Adoptions by the
Statutory Accounting Principles (E)
Working Group

This list of adopted items will be updated following each interim and national meeting of the Statutory Accounting Principles (E) Working Group.

January 27, 2022 – Interim Meeting ............................................... 3
April 4, 2022 – Spring National Meeting ......................................... 17
May 24, 2022 – Interim Meeting...................................................... 53
August 10, 2022 – Summer National Meeting............................... 89
August 13, 2022 – Life Actuarial (A) Task Force......................... 187
October 24, 2022 – Interim Meeting............................................... 194
This page intentionally left blank.
Revisions to the
As of March 2022, Accounting Practices and Procedures Manual

On January 27, 2022, the Statutory Accounting Principles (E) Working Group adopted the following revisions to the As of March 2022 Accounting Practices and Procedures Manual. Documents associated with these revisions are linked to the reference numbers in bold text below.

<table>
<thead>
<tr>
<th>Ref #</th>
<th>SSAP/Appendix</th>
<th>Title</th>
<th>Summary</th>
</tr>
</thead>
<tbody>
<tr>
<td>2021-18</td>
<td>SSAP No. 108</td>
<td>VM-21 Scenario Consistency Update</td>
<td>Revisions ensure consistency with the Valuation Manual, specifically Section 21, by updating references to the “standard” scenario.”</td>
</tr>
<tr>
<td></td>
<td></td>
<td>SAP Clarification</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>December 31, 2021</td>
<td></td>
</tr>
<tr>
<td>2021-31</td>
<td>SSAP No. 61R</td>
<td>Life Reinsurance Disclosure Clarifications</td>
<td>Revisions clarify and, in some cases, remove certain disclosures for life and health reinsurance contracts. Clarifications also address the information in the audited report.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>SAP Clarification</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>December 31, 2021</td>
<td></td>
</tr>
</tbody>
</table>
Statutory Accounting Principles (E) Working Group  
Maintenance Agenda Submission Form  
Form A

Issue: VM-21 Scenario Consistency Update

Check (applicable entity):  
Modification of Existing SSAP ☒  
New Issue or SSAP ☐  
Interpretation ☐

Description of Issue:  
This agenda item provides a revision to Statement of Statutory Accounting Principles (SSAP) No. 108—Derivatives Hedging Variable Annuity Guarantees (SSAP No. 108) to ensure consistency with the Valuation Manual. This agenda item was developed in response to comments from an actuarial firm identifying an existing reference in SSAP No. 108 to the standard scenario in VM-21: Requirements for Principle-Based Reserves for Variable Annuities (VM-21). The Life Actuarial (A) Task Force NAIC staff support confirmed that the reference to the standard scenario has been deleted from VM-21.

VM-21 previously applied the standard scenario to all contracts in scope to generate the standard scenario amount. Revisions to VM-21 following the adoption of the Variable Annuity Framework resulted in the elimination of the standard scenario amount. Instead, VM-21 uses the prescribed projections amount, based on either the Company Specific Market Path (CSMP) or Conditional Tail Expectations (CTE) with Prescribed Assumptions (CTEPA). The CSMP and the CTEPA use random sets of scenarios to generate a CTE70 (adjusted) amount. This agenda item proposes using the VM-21 permitted approach that produces the CSMP or CTEPA scenario reserve closest to the CTE70 (adjusted) as the replacement for the standard scenario when determining the Macaulay duration in paragraph 14 of SSAP No. 108.

Existing Authoritative Literature:

SSAP No. 108—Derivatives Hedging Variable Annuity Guarantees provides the following (bolding added for emphasis)

13. Fair value fluctuations in the measurement of outstanding (non-expired) derivatives within a highly effective hedging strategy shall be reflected as follows:
   
a. Fair value fluctuations in the hedging instruments attributable to the hedged risk that offset the current period change in the designated portion of the VM-21 reserve liability⁷ shall be recognized as a realized⁸ gain or loss.

⁷ Hedge effectiveness is determined by comparing fair value fluctuations between the hedging instruments and the hedged item. However, in determining recognition in the financial statements, the fair value fluctuation of the hedging instruments is compared to the change in the reported value of the designated portion of the VM-21 liability. The designated portion of the VM-21 liability is not reported at fair value in the statutory financial statements, as such, the offset reported as realized gains and losses is the portion of the fair value change in hedging instruments offset by the change in the reported value of the designated portion of the VM-21 reserve. In accordance with the documented hedging strategy, reporting entities shall compare the fair value fluctuations to the change in the designated portion of the reserve liability, after considering recognized derivative returns (including recognized derivative income), when determining the recognition of fair value fluctuations.

⁸ Recognizing the fair value change for open derivative positions that offset the VM-21 change as a realized gain/loss (instead of an unrealized gain or loss) directly offsets the VM-21 reserve change in the income statement.
b. Fair value fluctuations in the hedging instruments attributable to the hedged risk\(^9\) that do not offset the current period change in the designated portion of the VM-21 reserve liability shall be recognized as deferred assets (admitted) and deferred liabilities. The ability to recognize a deferred asset and deferred liability is limited to only the portion of the fair value fluctuation in the hedging instruments that is attributed to the hedged risk and does not immediately offset changes in the designated portion of the VM-21 reserve liability.

(Drafting Note subparagraphs 13.c. through 13.e. omitted to conserve space.)

14. Deferred assets and deferred liabilities recognized under paragraph 13.b. shall be amortized using a straight-line method into realized gains or realized losses over a finite amortization period. The amortization timeframe shall equal the Macaulay duration of the guarantee benefit cash flows based on the VM-21 Standard Scenario, but shall not exceed a period of 10 years.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): None

Information or issues (included in Description of Issue) not previously contemplated by the Working Group: None


Staff Recommendation:
NAIC staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to SSAP No. 108, paragraph 14 as illustrated below. The revision will ensure consistency with VM-21 as it no longer references the standard scenario. With exposure, it is recommended that the Life Actuarial (A) Task Force receive notice of the exposure as part of the coordination process.

14. Deferred assets and deferred liabilities recognized under paragraph 13.b. shall be amortized using a straight-line method into realized gains or realized losses over a finite amortization period. The amortization timeframe shall equal the Macaulay duration of the guarantee benefit cash flows based on the VM-21 Standard Scenario adjusted run scenario that produces the scenario reserve closest to conditional tail expectation (CTE) 70 (adjusted), but shall not exceed a period of 10 years. The CTE 70 (adjusted) and the scenario reserve closest to the CTE 70 (adjusted) are determined using the method (company specific market path (CSMP) or conditional tail expectations (CTE) with prescribed assumptions (CTEPA)) applied by the reporting entity\(^{FN}\) to calculate the prescribed projections amount.

New Footnote:
VM-21 allows a reporting entity to choose whether to use the CSMP method or the CTEPA method. Once the choice is made the company cannot change the method without the approval of the commissioner. For the purpose of determining the SSAP No. 108 amortization timeframe, the company shall apply its current method to determine the adjusted run scenario.

Staff Review Completed by: Robin Marcotte, NAIC Staff - October 2021

Status:
On October 25, 2021, in response to an e-vote to expose, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to SSAP No. 108.

---

\(^9\) The change in fair value of the hedging instruments and hedged item is limited to changes driven by market factors. For example, periodic recognition of a cost owed to acquire the derivative from a counterparty (financing cost) shall not be captured as a change in the derivative instrument’s fair value. The fair value of the instrument shall be determined based on the underlying derivative without inclusion of acquisition costs (or other such contractual elements that may exist with the counterparty) that do not change based on the underlying derivative interests or market factors.
Derivatives Hedging Variable Annuity Guarantees to ensure consistency with revisions to VM-21, removing references to the standard scenario. The Working Group also provided notice of the exposure to the Life Actuarial (A) Task Force.

On December 11, 2021, Statutory Accounting Principles (E) Working Group exposed revisions, to SSAP No. 108—Derivatives Hedging Variable Annuity Guarantees, as illustrated below. The revisions, which incorporate edits proposed from Life Actuarial (A) Task Force representatives, ensure consistency with revisions to VM-21 by removing reference to the standard scenario while adding reference to the conditional tail expectation 70 guidance. This agenda item has a shortened exposure period, ending Jan. 14, 2022, so that the Working Group may consider adoption for year-end 2021 reporting.

Exposed Revisions to SSAP No. 108

14. Deferred assets and deferred liabilities recognized under paragraph 13.b. shall be amortized using a straight-line method into realized gains or realized losses over a finite amortization period. The amortization timeframe shall equal the Macaulay duration of the guarantee benefit cash flows based on the VM-21 Standard Scenario Projection (new FN), but shall not exceed a period of 10 years.

New Footnote:

The VM-21 Standard Projection calculation shall be the prescribed assumption run for the scenario that produces the scenario reserve closest to conditional tail expectation (CTE) 70 (adjusted) and a discount rate equal to the valuation interest rate specified by the Standard Valuation Law for annuities valued on an issue year basis, using Plan Type A and a Guarantee Duration greater than 10 years but not more than 20 years. The VM-21 Standard Projection with prescribed assumption run is determined using the method (company specific market path (CSMP) or conditional tail expectations (CTE) with prescribed assumptions (CTEPA)) applied by the reporting entity to calculate the prescribed projections amount. For the CSMP method, the economic scenario is Path A, with the guarantee benefit cash flows from the run to calculate Prescribed Amount A. For the CTEPA method, the economic scenario is the scenario that produces the scenario reserve closest to the CTE70 (Adjusted) from the stochastic reserve calculation, with the guarantee benefit cash flows from the VM-21 Standard Projection with prescribed assumption run for this economic scenario.

On January 27, 2022, the Statutory Accounting Principles (E) Working Group adopted SAP clarifications which update SSAP No. 108 references to be consistent with the Valuation Manual, Section 21 with a December 31, 2021, effective date, as detailed below. The adopted revisions included additional changes to the exposed language as recommended by a member of the Life Actuarial (A) Task Force.

Adopted SSAP No. 108 revisions effective December 31, 2021:

14. Deferred assets and deferred liabilities recognized under paragraph 13.b. shall be amortized using a straight-line method into realized gains or realized losses over a finite amortization period. The amortization timeframe shall equal the Macaulay duration of the guarantee benefit cash flows based on the VM-21 Standard Scenario Projection (new FN), but shall not exceed a period of 10 years.

