

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

Issue: Holders of Capital Notes**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 prepared in response to the direction of the Working Group during the 2024 Fall National Meeting with the adoption of *INT 24-01: Principles-Based Bond Definition Implementation Questions and Answers*. With the adoption of the INT, and the guidance for reporting certain debt securities as capital notes in scope of *SSAP No. 41—Surplus Notes*, industry identified that slight revisions may be necessary to reflect the capital note distinctions. The Working Group directed NAIC staff to work with industry in this review and identifying necessary changes.

From the initial review and working with industry, revisions have been proposed to address the following specifically for capital notes:

1. Incorporate a definition/reference to the INT for capital notes.
2. Clarify the admittance restrictions.
3. Clarify the guidance for NAIC designations.
4. Update the impairment guidance to refer to capital notes.

In addition to these items, it was identified that an existing disclosure for surplus notes, which requires disclosure of any holder of 10% or more of an SEC-registered surplus note, is likely an extensive administrative burden, may be difficult to complete, and as a narrative disclosure only (not data-captured), is likely not often utilized. From a review of the disclosure, it predates the issuance of *SSAP No. 41—Surplus Notes*, and there are questions as to how a disclosure of certain holders of SEC-registered notes would be purposeful or used. NAIC staff has proposed to eliminate this aspect of the disclosure but retain the disclosure focusing on surplus notes with affiliates. NAIC staff requests feedback on whether this disclosure should be retained.

Existing Authoritative Literature:

- *SSAP No. 41—Surplus Notes*

1. This statement establishes statutory accounting principles for issuers and holders of surplus notes, and for holders of capital notes. Statutory accounting principles for issuers of capital notes are provided in *SSAP No. 15—Debt and Holding Company Obligations*.

(Paragraphs 2-8 Is limited to “Issuers of Surplus Notes” so is not included.)

Holders of Capital or Surplus Notes

9. Investments in capital or surplus notes meet the definition of assets as defined in *SSAP No. 4—Assets and Nonadmitted Assets* and are admitted assets to the extent they conform to the requirements of this statement. Additionally, the amount admitted is specifically limited to the following two provisions:
 - a. The admitted asset value of a capital or surplus note shall not exceed the amount that would be admitted if the instrument was considered an equity instrument and added to any other equity instruments in the issuer held directly or indirectly by the holder of the capital or surplus note.

- b. The surplus note shall be nonadmitted if issued by an entity that is subject to any order of liquidation, conservation, rehabilitation or any company action level event based on its risk-based capital. Subsequent to this nonadmittance, if any of the conditions described ceased to exist, the holder may admit the surplus note at the value determined under paragraph 11. If a surplus note was nonadmitted pursuant to this paragraph, and the surplus note was ultimately determined to be other-than-temporarily impaired, the reporting entity shall recognize a realized loss for the portion of the surplus note determined to be other-than-temporarily impaired, with elimination of a corresponding amount of the previously nonadmitted assets.

10. Capital or surplus notes shall be valued in accordance with paragraph 11. Pursuant to that paragraph, the value is determined by NAIC credit rating provider (CRP) ratings. Part One – Capital and Surplus Debentures of the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* provides guidance in determining the NAIC designation for these investments.

11. If the capital or surplus note has been rated by an NAIC CRP and has a designation equivalent of NAIC 1 or NAIC 2, then it shall be reported at amortized cost. If the capital or surplus note is not CRP rated or has an NAIC designation equivalent of NAIC 3 through 6, then the balance sheet amount shall be reported at the lesser of amortized cost or fair value, with fluctuations in value reflected as unrealized valuation changes.

12. For reporting entities required to 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*. For reporting entities not required to maintain an AVR, unrealized gains and losses shall be recorded as a direct credit or charge to unassigned funds (surplus).

13. For surplus notes issued and held (directly or indirectly) between insurance reporting entities and subsidiary, controlled and affiliated entities, the guidance in *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities* requires adjustment to prevent double-counting of surplus notes. For example, an insurance reporting entity is not permitted to report the issuance of a surplus note as an increase in surplus and have an asset representing an investment in the SCA that includes the issued surplus note (held by an SCA). Pursuant to *SSAP No. 97*, the “investment in the SCA” shall be adjusted to eliminate the surplus note issued by the direct or indirect parent insurance reporting entity. This treatment shall also apply for instances in which the SCA acquires any portion of outstanding surplus notes issued by the direct or indirect parent through any means (e.g., directly acquired from the parent, acquired through a third-party broker, or via the market).

