Reserve (AVR), asset-backed securities, **excluding residual tranches or interests**, 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. 3
- b. For reporting entities that do not maintain an AVR, asset-backed securities designated highest-quality and high-quality (NAIC designations 1 and 2, respectively), **excluding residual tranches or interests**, shall be reported at amortized cost; loan-backed and structured securities that are designated medium quality, low quality, lowest quality and in or near default (NAIC designations 3 to 6, respectively) shall be reported at the lower of amortized cost or fair value.
- c. For residual tranches or interests⁴, all reporting entities shall report the item on Schedule BA: Other Long-Term Invested Assets at the lower of amortized cost or fair value. Changes in the reported value from the prior period shall be recorded as unrealized gains or losses. For reporting entities that maintain an AVR, the accounting for unrealized gains and losses shall be in accordance with SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve. These items are captured in SSAP No. 21R—Other Admitted Assets and subject to admittance restrictions detailed in that statement.

Footnote 4: Reference to “residual tranches or interests” intends to capture securitization tranches and beneficial interests as well as other structures that reflect loss layers without any contractual payments, whether principal or interest, or both. Payments to holders of these investments occur after contractual interest and principal payments have been made to other tranches or interests and are based on the remaining available funds. Although payments to holders can occur throughout an investment’s duration (and not just at maturity), such instances still reflect the residual amount permitted to be distributed after other holders have received contractual interest and principal payments.

Residual Tranches or Interests

27. A residual interest or a residual security tranche (collectively referred to as residuals) exists in investment structures that issue one or more classes of debt securities created for the primary purpose of raising debt capital backed by collateral assets. The primary source of debt repayment is derived through rights to the cash flows of a discrete pool of collateral assets. These designs could be backed directly or indirectly through a feeder fund. The collateral assets generate cash flows that provide interest and principal payments to debt holders through a contractually prescribed distribution methodology (e.g., waterfall dictating the order and application of all collateral cash flows). Once those contractual requirements are met, the remaining cash flows generated by (or with the sale of) the collateral assets are provided to the holder of the residual security/residual interest holder. When an asset within the discrete pool of assets does not perform as expected, it impacts the extent to which cash flows will be generated and distributed. The residual holders in the structure continue to receive payments from the collateral so long as there are cash flows in excess of the debt obligations. The payments to the residual holder may vary significantly, both in timing and amount, based on the underlying collateral performance.

28. The structural design of a residual interest or residual security tranche can vary, but the overall concept is that they receive the remaining cash flows after all debt holders receive contractual interest and principal payments. Determining whether an investment in a structure reflects a residual interest or tranche shall be based on the substance of the investment held rather than its legal form. Common characteristics of residual interests/residual security tranches include the items noted below, but the presence or absence of any of these factors should not be definitive

in determination. Classification as a residual should be based on the substance of the investment and how cash flows to the holder are determined.

- a. Residuals often do not have contractual principal or interest.
- b. Residuals may be structured with terms that appear to be stated principal or interest but that lack substance, and result in receiving the residual cash flows of the underlying collateral. The terms allow for significant variation in the timing and amount of cash flows without triggering a default of the structure.
- c. Residuals do not have credit ratings or NAIC assigned designations. Rather, they are first loss positions that provide subordination to support the credit quality of the typically rated debt tranches.
- d. Residuals may provide payment throughout the investment duration (and not just at maturity), but the payments received continue to reflect the residual amount permitted after debt tranche holders receive contractual principal and interest payments.
- e. Frequently, there are contractual triggers that divert cash flows from the residual holders to the debt tranches if the structure becomes stressed.

- *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*

Residual Interests and Reporting

18. Investments in scope of this statement are reported on *Schedule BA: Other Long-Term Assets*. Schedule BA includes dedicated reporting categories for joint ventures, partnerships, and limited liability company investments as well as for residual interests, both with reporting lines in accordance with underlying asset characteristics. Investments within scope of this standard shall be divided within these reporting categories, with investments that reflect residual interests, or that predominantly hold residual interests captured in the residual interest reporting category.