New Footnote: The VM-21 Standard Projection benefit cash flows shall be based on the prescribed assumptions run for the scenario that produces the scenario reserve closest to conditional tail expectation (CTE) 70 (adjusted). The VM-21 Standard Projection with prescribed assumptions run is determined using the method (company specific market path (CSMP) or conditional tail expectations with prescribed assumptions (CTEPA)) applied by the reporting entity to calculate the prescribed projections amount. For the CSMP method, the economic scenario is Path A, with the guarantee benefit cash flows from the run to calculate Prescribed Amount A. For the CTEPA method, the economic scenario is the scenario that produces the scenario reserve closest to the CTE70 (Adjusted) from the stochastic reserve calculation, with the guarantee benefit cash flows from the VM-21 Standard Projection with prescribed assumptions run for this economic scenario. The discount rate for the Macaulay duration calculation shall be equal to the
valuation interest rate specified by the Standard Valuation Law for annuities valued on an issue year basis, using Plan Type A and a Guarantee Duration greater than 10 years but not more than 20 years.
Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A

Issue: Life Reinsurance Disclosure Clarifications

Check (applicable entity):

- Modification of Existing SSAP
- New Issue or SSAP
- Interpretation

<table>
<thead>
<tr>
<th>P/C</th>
<th>Life</th>
<th>Health</th>
</tr>
</thead>
<tbody>
<tr>
<td>✓</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>✓</td>
</tr>
</tbody>
</table>

Description of Issue:
This agenda item is to address questions received from members of the American Institute of Certified Public Accountants (AICPA) NAIC Task Force regarding the life reinsurance disclosures and the related audited notes that were first effective in December 2020. The disclosures were adopted in SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance in agenda item 2017-28: Reinsurance Risk Transfer for Short Duration Contracts. Preparers and auditors have highlighted unclear elements in the disclosures that could use additional clarification. Requested clarifications and responses are detailed in the recommendation section, but they include items regarding whether the disclosures apply to ceding and assuming contracts, the format expected for the audited notes and how broadly to interpret the scope of certain disclosures. In the statutory annual statement filing the disclosures are in Note 23H and are not data captured. The proposed revisions to SSAP No. 61R narrow the scope of the disclosures and clarify what is required in the disclosures.

Existing Authoritative Literature:

SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance includes the following disclosures:

78. Disclosures for paragraphs 79-84 are required to be included with the annual audit report financial statements beginning with the period ended December 31, 2020, regarding reinsurance contracts. The disclosures required within paragraphs 79-84 shall be included in accompanying supplemental schedules of the annual audit report beginning in year-end 2020. These disclosures shall be limited to reinsurance contracts entered into, renewed or amended on or after January 1, 1996. This limitation applies to the annual audit report only and does not apply to the statutory annual statement interrogatories and the property and casualty reinsurance summary supplemental filing.

79. Disclose any reinsurance contracts (or multiple contracts with the same reinsurer or its affiliates) subject to A-791 that includes a provision, which limits the reinsurer’s assumption of significant risks identified as in A-791. Examples of risk-limiting features include provisions such as a deductible, a loss ratio corridor, a loss cap, an aggregate limit or similar effect. If true, indicate the number of reinsurance contracts to which such provisions apply. If affirmative, indicate if the reinsurance credit was reduced for the risk-limiting features.

80. Disclose any reinsurance contracts (or multiple contracts with the same reinsurer or its affiliates) not subject to A-791, for which reinsurance accounting was applied and includes a provision that limits the reinsurer's assumption of risk. Examples of risk-limiting features include provisions such as a deductible, a loss ratio corridor, a loss cap, an aggregate limit or similar effect. If true, indicate the number of reinsurance contracts to which such provisions apply. If affirmative, indicate if the reinsurance credit was reduced for the risk-limiting features.

81. Disclose if any reinsurance contracts contain features (except reinsurance contracts with a federal or state facility) described below which result in delays in payment in form or in fact:

a. Provisions which permit the reporting of losses, or settlements are made, less frequently than quarterly or payments due from the reinsurer are not made in cash within ninety (90) days of the settlement date (unless there is no activity during the period).
b. Payment schedule, accumulating retentions from multiple years or any features inherently designed to delay timing of the reimbursement to the ceding entity.

82. Disclose if the reporting entity has reflected reinsurance accounting credit for any contracts not subject to Appendix A-791 and not yearly renewable term, which meet the risk-transfer requirements of SSAP No. 61R and identify the type of contracts and the reinsurance contracts.
   a. Assumption Reinsurance – new for the reporting period.
   b. Non-proportional reinsurance, which does not result in significant surplus relief. If yes, indicate if the insured events(s) triggering contract coverage has been recognized.

83. Disclose if the reporting entity ceded any risk which is not subject to A-791 and not yearly renewable term reinsurance, under any reinsurance contract (or multiple contracts with the same reinsurer or its affiliates) during the period covered by the financial statement, and either:
   a. Accounted for that contract as reinsurance under statutory accounting principles (SAP) and
      as a deposit under generally accepted accounting principles (GAAP); or
   b. Accounted for that contract as reinsurance under GAAP and as a deposit under SAP.

84. If affirmative disclosure is required for paragraph 83, explain why the contract(s) is treated differently for GAAP and SAP.

The SSAP No. 61R disclosures were developed based on existing SSAP No. 62R—Property and Casualty Reinsurance disclosures with modifications for life and health reinsurance guidance. SSAP No. 62R includes the following disclosures:

113. Disclosures for paragraphs 114-119 represent annual statement interrogatories, which are required to be included with the annual audit report beginning with audit reports on financial statements as of and for the period ended December 31, 2006. The disclosures required within paragraphs 114-119 shall be included in accompanying supplemental schedules of the annual audit report beginning in year-end 2006. These disclosures shall be limited to reinsurance contracts entered into, renewed or amended on or after January 1, 1994. This limitation applies to the annual audit report only and does not apply to the statutory annual statement interrogatories and the reinsurance summary supplemental filing.

114. Disclose if any risks are reinsured under a quota share reinsurance contract with any other entity that includes a provision that would limit the reinsurer’s losses below the stated quota share percentage (e.g. a deductible, a loss ratio corridor, a loss cap, an aggregate limit or any similar provisions)? If yes, indicate the number of reinsurance contracts containing such provisions and if the amount of reinsurance credit taken reflects the reduction in quota share coverage caused by any applicable limiting provision(s).

115. Disclose if the reporting entity ceded any risk under any reinsurance contract (or under multiple contracts with the same reinsurer or its affiliates) for which during the period covered by the statement: (i) it recorded a positive or negative underwriting result greater than 5% of prior year-end surplus as regards policyholders or it reported calendar year written premium ceded or year-end loss and loss expense reserves ceded greater than 5% of prior year-end surplus as regards policyholders; (ii) it accounted for that contract as reinsurance and not as a deposit; and (iii) the contract(s) contain one or more of the following features or other features that would have similar results:

   a. A contract term longer than two years and the contract is noncancellable by the reporting entity during the contract term;
   b. A limited or conditional cancellation provision under which cancellation triggers an obligation by the reporting entity, or an affiliate of the reporting entity, to enter into a new reinsurance contract with the reinsurer, or an affiliate of the reinsurer;
   c. Aggregate stop loss reinsurance coverage;
d. A unilateral right by either party (or both parties) to commute the reinsurance contract, whether conditional or not, except for such provisions which are only triggered by a decline in the credit status of the other party;

e. A provision permitting reporting of losses, or payment of losses, less frequently than on a quarterly basis (unless there is no activity during the period); or

f. Payment schedule, accumulating retentions from multiple years or any features inherently designed to delay timing of the reimbursement to the ceding entity.

116. Disclose if the reporting entity during the period covered by the statement ceded any risk under any reinsurance contract (or under multiple contracts with the same reinsurer or its affiliates) for which it recorded a positive or negative underwriting result greater than 5% of prior year-end surplus as regards policyholders or it reported calendar year written premium ceded or year-end loss and loss expense reserves ceded greater than 5% of prior year-end surplus as regards policyholders. This disclosure is limited to reinsurance contracts with written premium cessions or loss and loss expense reserve cessions described in this paragraph that meet the criteria of paragraph 116.a. or paragraph 116.b. This disclosure excludes cessions to approved pooling arrangements or to captive insurance companies that are directly or indirectly controlling, controlled by, or under common control with (i) one or more unaffiliated policyholders of the reporting entity, or (ii) an association of which one or more unaffiliated policyholders of the reporting entity is a member.

a. The written premium ceded to the reinsurer by the reporting entity or its affiliates represents fifty percent (50%) or more of the entire direct and assumed premium written by the reinsurer based on its most recently available financial statement; or

b. Twenty-five percent (25%) or more of the written premium ceded to the reinsurer has been retroceded back to the reporting entity or its affiliates in separate reinsurance contract.

117. If affirmative disclosure is required for paragraph 115 or 116, provide the following information:

a. A summary of the reinsurance contract terms and indicate whether it applies to the contracts meeting paragraph 115 or 116;

b. A brief discussion of management's principal objectives in entering into the reinsurance contract including the economic purpose to be achieved; and

c. The aggregate financial statement impact gross of all such ceded reinsurance contracts on the balance sheet and statement of income.

118. Except for transactions meeting the requirements of paragraph 36, disclose if the reporting entity ceded any risk under any reinsurance contract (or multiple contracts with the same reinsurer or its affiliates) during the period covered by the financial statement, and either:

a. Accounted for that contract as reinsurance (either prospective or retroactive) under statutory accounting principles (SAP) and as a deposit under generally accepted accounting principles (GAAP); or

b. Accounted for that contract as reinsurance under GAAP and as a deposit under SAP.

119. If affirmative disclosure is required for paragraph 118, explain in a supplemental filing why the contract(s) is treated differently for GAAP and SAP.

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 2017-28 adopted the SSAP No. 61R disclosures in paragraphs 78-84. The disclosures were developed at the request of the Financial Analysis (E) Working Group and were based on existing disclosures in SSAP No. 62R—Property and Casualty Reinsurance in paragraphs 114-119 that are designed to identify contracts with risk...
limiting features or other items that may need additional regulatory review. The disclosures had to be modified to meet the requirements of SSAP No. 61R and Appendix A-791- Life and Health Reinsurance Agreements

Information or issues (included in Description of Issue) not previously contemplated by the Working Group: None

Convergence with International Financial Reporting Standards (IFRS): None

Staff Recommendation:
NAIC staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose the revisions to SSAP No. 61R disclosures illustrated below. These items are recommended for a shortened comment period to allow for possible adoption in early 2022 with a year-end 2021 effective date. The proposed revisions provide clarifications and, in some cases, narrow the scope of disclosure. No additional disclosures are proposed. Having the disclosure revisions final for year-end 2021 will assist preparers and auditors.

1. Does the Statutory Accounting Principles (E) Working Group expect the disclosures to be filed as a supplemental schedule in the audited financial statements even when all answers are not applicable or none? (This is the most common question that the auditing firms received.)

Response: If there are no contracts with the applicable features, a narrative note would be sufficient. See suggested edit to paragraph 78 which provides that the information can be in a note or a supplemental schedule. NAIC staff notes that Note 23H is not data captured in the statutory annual statement filing.

2. Is the supplemental schedule specific to ceded reinsurance only?

Response: While some of the disclosures are primarily designed to identify ceding contracts which may require additional scrutiny to verify that too large of a reinsurance credit was taken by the ceding entity, the scope of the disclosures includes all reinsurance contracts unless specifically identified otherwise. See proposed clarifications to limit paragraphs 79 and 80 to ceding contracts. This clarification would be similar to corresponding paragraphs in SSAP No. 62. Also, a clarification also specifies that paragraph 81 is applicable to both assumed and ceding contracts.