Income

14. Only interest that has been approved by the issuer’s domiciliary commissioner shall be accrued as income by a holder of surplus notes. Interest income for any period consists of interest collected during the period and the change in the due and accrued interest between the beginning and end of the period approved by the issuer’s domiciliary commissioner.

15. Except for the specific limitations on recognizing interest income in paragraph 14, investment income, and the recognition of uncollectible accrued interest, shall follow the guidance in *SSAP No. 34—Investment Income Due and Accrued*.

Impairment

16. An other-than-temporary impairment^(INT 06-07) shall be considered to have occurred if it is probable that the reporting entity will be unable to collect all amounts due according to the contractual terms of the surplus note. Pursuant to the terms of a surplus note, payments of principal and interest may be delayed if the issuer’s domiciliary commissioner does not approve payment. Extended delays of either principal or interest shall trigger an evaluation for an other-than-temporary impairment. An other-than-temporary impairment shall be recognized in situations when the reporting entity has made a decision to sell a surplus note prior to its maturity at an amount below its carrying value. If it is determined that a decline in fair value is other-than-temporary, an impairment loss shall be recognized as a realized loss equal to the difference between the surplus note’s carrying value and the fair value at the balance sheet date of the reporting period for which the assessment is made. The measurement of impairment shall not include partial recoveries of fair value subsequent to the balance sheet date. For reporting entities required to maintain an AVR, realized losses shall be accounted for in accordance with *SSAP No. 7*.

17. In periods subsequent to the recognition of an other-than-temporary impairment loss for a surplus note, the holder of the surplus note shall account for the other-than-temporarily impaired surplus note as if the surplus note had been purchased on the measurement date of the other-than-temporary impairment. The fair value of the surplus note on the measurement date shall become the new cost basis of the surplus note and the new cost basis shall not be adjusted for subsequent recoveries in fair value. The discount or reduced premium recorded for the surplus note, based on the new cost basis, shall be amortized over the remaining life of the surplus note in the prospective manner based on the amount and timing of future estimated cash flows. The surplus note shall continue to be subject to impairment analysis for each subsequent reporting period. Future declines in fair value which are determined to be other-than-temporary shall be recorded as realized losses.

Disclosures

18. The notes to the financial statements of a reporting entity that issues surplus notes shall disclose the following as long as the surplus notes are outstanding:

- a. Date issued;
- b. Description and fair value of the assets received;
- c. Holder of the note or, if public, the names of the underwriter and trustee, with identification on whether the holder of the surplus note is a related party per *SSAP No. 25—Affiliates and Other Related Parties*;
- d. Original issue amount of note;
- e. Carrying value of note;
- f. The rate at which interest accrues;
- g. Maturity dates or repayment schedules, if stated;
- h. Unapproved interest and/or principal;
- i. Life-to-date and current year approved interest and principal recognized;
 - i. Percentage interest payments offset through 'administrative offsetting' (not inclusive of amounts paid to a third-party liquidity provider). For example, if \$100 in interest was recognized through the year, \$10 of which was remitted to a third-party liquidity provider and the remainder \$90 was offset, the reporting entity shall report 100% as offset.
- j. Disclosure of whether the surplus note was issued as part of a transaction with any of the following attributes:
 - i. Do surplus note/associated asset terms negate or reduce cash flow exchanges, and/or are amounts payable under surplus note and amounts receivable under other agreements contractually linked? (For example, the asset provides interest payments only when the surplus note provides interest payments.)
 - ii. Are any amounts due under surplus notes and associated assets netted or offset (partially or in full) thus eliminating or reducing the exchange of cash or assets that would normally occur throughout the duration, or at maturity, of the agreement? (This may be referred to as administrative offsetting.)
 - iii. Were the proceeds from the issuance of a surplus note used to purchase an asset directly or indirectly from the holder of the surplus note?
- k. Principle amount and fair value of assets received upon surplus note issuance, if applicable;
- l. Subordination terms;

- m. Liquidation preference to the reporting entity's common and preferred shareholders;
- n. The repayment conditions and restrictions;
- o. Information about any guarantees, support agreements or related party transactions associated with the surplus note issuance, and whether payments have been made under such agreements.