19. A residual interest or a residual security tranche (collectively referred to as residuals) exists in investment structures that issue one or more classes of debt securities created for the primary purpose of raising debt capital backed by collateral assets. The primary source of debt repayment is derived through rights to the cash flows of a discrete pool of collateral assets. These designs could be backed directly or indirectly through a feeder fund. The collateral assets generate cash flows that provide interest and principal payments to debt holders through a contractually prescribed distribution methodology (e.g., waterfall dictating the order and application of all collateral cash flows). Once those contractual requirements are met, the remaining cash flows generated by (or with the sale of) the collateral assets are provided to the holder of the residual security/residual interest holder. When an asset within the discrete pool of assets does not perform as expected, it impacts the extent to which cash flows will be generated and distributed. The residual holders in the structure continue to receive payments from the collateral so long as there are cash flows in excess of the debt obligations. The payments to the residual holder may vary significantly, both in timing and amount, based on the underlying collateral performance.

20. The structural design of a residual interest or residual security tranche can vary, but the overall concept is that they receive the remaining cash flows after all debt holders receive contractual interest and principal payments. Determining whether an investment in a structure reflects a residual interest or tranche shall be based on the substance of the investment held rather than its legal form. Common characteristics of residual interests/residual security tranches include the items noted below, but the presence or absence of any of these factors should not be definitive in determination. Classification as a residual should be based on the substance of the investment and how cash flows to the holder are determined.

- a. Residuals often do not have contractual principal or interest.

- b. **Residuals may be structured with terms that appear to be stated principal or interest but that lack substance and result in receiving the residual cash flows of the underlying collateral. The terms allow for significant variation in the timing and amount of cash flows without triggering a default of the structure.**
- c. **Residuals do not have credit ratings or NAIC assigned designations. Rather, they are first loss positions that provide subordination to support the credit quality of the typically rated debt tranches.**
- d. **Residuals may provide payment throughout the investment duration (and not just at maturity), but the payments received continue to reflect the residual amount permitted after debt tranche holders receive contractual principal and interest payments.**
- e. **Frequently, there are contractual triggers that divert cash flows from the residual holders to the debt tranches if the structure becomes stressed.**

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 Item 2021-15 – SSAP No. 43R – Residual Tranches, was adopted November 10, 2021, to incorporate accounting guidance for residuals and clarify that residuals shall be reported on Schedule BA.
- Agenda item 2023-12 – Residuals in SSAP No. 48 Investments, was adopted September 21, 2023 to define residuals consistently between *SSAP No. 43R—Asset-Backed Securities* and *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies* and to add Annual Statement Instructions for the Schedule BA residual reporting category.
- Agenda Item 2023-23 – Residuals in Preferred Stock and Common Stock Structures was adopted during the 2023 Fall National Meeting to exclude residual interests from *SSAP No. 30R—Unaffiliated Common Stock* and *SSAP No. 32R—Preferred Stock*.
- Principles-Based Bond Definition – During the 2023 Summer National Meeting, the Working Group adopted the principles-based bond definition in a revised *SSAP No. 26R—Bonds* and *SSAP No. 43R—Asset-Backed Securities*. Subsequent to this adoption, revisions to *SSAP No. 21R—Other Admitted Assets* were exposed to capture accounting and reporting guidance for non-bond debt securities as well as residual interests. The revisions to *SSAP No. 21R* for debt securities that do not qualify as bonds to prescribe the measurement method and accounting provisions for residual interests was adopted March 16, 2024 during the 2024 Spring National Meeting.

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 recommend that the Working Group move this item to the active listing of the maintenance agenda categorized as a SAP clarification and expose revisions to incorporate consistency revisions for residuals so that all SSAPs refer to SSAP No. 21R for the formal definition and accounting and reporting guidance. This recommendation involves revisions to *SSAP No. 26R—Bonds* (Effective 2025), *SSAP No. 30R—Unaffiliated Common Stock*, *SSAP No. 32R—Preferred Stock*, *SSAP No. 43R—Asset-Backed Securities* (Effective 2025), and *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*.