3. With regard to paragraph 80, would a stop loss or excess of loss reinsurance agreement with a loss cap or with deductibles (which are common contractual provisions) be required to be disclosed?

Response: Paragraph 80 provides the following:

80. Disclose any reinsurance contracts (or multiple contracts with the same reinsurer or its affiliates) not subject to A-791, for which reinsurance accounting was applied and includes a provision that limits the reinsurer’s assumption of risk. Examples of risk-limiting features include provisions such as a deductible, a loss ratio corridor, a loss cap, an aggregate limit or similar effect. If true, indicate the number of reinsurance contracts to which such provisions apply. If affirmative, indicate if the reinsurance credit was reduced for the risk-limiting features.

Paragraph 80 is a modification of the following SSAP No. 62R disclosure:

114. Disclose if any risks are reinsured under a quota share reinsurance contract with any other entity that includes a provision that would limit the reinsurer’s losses below the stated quota share percentage (e.g. a deductible, a loss ratio corridor, a loss cap, an aggregate limit or any similar provisions)? If yes, indicate the number of reinsurance contracts containing such provisions and if the amount of reinsurance credit taken reflects the reduction in quota share coverage caused by any applicable limiting provision(s).
Response: Paragraph 80 was modified to capture contracts not subject to A-791 and not quota share contracts as shown in SSAP No. 62R, paragraph 114 because the requirements of A-791 do not allow significant risks which are required to be ceded to be limited. As currently drafted, the disclosure is written too broadly in that it may be capturing more nonproportional contracts with “standard” features than what is useful. See proposed clarification to paragraph 80 in the illustration below to remove stop loss or excess of loss reinsurance agreements with deductibles or loss caps that apply to the entire contract and are not adjustable based on other features from the disclosure.

4. Please clarify the intent and what information should be disclosed in subparagraphs 82.a. and 82.b.

   a. We thought that for paragraph 82.a., the intent related to ceding companies with assumption reinsurance agreements (paragraph 60 of SSAP 61R) entered into during the current year for which indemnity reinsurance is being applied for policyholders who have not yet agreed to the transfer to the new insurer or for which the regulator has not yet approved the novation to the new insurer.

Response: Paragraph 82.a. is intended to reference assumption reinsurance agreements referenced in paragraph 60 of SSAP No. 61R entered into during the current year for which reinsurance credit is reported. It does not make a distinction regarding those that have or have not been approved by the policyholder. A simple reading of the disclosure is intended - to identify new assumption reinsurance agreements. This paragraph does not have a similar paragraph in SSAP No. 62R. See edits to SSAP No. 61R illustrated below which add reference to the contracts in paragraph 60.

   b. With regard to paragraph 82.b., what is the concern related to non-proportionate contracts that do not provide significant surplus relief?

Response: Paragraph 82. b is proposed for deletion, as it does not provide useful information. This is because it would require disclosure of contracts which do not provide significant surplus relief and it is unclear what types of assumption reinsurance would be captured. This paragraph does not have a similar paragraph in SSAP No. 62R. See edits to SSAP No. 61R illustrated below.

5. How should an entity answer paragraphs 83-84 if no GAAP financial statements are prepared?

Response: If the reporting entity and or its holding company group does not prepare GAAP financials this is not an analysis that would be required. See proposed clarification in paragraph 83 below. AICPA representatives noted, and NAIC staff agrees, that because of A-791 differences there may be more life and health contracts reported differently for GAAP.

Recommended Revisions to SSAP No. 61R:

78. Disclosures for paragraphs 79-84 are required to be included with the annual audit report financial statements beginning with the period ended December 31, 2020, regarding reinsurance contracts. The disclosures required within paragraphs 79-84 shall be included in accompanying supplemental schedules or the notes of the annual audit report beginning in year-end 2020. If not applicable, an affirmative statement that no such contracts were identified is acceptable. These disclosures shall be limited to reinsurance contracts entered into, renewed or amended on or after January 1, 1996. This limitation applies to the annual audit report only and does not apply to the statutory annual statement interrogatories and the property and casualty reinsurance summary supplemental filing.

79. Disclose any ceding reinsurance contracts (or multiple contracts with the same reinsurer or its affiliates) subject to A-791 that includes a provision, which limits the reinsurer's assumption of significant risks identified as in A-791. Examples of risk-limiting features include provisions such as a deductible, a loss ratio corridor, a loss cap, an aggregate limit or similar effect. If true, indicate the number of reinsurance contracts to which such provisions apply. For contracts subject to A-791, indicate if deposit accounting was applied for all contracts, which limit significant risks.
80. Disclose any ceding reinsurance contracts (or multiple contracts with the same reinsurer or its affiliates) not subject to A-791, for which reinsurance accounting was applied and includes a provision that limits the reinsurer's assumption of risk. Examples of risk-limiting features include provisions such as a deductible, a loss ratio corridor, a loss cap, an aggregate limit or similar effect. Note that a stop loss or excess of loss reinsurance agreement with deductibles or loss caps which apply to the entire contract and are not adjustable based on other features, do not require disclosure under this paragraph. If true, indicate the number of reinsurance contracts to which such provisions apply. If affirmative, indicate if the reinsurance credit was reduced for the risk-limiting features.

81. Disclose if any assumed or ceded reinsurance contracts contain features (except reinsurance contracts with a federal or state facility) described below which result in delays in payment in form or in fact:

a. Provisions which permit the reporting of losses, or settlements are made, less frequently than quarterly or payments due from the reinsurer are not made in cash within ninety (90) days of the settlement date (unless there is no activity during the period).

b. Payment schedule, accumulating retentions from multiple years or any features inherently designed to delay timing of the reimbursement to the ceding entity.

82. Disclose if the reporting entity has reflected reinsurance accounting credit for any contracts not subject to Appendix A-791 and not yearly renewable term, which meet the risk-transfer requirements of SSAP No. 61R and identify the type of contracts and the reinsurance contracts.

a. Assumption Reinsurance – as discussed in paragraph 60, which are new for the reporting period.

b. Non-proportional reinsurance, which does not result in significant surplus relief. If yes, indicate if the insured events(s) triggering contract coverage has been recognized.

83. Disclose if the reporting entity ceded any risk which is not subject to A-791 and not yearly renewable term reinsurance, under any reinsurance contract (or multiple contracts with the same reinsurer or its affiliates) during the period covered by the financial statement, and either:

a. Accounted for that contract as reinsurance under statutory accounting principles (SAP) and as a deposit under U.S. generally accepted accounting principles (GAAP); or

b. Accounted for that contract as reinsurance under U.S. GAAP and as a deposit under SAP.

If the reporting entity does not prepare U.S. GAAP financial statements or its financial statements are not part of upstream U.S. GAAP financial statements, this disclosure can be answered not applicable.

84. If affirmative disclosure is required for paragraph 83, explain why the contract(s) is treated differently for GAAP and SAP.

Staff Review Completed by: Robin Marcotte, NAIC Staff - November 2021

Status:
On December 11, 2021, the Statutory Accounting Principles (E) Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to SSAP No. 61R, as illustrated above. These revisions intend to clarify, and in some cases, narrow the scope of certain disclosures. This agenda item has a shortened exposure period, ending Jan. 14, 2022, so that the Working Group may consider adoption for year-end 2021 reporting.

On January 27, 2022, the Statutory Accounting Principles (E) Working Group adopted SAP clarifications which update the SSAP No. 61R disclosures with a December 31, 2021, effective date, as detailed below. The adopted revisions included additional changes to the exposed language as recommended by members of the ACIPA’s NAIC Task Force and interested parties.
Adopted Revisions to SSAP No. 61R:

78. Disclosures for paragraphs 79-84 apply to reinsurance contracts in effect for the current period covered by the statement and are required to be included with the annual audit report financial statements beginning with the period ended December 31, 2020, regarding reinsurance contracts. The disclosures required within paragraphs 79-84 shall be included in accompanying supplemental schedules of the annual audit report beginning in year-end 2020. If the disclosures are not applicable, an affirmative statement that no such contracts were identified is acceptable in the notes to the financial statements or the supplemental schedules. These disclosures shall be limited to reinsurance contracts entered into, renewed or amended on or after January 1, 1996. This limitation applies to the annual audit report only and does not apply to the statutory annual statement interrogatories and the property and casualty reinsurance summary supplemental filing.

79. Disclose any ceded reinsurance contracts (or multiple contracts with the same reinsurer or its affiliates) subject to A-791 that includes a provision, which limits the reinsurer’s assumption of significant risks identified as in A-791. Examples of risk-limiting features include provisions such as a deductible, a loss ratio corridor, a loss cap, an aggregate limit or similar effect. If true, indicate the number of reinsurance contracts to which such provisions apply. For contracts subject to A-791, indicate if deposit accounting was applied for all contracts, which limit significant risks.

80. Disclose any ceded reinsurance contracts (or multiple contracts with the same reinsurer or its affiliates) not subject to A-791, for which reinsurance accounting was applied and includes a provision that limits the reinsurer's assumption of risk. Examples of risk-limiting features include provisions such as a deductible, a loss ratio corridor, a loss cap, an aggregate limit or similar effect. Note that a stop loss or excess of loss reinsurance agreement with deductibles or loss caps which apply to the entire contract and are not adjustable based on other features, do not require disclosure under this paragraph. If true, indicate the number of reinsurance contracts to which such provisions apply. If affirmative, indicate if the reinsurance credit was reduced for the risk-limiting features.

81. Disclose if any ceded reinsurance contracts contain features (except reinsurance contracts with a federal or state facility) described below which result in delays in payment in form or in fact:
   a. Provisions which permit the reporting of losses, or settlements are made, less frequently than quarterly or payments due from the reinsurer are not made in cash within ninety (90) days of the settlement date (unless there is no activity during the period).
   b. Payment schedule, accumulating retentions from multiple years or any features inherently designed to delay timing of the reimbursement to the ceding entity.

82. Disclose if the reporting entity has reflected reinsurance accounting credit for any contracts not subject to Appendix A-791 and not yearly renewable term, which meet the risk-transfer requirements of SSAP No. 61R and identify the type of contracts and the reinsurance contracts.
   a. Assumption Reinsurance – as discussed in paragraph 60, which are new for the reporting period.
   b. Non-proportional reinsurance, which does not result in significant surplus relief. If yes, indicate if the insured events(s) triggering contract coverage has been recognized.