19. If a reporting entity has ceded business to a surplus note issuer that is a related party as part of a reinsurance transaction in which the surplus note meets any of the criteria in paragraph 18.j., the ceding entity shall provide a description of the transaction, including whether the criteria in paragraph 18.j. were met with respect to the surplus note issuance, as long as the reinsurance agreement remains in force. The ceding entity should provide a description of the risks reinsured, the related party reinsurer, any guarantees or support agreements, and the amount of notes outstanding.

20. If the proceeds from the issuance of a surplus note used to purchase an asset directly or indirectly from the holder of the surplus note, the following information shall be disclosed regarding the assets received:

- a. Identification of asset, including the investment schedule where the asset is reported and reported NAIC designation.
- b. Book/adjusted carrying value of asset as of the current reporting date.
- c. A description of terms under which liquidity would be provided should a triggering event occur.

21. In addition to the above, a reporting entity shall identify all affiliates that hold any portion of a surplus debenture or similar obligation (including an offering registered under the Securities Act of 1933 or distributed pursuant to rule 144A under the Securities Act of 1933), and any holder of 10% or more of the outstanding amount of any surplus note registered under the Securities Act of 1933 or distributed pursuant to Rule 144A under the Securities Act of 1933.

INT 24-01: Principles-Based Bond Definition Implementation Questions and Answers

10. Q – How should hybrid securities be accounted and reported? [SSAP No. 26, paragraph 13]

10.1 A – SSAP No. 26 prior to the principles-based bond definition explicitly scoped in a class of assets referred to as “hybrid securities” which are defined as “securities whose proceeds are accorded some degree of equity treatment by one or more of the nationally recognized statistical rating organizations (NRSRO) and/or which are recognized as regulatory capital by the issuer’s primary regulatory authority. Hybrid securities are designed with characteristics of debt and equity and are intended to provide protection to the issuer’s senior note holders. Hybrid securities are sometimes referred to as capital securities.” During the development of the principles-based bond definition, it was decided to remove the explicit scope-in and instead rely on the new principles to determine whether bond classification is appropriate. As these securities come in several forms, additional clarity on where to report such securities is warranted.

10.2 Equity Securities: Investments that represent shares, units, or an ownership interest in a company or other entity but do not reflect common stock that were previously considered hybrids under SSAP No. 26 are equity investments and shall be captured as preferred stock in scope of *SSAP No. 32—Preferred Stock*. Investments in debt securities are not permitted to be reported in scope of *SSAP No. 30—Unaffiliated Common Stock* or *SSAP No. 32*.

10.3 Debt Securities: Investments in debt securities previously considered hybrids under SSAP No. 26 (including those debt securities with cumulative interest features) **that qualify** under the principles-based bond definition shall be reported as bonds on Schedule D. An example may include certain debt securities which NRSROs allow to be treated as equity but for which all the principles-based bond definition requirements are present. To be clear, a set maturity date for a debt security is not a requirement for bond classification if the bond otherwise qualifies under the definition. (Perpetual bonds that qualify under the bond definition are permitted as bonds.)

10.4 Investments in debt securities treated as regulatory capital by the issuer's primary regulatory authority, and **that do not qualify** under the principles-based bond definition solely because interest can be cancelled in the event of financial stress in a non-resolution scenario without triggering an act of default are capital notes and shall be captured in *SSAP No. 41—Surplus Notes*. These capital notes are often issued by domestic or foreign banks, and the domestic or foreign bank regulator or the Issuer has the ability to cancel interest or dividends, without future interest accumulation or payment.

10.5 Debt securities other than capital notes (as defined in 10.4 above) that permit the issuing entity to cancel interest without future interest accumulation or payment and without triggering an act of default, or that incorporate other equity components that do not permit bond classification under the principles-based bond definition are non-bond debt securities and shall be captured in scope of *SSAP No. 21—Other Admitted Assets*.