Staff Review Completed by: Julie Gann, NAIC Staff—February 2024

Status:

On March 16, 2024, the Statutory Accounting Principles (E) Working Group exposed consistency revisions for residuals so that *SSAP No. 26R—Bonds* (Effective 2025), *SSAP No. 30R—Unaffiliated Common Stock*, *SSAP No. 32R—Preferred Stock*, *SSAP No. 43R—Asset-Backed Securities* (Effective January 1, 2025), and *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies* refer directly to *SSAP No. 21R—Other Admitted Assets* for the formal definition and accounting and reporting guidance.

Proposed Revisions:**SSAP No. 26R—Bonds (Effective Jan. 1, 2025)**

4. This statement excludes:

- a. Mortgage loans and other real estate lending activities made in the ordinary course of business. These investments are addressed in *SSAP No. 37—Mortgage Loans* and *SSAP No. 39—Reverse Mortgages*.
- b. Investments that qualify within the principles-based definition as an ABS. These investments shall follow the guidance in *SSAP No. 43R—Asset-Backed Securities*.
- c. Securities that provide varying principal or interest based on underlying equity appreciation or depreciation, an equity-based derivative, real estate or other non-debt variable, as described in paragraph 6.d.
- d. Securities that do not qualify as bonds pursuant to the principles-based bond definition, including first loss positions that lack ~~contractual payments or~~ substantive credit enhancement as described in paragraph 10.b., as those items are residual interests. All investments that are in substance residual interests or that is a residual security tranche, as defined in SSAP No. 21R—Other Admitted Assets. ~~These investments~~ shall follow the appropriate guidance in SSAP No. 21R—~~Other Admitted Assets~~.
- e. Replication (synthetic asset) transactions addressed in *SSAP No. 86—Derivatives*. The admissibility, classification and measurement of a replication (synthetic asset) transactions are not preemptively determined by the principles-based bond definition and should be evaluated in accordance with the guidance on replication (synthetic asset) transactions within SSAP No. 86.
- f. Investments that are captured specifically within other SSAPs. For example, reporting entity acquired structured settlements are captured in scope of *SSAP No. 21R—Other Admitted Assets*, held surplus notes are captured in scope of *SSAP No. 41R—Surplus Notes* and working capital finance investments are captured in scope of *SSAP No. 105—Working Capital Finance Investments*. Investments captured in scope of other SSAPs are subject to the measurement and admittance provisions of those SSAPs. Furthermore, investments that have specific reporting lines on dedicated schedules (such as with both surplus notes and WCFI) shall be reported on their dedicated lines.

10. The holder of a debt instrument issued by an ABS Issuer is in a different economic position than if the holder owned the ABS Issuer's assets directly. The holder of the debt instrument is in a different economic position if such debt instrument benefits from substantive credit enhancement through guarantees (or other similar forms of recourse), subordination and/or overcollateralization.

- a. Substantive Credit Enhancement: The intent of the criteria requiring the holder to be in a different economic position is to distinguish qualifying bonds from instruments with equity-like

characteristics or where the substance of the transaction is more closely aligned with that of the underlying collateral. To qualify as an ABS under this standard, there is a requirement that there are substantive credit enhancements within the structure that absorb losses before the debt instrument being evaluated would be expected to absorb losses. This is inherent in the context of an issuer credit obligation in scope of SSAP No. 26R as the owners of the equity in the operating entity are the first to absorb any variability in performance of the operating entity. The same concept applies to asset-backed securities. If substantive credit enhancement did not exist, the substance of the debt instrument being evaluated would be more closely aligned with that of the underlying collateral than that of a bond. Credit enhancement that is merely nominal or lacks economic substance does not put a holder in a different economic position. The substantive credit enhancement required to be in a different economic position is specific to each transaction; determined at origination; and refers to the level of credit enhancement a market participant (i.e., knowledgeable investor transacting at arm's length) would conclude is substantive.