83. Disclose if the reporting entity ceded any risk which is not subject to A-791 and not yearly renewable term reinsurance, under any reinsurance contract (or multiple contracts with the same reinsurer or its affiliates) during the period covered by the financial statement, and either:
   a. Accounted for that contract as reinsurance under statutory accounting principles (SAP) and as a deposit under U.S. generally accepted accounting principles (GAAP); or
   b. Accounted for that contract as reinsurance under U.S. GAAP and as a deposit under SAP.
If the reporting entity does not prepare U.S. GAAP financial statements or its financial statements are not part of upstream U.S. GAAP financial statements, this disclosure can be answered not applicable.

84. If affirmative disclosure is required for paragraph 83, explain why the contract(s) is treated differently for GAAP and SAP.

This page intentionally left blank.
Revisions to the
*As of March 2022, Accounting Practices and Procedures Manual*

On **April 4, 2022**, the Statutory Accounting Principles (E) Working Group adopted the following revisions to the *As of March 2022 Accounting Practices and Procedures Manual*. Documents associated with these revisions are linked to the reference items in bold text.

<table>
<thead>
<tr>
<th>Ref #</th>
<th>SSAP/ Appendix</th>
<th>Title</th>
<th>Summary</th>
</tr>
</thead>
</table>
| 2021-22 | SSAP No. 97 | Schedule D-6-1, Supplemental Reporting  
No Statutory Revisions | Agenda item did not result in statutory revisions; however, adoption expressed support for a corresponding Blanks (E) Working Group proposal (2022-02BWG) to add supplemental data capture elements in *Schedule D – Part 6 – Section 1: Valuation of Shares of Subsidiary, Controlled or Affiliated Entities*.  |
| 2021-23 | SSAP No. 43R | SSAP No. 43R – Financial Modeling, Updated Guidance  
*SAP Clarification*  
| 2021-24 | SSAP No. 2R | Cryptocurrency General Interrogatory  
No Statutory Revisions | Agenda item did not result in statutory revisions; however, adoption expressed support for a corresponding Blanks (E) Working Group proposal (2022-01BWG) to add a new general interrogatory regarding the use or acceptance of cryptocurrencies.  |
| 2021-26EP | Various | Editorial Updates (Substantive vs. Nonsubstantive)  
*SAP Clarification*  
Effective Immediately (April 4, 2022) | Revisions to the Preamble, Table of Contents, Summary of Changes, and Appendix F to reflect recently adopted guidance (agenda item 2021-14: *SAP Terminology*) to replace the terms “substantive” and “nonsubstantive.”  |
| 2021-27 | SSAP No. 72 | ASU 2021-04, Accounting for Certain Modifications  
*SAP Clarification*  
Effective Immediately (April 4, 2022) | Revisions incorporate guidance related to the accounting for the changes in fair value when exchanging equity-classified written call options, while rejecting ASU 2021-04 for statutory accounting.  |
<table>
<thead>
<tr>
<th>Ref #</th>
<th>SSAP/ Appendix</th>
<th>Title</th>
<th>Summary</th>
</tr>
</thead>
<tbody>
<tr>
<td>2021-28</td>
<td>SSAP No. 68</td>
<td>ASU 2021-03, Intangibles - Goodwill</td>
<td>Revisions reject ASU 2021-03 for statutory accounting.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>SAP Clarification</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Effective Immediately (April 4, 2022)</td>
<td></td>
</tr>
<tr>
<td>2021-29</td>
<td>SSAP No. 22R</td>
<td>ASU 2021-05, Variable Lease Payments</td>
<td>Revisions reject ASU 2021-05 for statutory accounting.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>SAP Clarification</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Effective Immediately (April 4, 2022)</td>
<td></td>
</tr>
<tr>
<td>2021-30</td>
<td>Appendix D</td>
<td>ASU 2021-06, Amendments to SEC Paragraphs</td>
<td>Revisions reject ASU 2021-06 for statutory accounting.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>SAP Clarification</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Effective Immediately (April 4, 2022)</td>
<td></td>
</tr>
</tbody>
</table>

https://naiconline.sharepoint.com/teams/frsstatutoryaccounting/national meetings/a. national meeting materials/2022/4- spring nm/adoptions/adoptions 4.4.2022 toc.docx
Issue: Schedule D-6-1, Supplemental Reporting

Check (applicable entity):

<table>
<thead>
<tr>
<th>Modification of Existing SSAP</th>
<th>P/C</th>
<th>Life</th>
<th>Health</th>
</tr>
</thead>
<tbody>
<tr>
<td>New Issue or SSAP</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interpretation</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Description of Issue: **SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities** defines the specific criteria for when an investment is considered a subsidiary, controlled or affiliated entity (SCA) for statutory accounting purposes. Broadly defined, SCAs are entities that are 1) directly or indirectly owned or controlled by a reporting entity (i.e., a subsidiary), or 2) within a holding company system or a party that is directly or indirectly, through one or more intermediaries, in which controls, is controlled by, or is under common control with a reporting entity (i.e., an affiliate). While SSAP No. 97 offers varying classifications of SCAs with differing valuation methods, all SCAs are ultimately reported on **Schedule D – Part 6 – Section 1: Valuation of Shares of Subsidiary, Controlled or Affiliated Entities**.

The reporting requirements for SCAs is defined in SSAP No. 97, Exhibit A, however in general, the process is as follows: (note: the following comments are not applicable for domestic SCA insurance companies)

- All SCA entities, regardless of if they are nonadmitted, have a zero value, or are immaterial to the reporting entity, must file a “Sub-1” within 90 days of the acquisition or formation of the investment. The Sub-1 filing is to gather basic information about the SCA and is used to determine if the transaction meets certain specific criteria specified within SSAP No. 97.

- Annually, but no later than August 31 (or one month after the audit report is issued for an SCA – for entities who routinely received their audit reports after August 31), SCAs must file a “Sub-2” filing. This filing details the valuation method utilized; the value claimed in Schedule D-6-1 and includes all required supporting documentation. (Nonadmitted assets are not required to file a Sub-2 if they are nonadmitted, or had a zero value, for the full reporting period). The Sub-2 filing is then reviewed by the NAIC for verification of the claimed value. If required, valuation adjustments are made. As directed in SSAP No 97, if the insurance company has reported a value for a SCA investment on its financial statement blank that differs from the value approved by the NAIC, the insurer is required to adjust the reported value in its next quarterly financial statement blanks, unless otherwise directed by the insurer’s state of domicile. (Note, the SCA review process occurs in arrears. As such, when a value is adjusted, the concepts for the adjustment shall be applied to the next year-end. For example, if a company did not incorporate required SSAP No. 97 adjustments in determining the reported value as of Dec. 31, 2020, those adjustments should be considered when determining the value reported as of Dec. 31, 2021 (or earlier if known when the quarterly financials are completed). When the adjustment is material, then the guidance in SSAP No. 3—Accounting Changes and Corrections of Errors would be applicable.)

In 2019, the NAIC reviewed 824 SCA filings (which includes both Sub-1 and Sub-2 filings). Of the total, 720 were Sub-2 filings (the filing in which a value is approved). Of the 720 Sub-2 filings, 125 (approx. 17%) resulted in valuation decreases. Presumably, per SSAP No. 97, entities (unless directed by their state of domicile) adjusted the reported values in their next quarterly financial statements, however NAIC staff have found that it is not uncommon for the same entities, year after year, to have approved values that vary significantly from their reported balances. It is also important to note that while the NAIC does send monthly reports on SCA activity to state regulators, the process of reviewing the activity reports and verifying compliance with SSAP No. 97, for state regulators (and NAIC staff) is operationally onerous. Accordingly, this agenda item has been drafted to propose new supplemental
reporting (in electronic only columns) to assist state regulators to 1) ensure Sub-1 and Sub-2 filings are being submitted by reporting entities, and 2) identify situations where the NAIC approved value varies significantly from the value reported on Schedule D-6-1.

Existing Authoritative Literature:

| Staff note – For completeness of the document, the authoritative guidance defining SCA’s in scope of SSAP No. 97 has been included herein. Certain relevant items have been bolded for emphasis. |

**SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities**

**Definition [of a SCA]**

1. **Parent and subsidiary are defined as follows:**
   a. **Parent**—An entity that directly or indirectly owns and controls the reporting entity;
   b. **Subsidiary**—An entity that is, directly or indirectly, owned and controlled by the reporting entity.

2. **An affiliate is defined as an entity that is within the holding company system or a party that, directly or indirectly, through one or more intermediaries, controls, is controlled by, or is under common control with the reporting entity.** An affiliate includes a parent or subsidiary and may also include partnerships, joint ventures, and limited liability companies as defined in SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies. Those entities are accounted for under the guidance provided in SSAP No. 48, which requires an equity method for all such investments.

3. **Control is defined as the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of the investee,** whether through the (a) ownership of voting securities, (b) by contract other than a commercial contract for goods or nonmanagement services, (c) by common management, or (d) otherwise. Control shall be presumed to exist if a reporting entity and its affiliates directly or indirectly, own, control, hold with the power to vote, or hold proxies representing 10% or more of the voting interests of the entity.

4. **Control as defined in paragraph 5 shall be measured at the holding company level.** For example, if one member of an affiliated group has a 5% interest in an entity and a second member of the group has an 8% interest in the same entity, the total interest is 13% and therefore each member of the affiliated group shall be presumed to have control. This presumption will stand until rebutted by an evaluation of all the facts and circumstances relating to the investment based on the criteria in FASB Interpretation No. 35, Criteria for Applying the Equity Method of Accounting for Investments in Common Stock, an Interpretation of APB Opinion No. 18. The corollary is required to demonstrate control when a reporting entity owns less than 10% of the voting securities of an investee. The insurer shall maintain documents substantiating its determination for review by the domiciliary commissioner. An investment in an SCA entity may fall below the level of ownership described in paragraph 5, in which case, the reporting entity would discontinue the use of the equity method, as prescribed in paragraph 13.g. Additionally, through an increase in the level of ownership, a reporting entity may become qualified to use the equity method of accounting (paragraph 8.b.), in which case, the reporting entity shall add the cost of acquiring additional interest to the current basis of the previously held interest and shall apply the equity method prospectively, as of the date the investment becomes qualified for equity method accounting. Examples of situations where the presumption of control may be in doubt include the following:
   a. Any limited partner investment in a limited partnership, unless the limited partner is affiliated with the general partner.
   b. An entity where the insurer owns less than 50% of an entity and there is an unaffiliated individual or group of investors who own a controlling interest.
c. An entity where the insurer has given up participating rights as a shareholder to the investee.

5. Investments in SCA entities 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.

EXHIBIT A – SCA REPORTING PROCESS

50. SCA entities, except for domestic SCA insurance company investments accounted for under paragraph 8.b.i of this statement, in which the reporting entity has an equity interest (common or preferred stock), are required to be filed with the NAIC. Nonadmitted assets are not required to be filed in a Sub-2 as long as they were nonadmitted, or had a zero value, for the full reporting period (all interim and annual reporting). Immaterial asset SCAs do not have an automatic exclusion from filing, as immateriality of an SCA will be ascertained by the state of domicile of the insurance reporting entity, but companies are allowed to request an exemption from the domiciliary state to not file an SCA on the basis that it is immaterial. The filing process does not include investments within the scope of SSAP No. 48.