10.6 Debt securities issued by regulated institutions where only the issuer's primary regulator may have regulatory power to cancel or convert to equity all or a portion of the debt and/or its related interest payments, solely in a resolution scenario were not previously considered hybrid securities and should continue to be reported as Schedule D bonds, as Issuer Credit Obligations under *SSAP No. 26*, so long as all principles-based bond definition requirements are met.

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):

On Nov. 17, 2024, the Statutory Accounting Principles (E) Working Group adopted *INT 24-01: Principles-Based Bond Definition Implementation Questions and Answers*. This INT addresses hybrid securities, including debt securities that are treated as regulatory capital. With the adoption of this guidance, and the reference for capital notes to be in scope of *SSAP No. 41*, industry identified minor revisions are needed to *SSAP No. 41*.

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 as a SAP clarification and expose revisions to *SSAP No. 41—Surplus Notes*, to incorporate needed changes to clarify certain aspects for capital notes. As part of the review, minor other clarification revisions were also incorporated.

As there are two separate reporting lines on Schedule BA for “Surplus Notes” and “Capital Notes” with very few items currently being reported in the “Capital Note” category, this agenda item recommends annual statement instruction revisions to clarify that qualifying insurer-issued notes held by another insurance reporting entity be reported as “Surplus Notes” on Schedule BA. There is also proposed clarification on what should be included as “Capital Notes.”

Proposed revisions to *SSAP No. 41*:

1. This statement establishes statutory accounting principles for issuers and holders of surplus notes, and for holders of capital notes^{FN}. Statutory accounting principles for issuers of capital notes are provided in *SSAP No. 15—Debt and Holding Company Obligations*.

[New Footnote: *INT 24-01: Principles-Based Bond Definition Implementation Questions and Answers* identifies that debt securities treated as regulatory capital by the issuer's primary regulatory authority and that do not qualify under the principles-based bond definition solely because interest can be cancelled in the event of financial stress in a non-resolution scenario without triggering an event of default are capital notes in scope of this statement. For consistency in investment reporting for held securities, only insurer-issued notes that qualify under paragraph 3 shall be reported as surplus notes. As detailed within, surplus notes are subject to additional restrictions not applicable capital notes.](#)

Holders of Capital or Surplus Notes

9. Investments in capital or surplus notes meet the definition of assets as defined in *SSAP No. 4—Assets and Nonadmitted Assets* and are admitted assets to the extent they conform to the requirements of this statement. Additionally, the amount admitted is specifically limited to the following two provisions:

- a. [In the absence of specific instruction pursuant to state law or direction of the domiciliary regulator,](#) ~~the~~ admitted asset value of a capital or surplus note shall not exceed the amount that would be admitted [under state investment limits](#) if the instrument was considered an equity instrument and added to any other equity instruments in the issuer held directly or indirectly by the holder of the capital or surplus note.

[NAIC Staff Note: The SSAPs do not have equity limits for admitted assets. The above paragraph would pertain to state investment limits. This guidance requires capital and surplus notes to be combined with other equity items to determine whether the state investment limit for equity instruments has been surpassed. It is not characteristic of the SSAPs to detail provisions used in state investment limitations, but this paragraph has been part of SSAP No. 41 since codification. If preferred by Working Group members, this paragraph could be deleted.](#)

- b. The surplus note shall be nonadmitted if issued by an entity that is subject to any order of liquidation, conservation, rehabilitation or any company action level event based on its risk-based capital. [Capital notes shall be nonadmitted in any event in which the regulatory authority halts principal or interest payments.](#) Subsequent to this nonadmittance, if any of the conditions described ceased to exist, the holder may admit the [capital or](#) surplus note at the value determined under paragraph 11. If a [capital or](#) surplus note was nonadmitted pursuant to this paragraph, and the [capital or](#) surplus note was ultimately determined to be other-than-temporarily impaired, the reporting entity shall recognize a realized loss for the portion of the surplus note determined to be other-than-temporarily impaired, with elimination of a corresponding amount of the previously nonadmitted assets.

10. Capital or surplus notes shall be valued in accordance with paragraph 11. Pursuant to that paragraph, the value is determined by NAIC ~~credit rating provider (CRP) ratings~~ [designations](#). ~~Part One—Capital and Surplus Debentures of t~~[The Purposes and Procedures Manual of the NAIC Investment Analysis Office](#) provides guidance in determining the NAIC designation for these investments.