- b. The first loss position may be issued as part of an ~~an securitization-ABS structure~~ in the form of a debt or equity interest, or it may be retained by the sponsor and not issued as part of the ~~securitization structure~~. If the first loss position (or a more senior position(s), if the first loss position(s) lacks ~~contractual payments along with a~~ substantive credit enhancement) is issued as part of the ~~securitization structure~~, and does not have ~~contractual principal and interest payments along with~~ substantive credit enhancement and is held by a reporting entity, the investment(s) does not qualify for reporting as a bond as it is a residual interest. All residual interests shall follow the accounting and reporting guidance in SSAP No. 21R—Other Admitted Assets. ~~and shall be reported on Schedule BA: Other Long-Term Invested Assets at the lower of amortized cost or fair value consistent with the treatment for residuals. (These items are further addressed in SSAP No. 21R—Other Admitted Assets.)~~

• **SSAP No. 30R—Unaffiliated Common Stock**

1. This statement establishes statutory accounting principles for common stocks.
2. Investments in common stock of subsidiaries, controlled or affiliated entities (investments in affiliates) are not within the scope of this statement. They are addressed in *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*.
3. Investments in the form of common stock that are in substance residual interests or a residual security tranche, as defined in ~~SSAP No. 21R—Other Admitted Assets~~ ~~SSAP No. 43R or SSAP No. 48~~, shall follow the accounting and reporting guidance in SSAP No. 21R with reporting ~~be reported~~ on *Schedule BA: Other Long-Term Assets* in the dedicated reporting lines for residuals.

• **SSAP No. 32R—Preferred Stock**

1. This statement establishes statutory accounting principles for preferred stock.
2. Investments in preferred stock of entities captured in *SSAP No. 97—Investments in Subsidiaries, Controlled or Affiliated Entities* or *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies* as well as preferred stock interests of certified capital companies per *INT 06-02: Accounting and Reporting for Investments in a Certified Capital Company* (CAPCO) are included within the scope of this statement. The requirement to file investments in preferred stock of certain subsidiaries, controlled or affiliated entities with the NAIC pursuant to SSAP No. 97 does not affect the application of the accounting, valuation or admissibility under this statement. In addition to the provisions of this statement, preferred stock investments in SCAs are also subject to the provisions of *SSAP No. 25—Affiliates and Other Related Parties* and *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*.

3. Investments in the form of preferred stock that are in substance residual interests or a residual security tranche, as defined in ~~SSAP No. 43R or SSAP No. No. 48~~ SSAP No. 21R—Other Admitted Assets, shall follow the accounting and reporting guidance in SSAP No. 21R with reporting ~~be reported~~ on Schedule BA: Other Long-Term Assets in the dedicated reporting lines for residuals.

- **SSAP No. 43R—Asset-Backed Securities (Effective 2025)**

4. This statement excludes:

- Securities captured in scope of SSAP No. 26R—Bonds.
- Mortgage loans in scope of SSAP No. 37—Mortgage Loans that qualify under an SVO structural assessment as SVO-Identified Credit Tenant Loans. These investments are excluded as these are captured as issuer credit obligations under SSAP No. 26R.
- Securities that do not qualify as Asset-Backed Securities per the bond definition in SSAP No. 26R—Bonds and residual interests as defined in SSAP No. 21R—Other Admitted Assets. ~~This exclusion includes residual or interests, as well as first loss positions, that do not have contractual payments or substantive credit enhancement. These securities~~ Debt securities that do not qualify and residual interests shall follow the accounting and reporting guidance in SSAP No. 21R. ~~—Other Admitted Assets~~

11. After initial recognition, the carrying value shall be determined in accordance with the reported NAIC designation. The determination of NAIC designations shall be in accordance with the requirements detailed in the Purposes and Procedures Manual of the NAIC Investment Analysis Office (P&P Manual):

- For reporting entities that maintain an Asset Valuation Reserve (AVR), asset-backed securities, ~~excluding residual tranches or interests~~, 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. 3

- For reporting entities that do not maintain an AVR, asset-backed securities designated highest-quality and high-quality (NAIC designations 1 and 2, respectively), ~~excluding residual tranches or interests~~, shall be reported at amortized cost; loan-backed and structured securities that are designated medium quality, low quality, lowest quality and in or near default (NAIC designations 3 to 6, respectively) shall be reported at the lower of amortized cost or fair value.