51. Except for domestic SCA insurance company investments accounted for under paragraph 8.b.i., all SCA investments within the scope of this statement, purchased during any one calendar year, shall be reported to the NAIC on a Sub-1 form within 90 days of the acquisition or formation of the investment; this includes nonadmitted, zero-valued and immaterial SCAs. The NAIC will process that filing in the same year but will not at that time approve or disapprove a value for the SCA investment. By August 31 of each year, the insurance company shall submit a Sub-2 filing for the previously purchased SCA investment reported on a Sub-1 form and later that year, the NAIC will approve a value for the transaction. For SCAs that routinely receive their audit reports after the August 31 deadline, a filing deadline of one month after the audit date shall be applied. Filers must provide previous years’ audit reports to verify an audit report dated after August 31 in order to not be charged a late fee for a Sub-2 filing that is filed after the August 31 deadline. The value approved by the NAIC at the conclusion of the Sub-2 form filing is reported by the insurance company on its financial statement blank. If the insurance company has reported a value for the SCA investment on its financial statement blank that differs from the value approved by the NAIC, the insurer is required to adjust the reported value in its next quarterly financial statement blank unless otherwise directed by the insurer's state of domicile.

52. Insurance companies shall use one of the valuation methods described in paragraph 8 to calculate the value of their investments in insurance and non-insurance SCA companies. An insurance company shall calculate the value of its investments in foreign insurance and all non-insurance company SCA entities and report the value to the NAIC no later than August 31, or one month after the audit report date for SCAs that routinely receive their audits after August 31 for existing SCA investments, and within 90 days of the acquisition or formation of a new SCA investment.

Initial Reporting of SCA Investments

53. Reporting the acquisition or formation of a new investment is accomplished by submitting a completed Sub-1 form for each investment, disclosing (i) the valuation reported or to be reported by the insurance company on its latest or next quarterly financial statement blank, (ii) which method of those described in paragraph 8 was used to arrive at the valuation, (iii) the factual context of the transaction and (iv) economic and business motivations for the transaction. The submission will be processed by the NAIC only if the NAIC determines it has been provided with all material information with respect to all SCA companies of the reporting insurance company that require valuation.

54. The purpose of a Sub-1 filing is to gather basic information about the SCA. If the NAIC determines that the reported transaction meets the tests specified, it will complete the filing in the VISION database. If the NAIC determines that the transaction does not meet the tests specified, it will not complete the filing in the VISION database and instead shall notify the reporting insurance company and the state of domicile in writing of its determination.
Subsequent Reporting of SCA Investments

55. **By August 31 or one month after the audit report date of each year and subsequent to the reporting of an SCA investment on the Sub-1 form, the insurance company shall submit a Sub-2 form filing, with all supporting documentation for foreign SCAs provided in English, for the same SCA investment. Additionally, by August 31 or one month after the audit report date of each year, any insurance company that has made a Sub-2 form filing in a previous year must update the information by filing an updated Sub-2 form filing.**

56. **Each year the NAIC shall compile a list of all SCA investments (excluding insurance company SCAs (paragraph 8.b.i.) nonadmitted and zero-value SCAs) reported as Sub-1 form filings for which a Sub-2 form filing has not yet been received. For these transactions, the NAIC will notify the responsible reporting insurance company and its state of domicile that it has not received a Sub-2 filing for the SCA investment.**

57. **The purpose of the Sub-2 filing is to determine whether the value calculated by the reporting insurance company for the SCA investment is appropriate and to approve that or some other value for reporting on the insurer's financial statement blank.**

58. **An insurance company that concludes an SCA transaction at year-end may be unable to file a Sub-1 form prior to the time it would be required to file a Sub-2 form. Where this is the case, the NAIC is authorized to accept and review a Sub-1 filing from such an insurance company and to accept and review the Sub-2 filing after the Sub-1 filing review has been completed.**

59. **No filing of an investment in a domestic SCA insurance company valued under paragraph 8.b.i. shall be required to be made with the NAIC.**

Assessment and Review of Sub-2 Form

64. **By August 31 or one month after the audit report date of each year, the NAIC shall initiate a review of all SCA investments for which new Sub-2 form filings have been received as well as an annual update review of Sub-2 SCA investments already logged in the VISION database. The NAIC review shall encompass a review of the most recent annual statutory reporting by the parent insurance company's Schedule Y (to ascertain the identity of the members of the holding company system and to ensure that information for all SCA companies has been submitted), a review of the parent’s financial statement blank to review the last reported value for the SCA investments and a review of the VISION database to determine whether SCA debt and SCA preferred securities have been assigned NAIC designations.** As part of its analysis, the NAIC shall review the portion of the bond investments carried by the parent or a subsidiary insurer with a Z notation. If the NAIC determines that the portion of the Z bonds shown on the documentation is significant, the NAIC shall not process the Sub-2 filing until the insurance company reports the bonds to permit removal of the Z notation. Beginning with year-end 2019, two new suffixes will apply: YE and IF. YE means that the security is a properly filed annual update that the SVO has determined will not be assigned an NAIC designation by the close of the year-end reporting cycle. The symbol YE is assigned by the SVO pursuant to the carryover administrative procedure described in Part One, Section 3 f) (iii) of the Purposes and Procedures Manual of the NAIC Investment Analysis Office. When the SVO assigns the symbol YE it also assigns the NAIC designation in effect for the previous reporting year. IF means that the security is an initial filing that has been properly filed with the SVO but which the SVO has determined will not be assigned an NAIC designation by the close of the year-end reporting cycle. The symbol IF is assigned by the SVO and communicates that the insurer should self-designate the security for year-end and identify it with the symbol IF. IF, therefore, also communicates to the regulator that the NAIC designation reported by the insurance company was not derived by or obtained from the SVO, but has been determined analytically by a reporting insurance company.

65. **Upon completion of the procedures described above, the NAIC will determine whether the value reported by the insurance company on the current SCA filing was calculated in accordance with the instructions for the valuation method chosen and verify that the filed value reflects the adjustments required by paragraph 9.**
66. Upon approval of a value (including making necessary adjustments), the NAIC will complete the Sub-2 filing with the approved value in the status field of the VISION database.

67. The NAIC shall report its determination to the insurance company. If a significant discrepancy exists between the value claimed by the reporting insurance company and the value approved by the NAIC, the NAIC shall communicate the discrepancy with the company. If the NAIC cannot come to a conclusion based on the support provided, the filing can be rejected in VISION, and written notification will be provided to the reporting insurance company and the company’s state of domicile of this action. This correspondence will be sent to the domiciliary state. Filers are able to download their review information from the NAIC filing system.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): None

Information or issues (included in Description of Issue) not previously contemplated by the Working Group: None

Convergence with International Financial Reporting Standards (IFRS): N/A

Staff Recommendation: NAIC staff recommends that the Working Group forward a proposal to the Blanks (E) Working Group to supplement the identification of SCA investments in Schedule D – Part 6 – Section 1: Valuation of Shares of Subsidiary, Controlled or Affiliated Entities. The supplemental data to be captured is consistent with current requirements in SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities, however this improved reporting granularity will significantly assist regulators to 1) ensure Sub-1 and Sub-2 filings are being submitted by reporting entities, and 2) identify situations where the NAIC approved value varies significantly from the value reported on Schedule D-6-1.

The proposed (electronic column) additions to Schedule D – Part 6 – Section 1 are shown below. (Note: for brevity, the included blanks instructions, which do not have proposed edits, have been abbreviated and should not be used for blanks filing purposes.)

SCHEDULE D – PART 6 – SECTION 1
Valuation of Shares of Subsidiary, Controlled or Affiliated Companies

<table>
<thead>
<tr>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
<th>7</th>
<th>8</th>
<th>9</th>
<th>10</th>
<th>11</th>
</tr>
</thead>
<tbody>
<tr>
<td>CUSIP Identification</td>
<td>Description Name of Subsidiary, Controlled or Affiliated Company</td>
<td>Foreign</td>
<td>NAIC Company Code</td>
<td>ID Number</td>
<td>NAIC Valuation Method</td>
<td>Book/Adjusted Carrying Value</td>
<td>Total Amount of Goodwill Included in Book/Adjusted Carrying Value</td>
<td>Nonadmitted Amount</td>
<td>Stock of Such Company Owned by Insurer on Statement Date</td>
<td></td>
</tr>
<tr>
<td>----------------------</td>
<td>----------------------------------</td>
<td>--------</td>
<td>-------------------</td>
<td>---------</td>
<td>------------------------</td>
<td>-----------------------------</td>
<td>---------------------------------</td>
<td>------------------</td>
<td>--------------------------------------------------</td>
<td></td>
</tr>
<tr>
<td>Ref #2021-22 XXX</td>
<td>XXX</td>
<td>XXX</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

1. Total amount of goodwill nonadmitted $.........................
Reporting Instructions for Schedule D, Part 6, Section 1

Column 1 – CUSIP Identification
Column 2 – Description
Column 3 – Foreign
Column 4 – NAIC Company Code
Column 5 – ID Number
Column 6 – NAIC Valuation Method
Column 8 – Total Amount of Goodwill
Column 9 – Nonadmitted Amount
Column 10 – Stock of Such Company Owned by Insurer on Statement Date Number of Shares and
Column 11 – Stock of Such Company Owned by Insurer on Statement Date % of Outstanding

** Column 12 through 159 will be electronic only. **

Column 12 – Legal Entity Identifier (LEI)
Column 13 – Issuer
Column 14 – Issue
Column 15 – ISIN Identification
Column 16 – Prior Year BACV
Column 17 – Prior Year Nonadmitted Amount
Column 18 – Prior year Sub-2 Verified Value

Provide the amount nonadmitted, if any, included in Column 4 of the Asset page.

If per SSAP No. 97 or by direction of the domiciliary regulator, the SCA is required to be filed with the NAIC, provide the prior year’s Sub-2 ‘Total Value Claimed.’

If per SSAP No. 97 or by direction of the domiciliary regulator, the SCA is required to be filed with the NAIC, provide the prior year NAIC VISION filing number.

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

Status:
On December 11, 2021, the Statutory Accounting Principles (E) Working Group moved this item to the active listing and exposed proposed revisions to be incorporated into a Blanks (E) Working Group proposal which would supplement the reporting of SCA investments reported in Schedule D-6-1, as illustrated above. The supplemental data to be captured is consistent with current requirements in SSAP No. 97 and as a result, the agenda item did not propose statutory revisions.