11. If the capital or surplus note has been rated by an NAIC CRP and has a designation equivalent of NAIC 1 or NAIC 2, then it shall be reported at amortized cost. If the capital or surplus note ~~is not CRP rated~~ [does not have an NAIC designation](#) or has an NAIC designation ~~equivalent~~ of NAIC 3 through 6, then the balance sheet amount shall be reported at the lesser of amortized cost or fair value, with fluctuations in value reflected as unrealized valuation changes.

12. For reporting entities required to 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*. For reporting entities not required to maintain an AVR, unrealized gains and losses shall be recorded as a direct credit or charge to unassigned funds (surplus).

13. For surplus notes issued and held (directly or indirectly) between insurance reporting entities and subsidiary, controlled and affiliated entities, the guidance in *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities* requires adjustment to prevent double-counting of surplus notes. For example, an insurance reporting entity is not permitted to report the issuance of a surplus note as an increase in surplus and have an asset representing an investment in the SCA that includes the issued surplus note (held by an SCA). Pursuant to SSAP No. 97, the “investment in the SCA” shall be adjusted to eliminate the surplus note issued by the direct or indirect parent insurance reporting entity. This treatment shall also apply for instances in which the SCA acquires any portion of outstanding surplus notes issued by the direct or indirect parent through any means (e.g., directly acquired from the parent, acquired through a third-party broker, or via the market).

Income

14. Only interest that has been approved by the issuer's domiciliary commissioner shall be accrued as income by a holder of surplus notes. Interest income for any period consists of interest collected during the period and the change in the due and accrued interest between the beginning and end of the period approved by the issuer's domiciliary commissioner.

15. Except for the specific limitations on recognizing interest income in paragraph 14, investment income, and the recognition of uncollectible accrued interest, shall follow the guidance in *SSAP No. 34—Investment Income Due and Accrued*.

Impairment

16. An other-than-temporary impairment^(INT 06-07) shall be considered to have occurred if it is probable that the reporting entity will be unable to collect all amounts due according to the contractual terms of the surplus or capital note. Pursuant to the terms ~~of a surplus note~~, payments of principal and interest may be delayed if the issuer's domiciliary commissioner or other regulatory authority does not approve payment. Extended delays of either principal or interest shall trigger an evaluation for an other-than-temporary impairment. An other-than-temporary impairment shall be recognized in situations when the reporting entity has made a decision to sell a surplus note prior to its maturity at an amount below its carrying value. If it is determined that a decline in fair value is other-than-temporary, an impairment loss shall be recognized as a realized loss equal to the difference between the surplus note's carrying value and the fair value at the balance sheet date of the reporting period for which the assessment is made. The measurement of impairment shall not include partial recoveries of fair value subsequent to the balance sheet date. For reporting entities required to maintain an AVR, realized losses shall be accounted for in accordance with SSAP No. 7.

17. In periods subsequent to the recognition of an other-than-temporary impairment loss for a surplus or capital note, the holder of the surplus note shall account for the other-than-temporarily impaired surplus or capital note as if the ~~surplus~~ note had been purchased on the measurement date of the other-than-temporary impairment. The fair value of the ~~surplus~~ note on the measurement date shall become the new cost basis ~~of the surplus note~~ and the new cost basis shall not be adjusted for subsequent recoveries in fair value. The discount or reduced premium recorded for the surplus or capital note, based on the new cost basis, shall be amortized over the remaining life of the ~~surplus~~ note in the prospective manner based on the amount and timing of future estimated cash flows. The ~~surplus~~ note shall continue to be subject to impairment analysis for each subsequent reporting period. Future declines in fair value which are determined to be other-than-temporary shall be recorded as realized losses.