- ~~For residual tranches or interests⁴, all reporting entities shall report the item on Schedule BA: Other Long-Term Invested Assets at the lower of amortized cost or fair value. Changes in the reported value from the prior period shall be recorded as unrealized gains or losses. For reporting entities that maintain an AVR, the accounting for unrealized gains and losses shall be in accordance with SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve. These items are captured in SSAP No. 21R—Other Admitted Assets and subject to admittance restrictions detailed in that statement.~~

~~Footnote 4: Reference to “residual tranches or interests” intends to capture securitization tranches and beneficial interests as well as other structures that reflect loss layers without any contractual payments, whether principal or interest, or both. Payments to holders of these investments occur after contractual interest and principal payments have been made to other tranches or interests and are based on the remaining available funds. Although payments to holders can occur throughout an investment’s duration (and not just at maturity), such instances still reflect the residual amount permitted to be distributed after other holders have received contractual interest and principal payments.~~

~~Residual Tranches or Interests~~

~~27. — A residual interest or a residual security tranche (collectively referred to as residuals) exists in investment structures that issue one or more classes of debt securities created for the primary purpose of raising debt capital backed by collateral assets. The primary source of debt repayment is derived through rights to the cash flows of a discrete pool of collateral assets. These designs could be backed directly or indirectly through a feeder fund. The collateral assets generate cash flows that provide interest and principal payments to debt holders through a contractually prescribed distribution methodology (e.g., waterfall dictating the order and application of all collateral cash flows). Once those contractual requirements are met, the remaining cash flows generated by (or with the sale of) the collateral assets are provided to the holder of the residual security/residual interest holder. When an asset within the discrete pool of assets does not perform as expected, it impacts the extent to which cash flows will be generated and distributed. The residual holders in the structure continue to receive payments from the collateral so long as there are cash flows in excess of the debt obligations. The payments to the residual holder may vary significantly, both in timing and amount, based on the underlying collateral performance.~~

~~28. — The structural design of a residual interest or residual security tranche can vary, but the overall concept is that they receive the remaining cash flows after all debt holders receive contractual interest and principal payments. Determining whether an investment in a structure reflects a residual interest or tranche shall be based on the substance of the investment held rather than its legal form. Common characteristics of residual interests/residual security tranches include the items noted below, but the presence or absence of any of these factors should not be definitive in determination. Classification as a residual should be based on the substance of the investment and how cash flows to the holder are determined.~~

- ~~a. — Residuals often do not have contractual principal or interest.~~
- ~~b. — Residuals may be structured with terms that appear to be stated principal or interest but that lack substance, and result in receiving the residual cash flows of the underlying collateral. The terms allow for significant variation in the timing and amount of cash flows without triggering a default of the structure.~~
- ~~c. — Residuals do not have credit ratings or NAIC assigned designations. Rather, they are first loss positions that provide subordination to support the credit quality of the typically rated debt tranches.~~
- ~~d. — Residuals may provide payment throughout the investment duration (and not just at maturity), but the payments received continue to reflect the residual amount permitted after debt tranche holders receive contractual principal and interest payments.~~
- ~~e. — Frequently, there are contractual triggers that divert cash flows from the residual holders to the debt tranches if the structure becomes stressed.~~

- **SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies**

1. This statement establishes statutory accounting principles for investments in any joint ventures, partnerships, and limited liability companies, including investments in certified capital companies (CAPCO) per *INT 06-02: Accounting and Reporting for Investments in a Certified Capital Company* (CAPCO), whether or not it is considered to be controlled by or affiliated with the reporting entity.