On April 4, 2022, the Statutory Accounting Principles (E) Working Group adopted this agenda item, which did not result in statutory accounting revisions, however adoption expressed support of the corresponding Blanks (E) Working Group proposal (2022-02BWG), which incorporates new electronic only columns in Schedule D-6-1. The supplemental data to be captured is consistent with current requirements in SSAP No. 97.
Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A

Issue: SSAP No. 43R – Financial Modeling – Updated Guidance

Check (applicable entity):

<table>
<thead>
<tr>
<th>Modification of Existing SSAP</th>
<th>P/C</th>
<th>Life</th>
<th>Health</th>
</tr>
</thead>
<tbody>
<tr>
<td>New Issue or SSAP</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interpretation</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Description of Issue: This agenda item reflects updated NAIC designation/NAIC designation category guidance recently adopted by the Valuation of Securities (E) Task Force (VOSTF) to the Purposes and Procedures Manual of the NAIC Investment Analysis Office (P&P Manual), for residential mortgage-backed securities (RMBS) and commercial mortgage-backed securities (CMBS).

On October 20, 2021, the VOSTF adopted instructions to the P&P Manual to designate that 1) modeled RMBS/CMBS tranches that do not have expected losses will be assigned an NAIC 1 Designation and a NAIC 1.A. Designation Category, and 2) financial modeling for “legacy” RMBS/CMBS securities (those that closed prior to January 1, 2013), shall continue to utilize the insurer’s carrying value for said modeling.

This agenda item has been drafted to ensure the financial modeling guidance summarized in SSAP No. 43R—Loan-Backed and Structured Securities reflects the practices as directed by the P&P Manual. (Note, while the Accounting Practices and Procedures Manual is higher than the P&P manual in the statutory hierarchy, the primary source of authoritative guidance for financial modeling is the P&P manual as only a general description of the modeling process is included in SSAP No. 43R).

Existing Authoritative Literature:

SSAP No. 43R—Loan-Backed and Structured Securities

Designation Guidance

27. For RMBS/CMBS securities within the scope of this statement, the initial NAIC designation used to determine the carrying value method and the final NAIC designation for reporting purposes is determined using a multi-step process. The P&P Manual provides detailed guidance. A general description of the processes is as follows:

a. Financial Modeling: Pursuant to the P&P Manual, the NAIC identifies select securities where financial modeling must be used to determine the NAIC designation. NAIC designation based on financial modeling incorporates the insurers’ carrying value for the security. For those securities that are financially modeled, the insurer must use NAIC CUSIP specific modeled breakpoints provided by the modelers in determining initial and final designation for these identified securities. As specified in the P&P Manual, securities where modeling results in zero expected loss in all scenarios and that would be equivalent to an NAIC designation and NAIC designation category of NAIC 1 and NAIC 1.A. respectively, if the filing exemption process in the P&P Manual was applied, are automatically considered to have a final NAIC designation of NAIC 1 and NAIC designation category of NAIC 1.A., regardless of the carrying value. The three-step process for modeled securities is as follows:

i. Step 1: Determine Initial Designation – The current amortized cost (divided by remaining par amount) of a loan-backed or structured security is compared to the modeled breakpoint values assigned to the six (6) NAIC designations for each CUSIP to establish the initial NAIC designation.
Step 2: Determine Carrying Value Method – The carrying value method, either the amortized cost method or the lower of amortized cost or fair value method, is then determined as described in paragraph 26 based upon the initial NAIC designation from Step 1.

Step 3: Determine Final Designation – The final NAIC designation is determined by comparing the carrying value (divided by remaining par amount) of a security (based on paragraph 27.a.ii.) to the NAIC CUSIP specific modeled breakpoint values assigned to the six (6) NAIC designations for each CUSIP. The final designation is mapped to an NAIC designation category according to the instructions in the P&P Manual. This final NAIC designation shall be applicable for statutory accounting and reporting purposes and the NAIC designation category will be used for investment schedule reporting and establishing RBC and AVR charges. The final NAIC designation is not used for establishing the appropriate carrying value method in Step 2 (paragraph 27.a.ii.).

b. All Other Loan-Backed and Structured Securities: For securities not subject to paragraph 27.a. (financial modeling) follow the established designation procedures according to the appropriate section of the P&P Manual. The NAIC designation shall be applicable for statutory accounting and reporting purposes (including determining the carrying value method and establishing the AVR charges). The carrying value method is established as described in paragraph 26. Examples of these securities include, but are not limited to equipment trust certificates, credit tenant loans (CTL), 5*/6* securities, interest only (IO) securities, securities with CRP ratings (excluding RMBS/CMBS), loan-backed and structured securities, and mortgage-referenced securities with SVO assigned NAIC designations. [NAIC staff note, it is anticipated that the revisions shown above in this paragraph will be reflected when agenda item 2021-11: SSAP No. 43R – CTL is adopted. As these edits do not impact this agenda item, they are shown here for reference and accordingly, are not shown below in the options presented for possible exposure.]

Specific Interim Reporting Guidance Financially Modeled Securities

28. For securities that will be financially modeled under paragraph 27, the guidance in this paragraph shall be applied in determining the reporting method for such securities acquired in the current year for quarterly financial statements. Securities reported as of the prior-year end shall continue to be reported under the prior-year end methodology for the current-year quarterly financial statements. For year-end reporting, securities shall be reported in accordance with paragraph 27, regardless of the quarterly methodology used.

a. Reporting entities that acquired the entire financial modeling database for the prior-year end are required to follow the financial modeling methodology (paragraph 27.a.) for all securities acquired in the subsequent year that were included in the financial modeling data acquired for the prior year-end.

b. Reporting entities that acquired identical securities (identical CUSIP) to those held and financially modeled for the prior year-end are required to follow the prior year-end financial modeling methodology (paragraph 27.a.) for these securities acquired subsequent to year-end.

c. Reporting entities that do not acquire the prior-year financial modeling information for current-year acquired individual CUSIPS, and are not captured within paragraphs 28.a. or 28.b., are required to follow the analytical procedures for non-financially modeled securities (paragraph 27.b. as appropriate). Reporting entities that do acquire the individual CUSIP information from the prior-year financial modeling database shall use that information for interim reporting.

d. Reporting entities that acquire securities not previously modeled at the prior year-end are required to follow the analytical procedures for non-financially modeled securities (paragraph 27.b. as appropriate).
SSAP No. 43R - EXHIBIT A – Question and Answer Implementation Guide

Index to Questions

Questions 8-10 are specific to securities subject to the financial modeling process. (This process is limited to qualifying RMBS/CMBS securities reviewed by the NAIC Structured Securities Group.) The guidance in questions 8-10 shall not be inferred to other securities in scope of SSAP No. 43R.

<table>
<thead>
<tr>
<th>Question</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>8</td>
<td>Do LBSS purchased in different lots result in a different NAIC designation for the same CUSIP? Can reporting entities use a weighted average method determined on a legal entity basis?</td>
</tr>
<tr>
<td>9</td>
<td>The NAIC Designation process for LBSS may incorporate loss expectations that differ from the reporting entity’s expectations related to OTTI conclusions. Should the reporting entities be required to incorporate recovery values obtained from data provided by the service provider used for the NAIC Designation process for impairment analysis as required by SSAP No. 43R?</td>
</tr>
<tr>
<td>10</td>
<td>For companies that have separate accounts, can the NAIC designation be assigned based upon the total legal entity or whether it needs to be calculated separately for the general account and the total separate account?</td>
</tr>
</tbody>
</table>

8. **Question** – Do LBSS purchased in different lots result in a different NAIC designation for the same CUSIP? Can reporting entities use a weighted average method determined on a legal entity basis?

8.1 Under the financial modeling process (applicable to qualifying RMBS/CMBS reviewed by the NAIC Structured Securities Group), the amortized cost of the security impacts the “final” NAIC designation used for reporting and RBC purposes. As such, securities subject to the financial modeling process acquired in different lots can result in a different NAIC designation for the same CUSIP. In accordance with the current instructions for calculating AVR and IMR, reporting entities are required to keep track of the different lots separately, which means reporting the different designations. For reporting purposes, if a SSAP No. 43R security (by CUSIP) has different NAIC designations by lot, the reporting entity shall either 1) report the aggregate investment with the lowest applicable NAIC designation or 2) report the investment separately by purchase lot on the investment schedule. If reporting separately, the investment may be aggregated by NAIC designation. (For example, all acquisitions of the identical CUSIP resulting with an NAIC 1 designation may be aggregated, and all acquisitions of the identical CUSIP resulting with an NAIC 3 designation may be aggregated.)

9. **Question** – The NAIC Designation process for LBSS subject to the financial modeling process may incorporate loss expectations that differ from the reporting entity’s expectations related to OTTI conclusions. Should the reporting entities be required to incorporate recovery values obtained from data provided by the service provider used for the NAIC Designation process for impairment analysis as required by SSAP No. 43R?

9.1 In accordance with INT 06-07: Definition of Phrase “Other Than Temporary,” reporting entities are expected to “consider all available evidence” at their disposal, including the information that can be derived from the NAIC designation.

10. **Question** - For companies that have separate accounts, can the NAIC designation be assigned based upon the total legal entity or whether it needs to be calculated separately for the general account and the total separate account?

10.1 The financial modeling process for qualifying RMBS/CMBS securities is required for applicable securities held in either the general or separate account.
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):

- To be consistent with the P&P Manual revisions, agenda item 2018-19 eliminated the multi-step designation guidance for modified filing exempt (MFE) securities. The elimination of MFE was effective March 31, 2019, with early application permitted for year-end 2018. With the elimination of MFE, for securities that are filing exempt, the NAIC designation reported will correspond to the CRP rating without adjustment based on carrying value. Also, in agenda item 2018-03, the Working Group clarified that securities acquired in lots shall not be reported with weighted average designations. With the adopted guidance, if a SSAP No. 43R security (by CUSIP) has different NAIC designations by lot, the reporting entity shall either 1) report the aggregate investment with the lowest applicable NAIC designation or 2) report the investment separately by purchase lot on the investment schedule. If reporting separately, the investment may be aggregated by NAIC designation. With the elimination of MFE, the instances of different designations by lot is not expected to be prevalent, but could still occur with the financial modeling process for RMBS and CMBS.

- In November 2020, the Working Group adopted edits to SSAP No. 43R from agenda item 2020-21: SSAP No. 43R – Designation Categories for RMBS/CMBS investments, incorporating newly adopted VOSTF guidance to the P&P manual detailing the use and mapping of NAIC designations to NAIC designation categories. Reporting entities were to then utilize the new NAIC designation categories for accounting and reporting purposes.

Information or issues (included in Description of Issue) not previously contemplated by the Working Group:
None


Staff Recommendation: NAIC staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to SSAP No. 43R—Loan-backed and Structured Securities to reflect the updated financial modeling guidance for RMBS/CMBS securities. These revisions reflect the guidance recently adopted for the Purposes and Procedures Manual of the NAIC Investment Analysis Office (P&P Manual).

NAIC staff note - Two options for incorporating the newly revised P&P manual guidance are presented below. Option 1 retains the past approach to summarize the financial modeling approach. Option 2 removes the summary and instead refers to the P&P Manual. When the modeling guidance was first adopted, it was identified as necessary to summarize in the AP&P. However, as the concept is no longer new, NAIC staff requests feedback on the extent the guidance needs to be retained. Since the P&P Manual governs this process, the AP&P guidance must currently be updated anytime they incorporate a change.