Disclosures

18. The notes to the financial statements of a reporting entity that issues surplus notes shall disclose the following as long as the surplus notes are outstanding:

- a. Date issued;
- b. Description and fair value of the assets received;
- c. Holder of the note or, if public, the names of the underwriter and trustee, with identification on whether the holder of the surplus note is a related party per *SSAP No. 25—Affiliates and Other Related Parties*;
- d. Original issue amount of note;
- e. Carrying value of note;
- f. The rate at which interest accrues;
- g. Maturity dates or repayment schedules, if stated;
- h. Unapproved interest and/or principal;

- i. Life-to-date and current year approved interest and principal recognized;
 - i. Percentage interest payments offset through 'administrative offsetting' (not inclusive of amounts paid to a third-party liquidity provider). For example, if \$100 in interest was recognized through the year, \$10 of which was remitted to a third-party liquidity provider and the remainder \$90 was offset, the reporting entity shall report 100% as offset.
 - j. Disclosure of whether the surplus note was issued as part of a transaction with any of the following attributes:
 - i. Do surplus note/associated asset terms negate or reduce cash flow exchanges, and/or are amounts payable under surplus note and amounts receivable under other agreements contractually linked? (For example, the asset provides interest payments only when the surplus note provides interest payments.)
 - ii. Are any amounts due under surplus notes and associated assets netted or offset (partially or in full) thus eliminating or reducing the exchange of cash or assets that would normally occur throughout the duration, or at maturity, of the agreement? (This may be referred to as administrative offsetting.)
 - iii. Were the proceeds from the issuance of a surplus note used to purchase an asset directly or indirectly from the holder of the surplus note?
 - k. Principle amount and fair value of assets received upon surplus note issuance, if applicable;
 - l. Subordination terms;
 - m. Liquidation preference to the reporting entity's common and preferred shareholders;
 - n. The repayment conditions and restrictions;
 - o. Information about any guarantees, support agreements or related party transactions associated with the surplus note issuance, and whether payments have been made under such agreements.
19. If a reporting entity has ceded business to a surplus note issuer that is a related party as part of a reinsurance transaction in which the surplus note meets any of the criteria in paragraph 18.j., the ceding entity shall provide a description of the transaction, including whether the criteria in paragraph 18.j. were met with respect to the surplus note issuance, as long as the reinsurance agreement remains in force. The ceding entity should provide a description of the risks reinsured, the related party reinsurer, any guarantees or support agreements, and the amount of notes outstanding.
20. If the proceeds from the issuance of a surplus note used to purchase an asset directly or indirectly from the holder of the surplus note, the following information shall be disclosed regarding the assets received:
- a. Identification of asset, including the investment schedule where the asset is reported and reported NAIC designation.
 - b. Book/adjusted carrying value of asset as of the current reporting date.
 - c. A description of terms under which liquidity would be provided should a triggering event occur.
21. ~~In addition to the above, a~~ reporting entity shall identify all affiliates that hold any portion of a surplus debenture or similar obligation (including an offering registered under the Securities Act of 1933 or distributed pursuant to rule 144A under the Securities Act of 1933), ~~and any holder of 10% or more of the outstanding amount of any surplus note registered under the Securities Act of 1933 or distributed pursuant to Rule 144A under the Securities Act of 1933.~~

Proposed Revisions to Annual Statement Instructions – Schedule BA

Surplus Debentures:

Include: That portion of any subordinated indebtedness, surplus debenture, surplus note, debenture note, premium income note, or other contingent evidence of indebtedness, [that qualifies as a surplus note pursuant to SSAP No. 41—Surplus Notes](#), that is reported in the surplus of the issuer.

Capital Notes:

Include: [This reporting line shall be utilized for held debt securities, that do not qualify as issued surplus notes pursuant to SSAP No. 41—Surplus Notes, that are treated as regulatory capital by the issuer’s primary regulatory authority and that do not qualify under the principles-based bond definition solely because interest can be cancelled in the event of financial stress in a non-resolution scenario without triggering an event of default.](#) ~~The portion of any capital note that is reported on the line for capital notes of the issuance insurance reporting entity.~~

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

Status:

On December 17, 2024, the Statutory Accounting Principles (E) Working Group moved this item to the active listing as a SAP clarification and exposed revisions, as shown above, to *SSAP No. 41—Surplus Notes* to incorporate changes to clarify capital notes references and guidance. With exposure, the Working Group agreed to sponsor a blanks proposal to update the definitions in the Schedule BA annual statement instructions as proposed above.