2. This statement excludes:

- a. Single real estate property investments that are wholly-owned by an LLC that is directly and wholly-owned by the reporting entity, and that meet the criteria established in SSAP No. 40R—Real Estate Investments, ~~are excluded from this statement.~~
- b. ~~This statement does not address the accounting for i~~investments in joint ventures, partnerships and limited liability companies that invest in tax credit programs and are in scope of Low Income Housing Tax Credit Properties as discussed in SSAP No. 93—Investments in Tax Credit Programs~~Low Income Housing Tax Credit Property Investments. However, investments in certain state Low Income Housing~~

~~Tax Credit Property Investments that do not fall within the scope of SSAP No. 93 are covered by the requirements of this statement. (Staff Note: This text reflects edits proposed to reflect the revised tax credit guidance in SSAP No. 93 exposed under agenda item 2022-14.)~~

- ~~c. [Investments that are in substance residual interests or a residual security tranche, as defined in SSAP No. 21R—Other Admitted Assets, shall follow the accounting and reporting guidance in SSAP No. 21R with reporting on Schedule BA: Other Long-Term Assets in the dedicated reporting lines for residuals.](#)~~

~~Residual Interests and Reporting~~

~~18. Investments in scope of this statement are reported on *Schedule BA: Other Long-Term Assets*. Schedule BA includes dedicated reporting categories for joint ventures, partnerships, and limited liability company investments as well as for residual interests, both with reporting lines in accordance with underlying asset characteristics. Investments within scope of this standard shall be divided within these reporting categories, with investments that reflect residual interests, or that predominantly hold residual interests captured in the residual interest reporting category.~~

~~19. A residual interest or a residual security tranche (collectively referred to as residuals) exists in investment structures that issue one or more classes of debt securities created for the primary purpose of raising debt capital backed by collateral assets. The primary source of debt repayment is derived through rights to the cash flows of a discrete pool of collateral assets. These designs could be backed directly or indirectly through a feeder fund. The collateral assets generate cash flows that provide interest and principal payments to debt holders through a contractually prescribed distribution methodology (e.g., waterfall dictating the order and application of all collateral cash flows). Once those contractual requirements are met, the remaining cash flows generated by (or with the sale of) the collateral assets are provided to the holder of the residual security/residual interest holder. When an asset within the discrete pool of assets does not perform as expected, it impacts the extent to which cash flows will be generated and distributed. The residual holders in the structure continue to receive payments from the collateral so long as there are cash flows in excess of the debt obligations. The payments to the residual holder may vary significantly, both in timing and amount, based on the underlying collateral performance.~~

~~20. The structural design of a residual interest or residual security tranche can vary, but the overall concept is that they receive the remaining cash flows after all debt holders receive contractual interest and principal payments. Determining whether an investment in a structure reflects a residual interest or tranche shall be based on the substance of the investment held rather than its legal form. Common characteristics of residual interests/residual security tranches include the items noted below, but the presence or absence of any of these factors should not be definitive in determination. Classification as a residual should be based on the substance of the investment and how cash flows to the holder are determined.~~

- ~~a. Residuals often do not have contractual principal or interest.~~
- ~~b. Residuals may be structured with terms that appear to be stated principal or interest but that lack substance and result in receiving the residual cash flows of the underlying collateral. The terms allow for significant variation in the timing and amount of cash flows without triggering a default of the structure.~~
- ~~c. Residuals do not have credit ratings or NAIC assigned designations. Rather, they are first loss positions that provide subordination to support the credit quality of the typically rated debt tranches.~~
- ~~d. Residuals may provide payment throughout the investment duration (and not just at maturity), but the payments received continue to reflect the residual amount permitted after debt tranche holders receive contractual principal and interest payments.~~
- ~~e. Frequently, there are contractual triggers that divert cash flows from the residual holders to the debt tranches if the structure becomes stressed.~~

On August 13, 2024, the Statutory Accounting Principles (E) Working Group adopted the exposed consistency revisions for residuals with an effective date of January 1, 2025. These revisions result with all noted SSAPs referring to *SSAP No. 21R—Other Admitted Assets* for the formal definition and accounting and reporting guidance.

<https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/NationalMeetings/A.NationalMeetingMaterials/2024/08-13-24SummerNationalMeeting/Adoptions/06-24-08-ResidualConsistencyRevisions.docx>