Proposed Revisions to SSAP No. 43R—Loan-Backed and Structured Securities

**OPTION #1 – Retain existing guidance in SSAP No. 43R with updates to reflect recent actions of the VOSTF. (If this option is preferred, further updates are likely forthcoming as the VOSTF considers additional modifications to the financial modeling guidance.)**

**Designation Guidance**

27. For RMBS/CMBS securities within the scope of this statement, the initial NAIC designation used to determine the carrying value method and the final NAIC designation for reporting purposes is determined using a multi-step process or the NAIC designation assigned by the NAIC Securities Valuation Office. The P&P Manual provides detailed guidance. A general description of the processes is as follows:
a. Financial Modeling: Pursuant to the P&P Manual, the NAIC identifies select securities where financial modeling must be used to determine the NAIC designation. For a modeled legacy security, meaning one which closed prior to January 1, 2013, the NAIC designation is based on financial modeling incorporating the insurers’ carrying value. For the security a modeled on-legacy security, meaning one which closed after December 31, 2012, the NAIC designation and NAIC designation category assigned by the NAIC Securities Valuation Office must be used. For those legacy securities that are financially modeled, the insurer must use NAIC CUSIP specific modeled breakpoints provided by the modelers in determining initial and final designation for these identified securities. As specified in the P&P Manual, a modeled legacy security RMBS or CMBS tranche that has no expected loss, as compiled and published by the NAIC Securities Valuation Office, under any of the selected modeling scenarios would be assigned an NAIC 1 designation and NAIC 1.A designation category regardless of the insurer’s book/adjusted carrying value. Securities where modeling results in zero expected loss in all scenarios and that would be equivalent to an NAIC designation and NAIC designation category of NAIC 1 and NAIC 1.A, respectively, if the filing exemption process in the P&P Manual was applied, are automatically considered to have a final NAIC designation of NAIC 1 and NAIC designation category of NAIC 1.A, regardless of the carrying value. The three-step process for modeled legacy securities is as follows:

i. Step 1: Determine Initial Designation – The current amortized cost (divided by remaining par amount) of a loan-backed or structured security is compared to the modeled breakpoint values assigned to each the six (6) NAIC designations and NAIC designation category for each CUSIP to establish the initial NAIC designation.

ii. Step 2: Determine Carrying Value Method – The carrying value method, either the amortized cost method or the lower of amortized cost or fair value method, is then determined as described in paragraph 26 based upon the initial NAIC designation from Step 1.

iii. Step 3: Determine Final Designation – The final NAIC designation is determined by comparing the carrying value (divided by remaining par amount) of a security (based on paragraph 27.a.ii.) to the NAIC CUSIP specific modeled breakpoint values assigned to the six (6) NAIC designations and NAIC designation category for each CUSIP. The final designation is mapped to an NAIC designation category, according to the instructions in the P&P Manual. This final NAIC designation shall be applicable for statutory accounting and reporting purposes and the NAIC designation category will be used for investment schedule reporting and establishing RBC and AVR charges. The final NAIC designation is not used for establishing the appropriate carrying value method in Step 2 (paragraph 27.a.ii.).

b. All Other Loan-Backed and Structured Securities: For securities not subject to paragraph 27.a. (financial modeling) follow the established designation procedures according to the appropriate section of the P&P Manual. The NAIC designation shall be applicable for statutory accounting and reporting purposes (including determining the carrying value method and establishing the AVR charges). The carrying value method is established as described in paragraph 26.

Specific Interim Reporting Guidance Financially Modeled Securities

28. For securities that will be financially modeled under paragraph 27, the guidance in this paragraph shall be applied in determining the reporting method for such securities acquired in the current year for quarterly financial statements. Securities reported as of the prior-year end shall continue to be reported under the prior-year end methodology for the current-year quarterly financial statements. For year-end reporting, securities shall be reported in accordance with paragraph 27, regardless of the quarterly methodology used.
a. Reporting entities that acquired the entire financial modeling database for the prior-year end are required to follow the financial modeling methodology (paragraph 27.a.) for all securities acquired in the subsequent year that were included in the financial modeling data acquired for the prior year-end.

b. Reporting entities that acquired identical securities (identical CUSIP) to those held and financially modeled for the prior year-end are required to follow the prior year-end financial modeling methodology (paragraph 27.a.) for these securities acquired subsequent to year-end.

c. Reporting entities that do not acquire the prior-year financial modeling information for current-year acquired individual CUSIPS, and are not captured within paragraphs 28.a. or 28.b., are required to follow the analytical procedures for non-financially modeled securities (paragraph 27.b. as appropriate). Reporting entities that do acquire the individual CUSIP information from the prior-year financial modeling database shall use that information for interim reporting.

d. Reporting entities that acquire securities not previously modeled at the prior year-end are required to follow the analytical procedures for non-financially modeled securities (paragraph 27.b. as appropriate).

**OPTION #2 – Remove summarized financial modeling guidance from SSAP No. 43R and refer to the guidance in the P&P Manual. (If this option is preferred, further updates to financial modeling guidance are expected to be isolated to the P&P Manual, which is the governs the designation process.)**

**Designation Guidance**

27. NAIC designations are determined in accordance with the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual). The NAIC designations shall be applicable for statutory accounting and reporting purposes (including determining the carrying value and establishing the AVR charges). For RMBS/CMBS securities within the scope of this statement may be subject to the financial modeling process. The P&P Manual shall be consulted for the specific process for obtaining or determining the NAIC designation, the initial NAIC designation used to determine the carrying value method and the final NAIC designation for reporting purposes is determined using a multi-step process. The P&P Manual provides detailed guidance. A general description of the processes is as follows:

*a Financial Modeling: Pursuant to the P&P Manual, the NAIC identifies select securities where financial modeling must be used to determine the NAIC designation. NAIC designation based on financial modeling incorporates the insurers’ carrying value for the security. For those securities that are financially modeled, the insurer must use NAIC CUSIP specific modeled breakpoints provided by the modelers in determining initial and final designation for these identified securities. As specified in the P&P Manual, securities where modeling results in zero expected loss in all scenarios and that would be equivalent to an NAIC designation and NAIC designation category of NAIC 1 and NAIC 1.A, respectively, if the filing exemption process in the P&P Manual was applied, are automatically considered to have a final NAIC designation of NAIC 1 and NAIC designation category of NAIC 1.A., regardless of the carrying value. The three-step process for modeled securities is as follows:

i. **Step 1: Determine Initial Designation** — The current amortized cost (divided by remaining par amount) of a loan-backed or structured security is compared to the modeled breakpoint values assigned to the six (6) NAIC designations for each CUSIP to establish the initial NAIC designation.

ii. **Step 2: Determine Carrying Value Method** — The carrying value method, either the amortized cost method or the lower of amortized cost or fair value method, is then determined as described in paragraph 26 based upon the initial NAIC designation from Step 1.
iii. Step 3: Determine Final Designation – The final NAIC designation is determined by comparing the carrying value (divided by remaining par amount) of a security (based on paragraph 27.a.ii.) to the NAIC CUSIP specific modeled breakpoint values assigned to the six (6) NAIC designations for each CUSIP. The final designation is mapped to an NAIC designation category according to the instructions in the P&P Manual. This final NAIC designation shall be applicable for statutory accounting and reporting purposes and the NAIC designation category will be used for investment schedule reporting and establishing RBC and AVR charges. The final NAIC designation is not used for establishing the appropriate carrying value method in Step 2 (paragraph 27.a.ii.).

b. All Other Loan-Backed and Structured Securities: For securities not subject to paragraph 27.a. (financial modeling) follow the established designation procedures according to the appropriate section of the P&P Manual. The NAIC designation shall be applicable for statutory accounting and reporting purposes (including determining the carrying value method and establishing the AVR charges). The carrying value method is established as described in paragraph 26.

Specific Interim Reporting Guidance Financially Modeled Securities

27. For securities that will be financially modeled under paragraph 27, the guidance in this paragraph shall be applied in determining the reporting method for such securities acquired in the current year for quarterly financial statements. Securities reported as of the prior-year end shall continue to be reported under the prior-year end methodology for the current-year quarterly financial statements. For year-end reporting, securities shall be reported in accordance with paragraph 27, regardless of the quarterly methodology used.

a. Reporting entities that acquired the entire financial modeling database for the prior-year end are required to follow the financial modeling methodology (paragraph 27.a.) for all securities acquired in the subsequent year that were included in the financial modeling data acquired for the prior-year end.

b. Reporting entities that acquired identical securities (identical CUSIP) to those held and financially modeled for the prior year-end are required to follow the prior-year end financial modeling methodology (paragraph 27.a.) for these securities acquired subsequent to year-end.

c. Reporting entities that do not acquire the prior-year financial modeling information for current-year acquired individual CUSIPS, and are not captured within paragraphs 28.a. or 28.b., are required to follow the analytical procedures for non-financially modeled securities (paragraph 27.b. as appropriate). Reporting entities that do acquire the individual CUSIP information from the prior-year financial modeling database shall use that information for interim reporting.

d. Reporting entities that acquire securities not previously modeled at the prior year-end are required to follow the analytical procedures for non-financially modeled securities (paragraph 27.b. as appropriate).

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

Status:
On December 11, 2021, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed two options for possible revision, as illustrated above, to update the summarized financial modeling guidance in SSAP No. 43R. The first option will retain existing guidance, with updates to reflect Valuation of Securities (E) Task Force adopted edits. The second option removes the summarized financial modeling guidance and refers users to the Purposes and Procedures Manual of the NAIC Investment Analysis Office, which is the source document for financial modeling guidance.
On April 4, 2022, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed revisions (Option #2), as illustrated below, retaining, but updating summarized financial modeling guidance for residential mortgage-backed securities and commercial mortgage-backed securities in SSAP No. 43R—Loan-Backed and Structured Securities. This guidance continues to refer users to the detailed financial modeling guidance in the Purposes and Procedures Manual of the Investment Analysis Office. The revisions incorporate a minor grammatical edit as proposed by interested parties.