On February 25, 2025, the Statutory Accounting Principles (E) Working Group adopted as final SAP clarification revisions to *SSAP No. 41—Surplus Notes*. These revisions were adopted with limited changes from the exposure, as detailed in the following bullets, but the adopted revisions to SSAP No. 41 are shown below:

- Paragraph 9a was deleted. (Paragraph 9b will become paragraph 9a.)
- Paragraph 18c was deleted with reference to related parties added to paragraph 21.

Adopted Revisions to SSAP No. 41:

1. This statement establishes statutory accounting principles for issuers and holders of surplus notes, and for holders of capital notes^{FN}. Statutory accounting principles for issuers of capital notes are provided in *SSAP No. 15—Debt and Holding Company Obligations*.

[New Footnote: INT 24-01: Principles-Based Bond Definition Implementation Questions and Answers identifies that debt securities treated as regulatory capital by the issuer’s primary regulatory authority and that do not qualify under the principles-based bond definition solely because interest can be cancelled in the event of financial stress in a non-resolution scenario without triggering an event of default are capital notes in scope of this statement. For consistency in investment reporting for held securities, only insurer-issued notes that qualify under paragraph 3 shall be reported as surplus notes. As detailed within, surplus notes are subject to additional restrictions not applicable capital notes.](#)

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~~a. The admitted asset value of a capital or surplus note shall not exceed the amount that would be admitted if the instrument was considered an equity instrument and added to any other equity instruments in the issuer held directly or indirectly by the holder of the capital or surplus note.~~

~~b.a.~~ The surplus note shall be nonadmitted if issued by an entity that is subject to any order of liquidation, conservation, rehabilitation or any company action level event based on its risk-based capital. Capital notes shall be nonadmitted in any event in which the regulatory authority halts principal or interest payments. Subsequent to this nonadmittance, if any of the conditions described ceased to exist, the holder may admit the capital or surplus note at the value determined under paragraph 11. If a capital or surplus note was nonadmitted pursuant to this paragraph, and the capital or surplus note was ultimately determined to be other-than-temporarily impaired, the reporting entity shall recognize a realized loss for the portion of the surplus note determined to be other-than-temporarily impaired, with elimination of a corresponding amount of the previously nonadmitted assets.

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15. Except for the specific limitations on recognizing interest income in paragraph 14, investment income, and the recognition of uncollectible accrued interest, shall follow the guidance in *SSAP No. 34—Investment Income Due and Accrued*.

Impairment

16. An other-than-temporary impairment^(INT 06-07) shall be considered to have occurred if it is probable that the reporting entity will be unable to collect all amounts due according to the contractual terms of the surplus or capital note. Pursuant to the terms ~~of a surplus note~~, payments of principal and interest may be delayed if the issuer’s domiciliary commissioner or other regulatory authority does not approve payment. Extended delays of either principal or interest shall trigger an evaluation for an other-than-temporary impairment. An other-than-temporary impairment shall be recognized in situations when the reporting entity has made a decision to sell a surplus note

prior to its maturity at an amount below its carrying value. If it is determined that a decline in fair value is other-than-temporary, an impairment loss shall be recognized as a realized loss equal to the difference between the surplus note's carrying value and the fair value at the balance sheet date of the reporting period for which the assessment is made. The measurement of impairment shall not include partial recoveries of fair value subsequent to the balance sheet date. For reporting entities required to maintain an AVR, realized losses shall be accounted for in accordance with SSAP No. 7.

17. In periods subsequent to the recognition of an other-than-temporary impairment loss for a surplus or capital note, the holder of the surplus note shall account for the other-than-temporarily impaired surplus or capital note as if the ~~surplus~~ note had been purchased on the measurement date of the other-than-temporary impairment. The fair value of the ~~surplus~~ note on the measurement date shall become the new cost basis ~~of the surplus note~~ and the new cost basis shall not be adjusted for subsequent recoveries in fair value. The discount or reduced premium recorded for the surplus or capital note, based on the new cost basis, shall be amortized over the remaining life of the ~~surplus~~ note in the prospective manner based on the amount and timing of future estimated cash flows. The ~~surplus~~ note shall continue to be subject to impairment analysis for each subsequent reporting period. Future declines in fair value which are determined to be other-than-temporary shall be recorded as realized losses.

Disclosures

18. The notes to the financial statements of a reporting entity that issues surplus notes shall disclose the following as long as the surplus notes are outstanding:

- a. Date issued;
- b. Description and fair value of the assets received;
- ~~c. Holder of the note or, if public, the names of the underwriter and trustee, with identification on whether the holder of the surplus note is a related party per SSAP No. 25 Affiliates and Other Related Parties;~~
- ~~d.c.~~ Original issue amount of note;
- ~~e.d.~~ Carrying value of note;
- ~~f.e.~~ The rate at which interest accrues;
- ~~g.f.~~ Maturity dates or repayment schedules, if stated;
- ~~h.g.~~ Unapproved interest and/or principal;
- ~~i.h.~~ Life-to-date and current year approved interest and principal recognized;
 - i. Percentage interest payments offset through 'administrative offsetting' (not inclusive of amounts paid to a third-party liquidity provider). For example, if \$100 in interest was recognized through the year, \$10 of which was remitted to a third-party liquidity provider and the remainder \$90 was offset, the reporting entity shall report 100% as offset.
- ~~j.i.~~ Disclosure of whether the surplus note was issued as part of a transaction with any of the following attributes:
 - i. Do surplus note/associated asset terms negate or reduce cash flow exchanges, and/or are amounts payable under surplus note and amounts receivable under other agreements contractually linked? (For example, the asset provides interest payments only when the surplus note provides interest payments.)
 - ii. Are any amounts due under surplus notes and associated assets netted or offset (partially or in full) thus eliminating or reducing the exchange of cash or assets that would normally occur throughout the duration, or at maturity, of the agreement? (This may be referred to as administrative offsetting.)

- iii. Were the proceeds from the issuance of a surplus note used to purchase an asset directly or indirectly from the holder of the surplus note?

~~k.~~j. Principle amount and fair value of assets received upon surplus note issuance, if applicable;

~~l.~~k. Subordination terms;

~~m.~~l. Liquidation preference to the reporting entity's common and preferred shareholders;

~~n.~~m. The repayment conditions and restrictions;

~~o.~~n. Information about any guarantees, support agreements or related party transactions associated with the surplus note issuance, and whether payments have been made under such agreements.

19. If a reporting entity has ceded business to a surplus note issuer that is a related party as part of a reinsurance transaction in which the surplus note meets any of the criteria in paragraph 18.j., the ceding entity shall provide a description of the transaction, including whether the criteria in paragraph 18.j. were met with respect to the surplus note issuance, as long as the reinsurance agreement remains in force. The ceding entity should provide a description of the risks reinsured, the related party reinsurer, any guarantees or support agreements, and the amount of notes outstanding.

20. If the proceeds from the issuance of a surplus note used to purchase an asset directly or indirectly from the holder of the surplus note, the following information shall be disclosed regarding the assets received:

- a. Identification of asset, including the investment schedule where the asset is reported and reported NAIC designation.
- b. Book/adjusted carrying value of asset as of the current reporting date.
- c. A description of terms under which liquidity would be provided should a triggering event occur.

21. ~~In addition to the above, a~~ reporting entity shall identify all related parties and affiliates that hold any portion of a surplus debenture or similar obligation (including an offering registered under the Securities Act of 1933 or distributed pursuant to rule 144A under the Securities Act of 1933), ~~and any holder of 10% or more of the outstanding amount of any surplus note registered under the Securities Act of 1933 or distributed pursuant to Rule 144A under the Securities Act of 1933.~~

Revisions to Annual Statement Instructions – Schedule BA

Surplus Debentures:

Include: That portion of any subordinated indebtedness, surplus debenture, surplus note, debenture note, premium income note, or other contingent evidence of indebtedness, that qualifies as a surplus note pursuant to SSAP No. 41—Surplus Notes, that is reported in the surplus of the issuer.

Capital Notes:

Include: This reporting line shall be utilized for held debt securities, that do not qualify as issued surplus notes pursuant to SSAP No. 41—Surplus Notes, that are treated as regulatory capital by the issuer's primary regulatory authority and that do not qualify under the principles-based bond definition solely because interest can be cancelled in the event of financial stress in a non-resolution scenario without triggering an event of default. ~~The portion of any capital note that is reported on the line for capital notes of the issuance insurance reporting entity.~~