**Designation Guidance**

**27.** For RMBS/CMBS securities within the scope of this statement, the initial NAIC designation used to determine the carrying value method and the final NAIC designation for reporting purposes is determined using a multi-step process or the NAIC designation assigned by the NAIC Securities Valuation Office. The P&P Manual provides detailed guidance. A general description of the processes is as follows:

a. **Financial Modeling:** Pursuant to the P&P Manual, the NAIC identifies select securities where financial modeling must be used to determine the NAIC designation. For a modeled legacy security, meaning one which closed prior to January 1, 2013, the NAIC designation is based on financial modeling incorporating the insurers’ carrying value. For the security a modeled non-legacy security, meaning one which closed after December 31, 2012, the NAIC designation and NAIC designation category assigned by the NAIC Securities Valuation Office must be used. For those legacy securities that are financially modeled, the insurer must use NAIC CUSIP specific modeled breakpoints provided by the modelers in determining initial and final designation for these identified securities. As specified in the P&P Manual, a modeled legacy security RMBS or CMBS tranche that has no expected loss, as compiled and published by the NAIC Securities Valuation Office, under any of the selected modeling scenarios would be assigned an NAIC 1 designation and NAIC 1.A designation category regardless of the insurer’s book/adjusted carrying value or securities where modeling results in zero expected loss in all scenarios and that would be equivalent to an NAIC designation and NAIC designation category of NAIC 1 and NAIC 1.A, respectively, if the filing exemption process in the P&P Manual was applied, are automatically considered to have a final NAIC designation of NAIC 1 and NAIC designation category of NAIC 1.A., regardless of the carrying value. The three-step process for modeled legacy securities is as follows:

i. **Step 1: Determine Initial Designation** – The current amortized cost (divided by remaining par amount) of a loan-backed or structured security is compared to the modeled breakpoint values assigned to each of the six (6) NAIC designations and NAIC designation category for each CUSIP to establish the initial NAIC designation.

ii. **Step 2: Determine Carrying Value Method** – The carrying value method, either the amortized cost method or the lower of amortized cost or fair value method, is then determined as described in paragraph 26 based upon the initial NAIC designation from Step 1.

iii. **Step 3: Determine Final Designation** – The final NAIC designation is determined by comparing the carrying value (divided by remaining par amount) of a security (based on paragraph 27.a.ii.) to the NAIC CUSIP specific modeled breakpoint values assigned to the six (6) NAIC designations and NAIC designation category for each CUSIP or. The final designation is mapped to an NAIC designation category, according to the instructions in the P&P Manual. This final NAIC designation shall be applicable for statutory accounting and reporting purposes and the NAIC designation category will be used for investment schedule reporting and establishing RBC and AVR charges. The final NAIC designation is not used for establishing the appropriate carrying value method in Step 2 (paragraph 27.a.ii.).
b. All Other Loan-Backed and Structured Securities: For securities not subject to paragraph 27.a. (financial modeling) follow the established designation procedures according to the appropriate section of the P&P Manual. The NAIC designation shall be applicable for statutory accounting and reporting purposes (including determining the carrying value method and establishing the AVR charges). The carrying value method is established as described in paragraph 26.

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

Issue: General Interrogatory for Cryptocurrencies

Check (applicable entity):

<table>
<thead>
<tr>
<th>Modification of Existing SSAP</th>
<th>P/C</th>
<th>Life</th>
<th>Health</th>
</tr>
</thead>
<tbody>
<tr>
<td>New Issue or SSAP</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interpretation</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Description of Issue: On May 20, 2021, the Statutory Accounting Principles (E) Working Group adopted INT 21-01: Accounting for Cryptocurrencies, which addressed the statutory accounting treatment for cryptocurrencies, and established that directly held cryptocurrencies do not meet the definition of an admitted asset for statutory accounting. While researching this topic, it was noted that some insurance companies held cryptocurrencies, but that these were not always easy to identify in the statutory financial statements. Additionally, as the use of cryptocurrencies by insurance companies evolves, regulators expressed a desire to better understand how companies are using cryptocurrencies. NAIC staff were directed by the Working Group to look at possible ways to get a better view of how cryptocurrencies are currently directly held and used by insurance companies.

NAIC staff have proposed a new general interrogatory within the annual reporting blanks with several questions specific to cryptocurrencies. This is proposed as a new general interrogatory as this is information that has not been previously disclosed and does not fit well with any existing disclosures.

There are no proposed changes to statutory accounting, however the agenda item does result in a sponsored blanks proposal to the Blanks (E) Working Group to incorporate the general interrogatory and related instructions. NAIC staff from the Statutory Accounting Principles (E) Working Group will work directly with the Blanks (E) Working Group staff support.

Existing Authoritative Literature: As articulated in the “description of issue” section, INT 21-01 established that directly held cryptocurrencies do not meet the definition of an admitted asset and are therefore nonadmitted for statutory accounting.

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): INT 21-01, discussed in the prior section.

Information or issues (included in Description of Issue) not previously contemplated by the Working Group: None

Convergence with International Financial Reporting Standards (IFRS): The IFRS Interpretations Committee issued a statement in June 2019 concluding that cryptocurrencies are not financial assets, however that they do meet the definition of an intangible asset.

Staff Recommendation:
NAIC staff recommends that the Working Group forward a sponsored blanks proposal to the Blanks (E) Working Group to add a new general interrogatory to the annual statement blanks to capture information about cryptocurrencies directly held or permitted for the remittance of premiums. Note, this agenda item does not propose statutory revisions. The proposed additions to the reporting blanks and the blanks instructions are shown below.
Annual Statement Instructions, General Interrogatories, Investment Section: (All Types):

38.1 Answer “YES” if the company directly owns cryptocurrencies. Answer “NO” if the company does not directly own cryptocurrencies or only holds cryptocurrencies indirectly through funds (ETFs, Mutual Funds, etc.) \(\text{INT 21-01: Accounting for Cryptocurrencies}\) established that directly held cryptocurrencies do not meet the definition of cash or an admitted asset and are therefore considered to be a nonadmitted asset for statutory accounting.

38.2 If the answer to 38.1 is “YES”, specify on which schedule they are reported. (e.g., Schedule BA, etc.)

39.1 Does the reporting entity directly accept cryptocurrencies as payment for premiums or immediately convert to U.S. dollars? 

39.2 If the answer to 39.1 is “YES”, indicate if it is the policy of the reporting entity to directly hold or immediately convert to U.S. dollars.

39.3 If the answer to 38.1 or 39.1 is “YES”, complete Columns 1 through 3 for each cryptocurrency accepted for payments of premiums or held directly.

Name of Cryptocurrency: 

Immediately Converted to USD, Directly Held, or Both: 

For each cryptocurrency listed, provide one of the following responses:

- Immediately converted to USD
- Directly held,
- Both.

Accepted for Payment of Premiums: 

If the cryptocurrencies are accepted for the payment of premiums provide the response of “YES” in the column otherwise the response in the column should be “NO”.

Annual Statement Blanks, General Interrogatories, Investment Section: (All Types):

<table>
<thead>
<tr>
<th></th>
<th>Name of Cryptocurrency</th>
<th>Immediately Converted to USD, Directly Held, or Both</th>
<th>Accepted for Payment of Premiums</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Staff Review Completed by: Jake Stultz, NAIC Staff, November 2021

Status:
On December 11, 2021, the Statutory Accounting Principles (E) Working Group moved this item to the active listing and exposed proposed revisions to be incorporated into a Blanks (E) Working Group proposal to add a new general interrogatory to the annual blanks, requiring disclosure of when cryptocurrencies are directly held or permitted for the remittance of premiums. This agenda item did not propose statutory revisions.

On April 4, 2022, the Statutory Accounting Principles (E) Working Group adopted this agenda item, which did not result in statutory accounting revisions, however adoption expressed support of the corresponding Blanks (E) Working Group proposal (2022-01BWG), which incorporates a new general interrogatory to detail if cryptocurrencies are directly held or permitted for the remittance of premiums.

Maintenance updates provide revisions to the Accounting Practices and Procedures Manual (AP&P Manual), such as editorial corrections, reference changes and formatting.

<table>
<thead>
<tr>
<th>SSAP/Appendix</th>
<th>Description/Revision</th>
</tr>
</thead>
<tbody>
<tr>
<td>Various</td>
<td>Pursuant to an Aug. 14 referral from the Financial Condition (E) Committee, the edits proposed herein update the terminology references of “substantive” and “nonsubstantive,” which have historically been used to describe statutory accounting revisions being considered by the Statutory Accounting Principles (E) Working Group to the AP&amp;P Manual. The Committee recommended terminology updates to alleviate concerns that users who are not familiar with the historical definitions of the aforementioned terms may incorrectly perceive that the terms reflect potential financial impact rather than their intended definitions. Accordingly, where applicable, the current concept/term of:</td>
</tr>
<tr>
<td></td>
<td>1) a “substantive” revision is proposed to be replaced with the phraseology of a “New SAP or New SAP concept in an existing SSAP,” and,</td>
</tr>
<tr>
<td></td>
<td>2) a “nonsubstantive” revision is proposed to be replaced with the phraseology of a “SAP clarification.”</td>
</tr>
<tr>
<td></td>
<td>Agenda item 2021-14: SAP Terminology, which was previously exposed by the Working Group on Aug. 26, addresses the proposed terminology/phraseology changes in the NAIC Policy Statement on Maintenance of Statutory Accounting Principles (Appendix F). This editorial agenda item identifies all remaining uses of the terms in the current AP&amp;P manual for change consideration.</td>
</tr>
<tr>
<td></td>
<td>Please note, it is anticipated that terminology changes will generally only occur on a go-forward basis as amendments to previously adopted SSAPs, issue papers, agenda items or other historical documents will not occur. As such, the terms used in previously adopted guidance will remain, with the new terms being used prospectively when considering future revisions to statutory accounting.</td>
</tr>
</tbody>
</table>

**Recommendation:**
NAIC staff recommend that the Statutory Accounting Principles (E) Working Group move this agenda item to the active listing, categorize as nonsubstantive, and expose editorial revisions as illustrated below.

**Status:**
On December 11, 2021, the Statutory Accounting Principles (E) Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to certain, remaining terminology references of “substantive” and “nonsubstantive,” as illustrated below.

On April 4, 2022, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed editorial revisions as shown below.
Various SSAPs in response to terminology changes of “Substantive” and “Nonsubstantive”

Edit 1: Table of Contents (How to use this Manual), Volume I, Page xvii

Summary of Changes:
The Summary of Changes outlines changes made to the prior edition of the Manual to create the current year’s version. It is divided into three sections: 1) the development of new SSAPs or new SAP concepts to existing SSAPs; substantive revisions to statutory accounting principles; 2) SAP clarifications; nonsubstantive revisions to statutory accounting principles; and 3) revisions to the appendices included in the Manual. The Summary of Changes is a key resource for readers who are looking to identify changes from the prior edition.

Edit 2: Table of Contents (How to use this Manual), Volume I, Page xviii

Statements of Statutory Accounting Principles:
As indicated by the Statutory Hierarchy, the Statements of Statutory Accounting Principles (SSAPs) are the primary authoritative statutory accounting practices and procedures promulgated by the NAIC. These statements are the result of issue papers that have been exposed for public comment and finalized. Finalized issue papers are found in Appendix E and ARE NOT authoritative. While it is not intended that there be any significant differences between an underlying issue paper and the resultant SSAP, if differences exist, the SSAP prevails and shall be considered definitive. Readers may use the NAIC website to keep abreast of adopted revisions; substantive and nonsubstantive changes; to the SSAPs. Completely superseded SSAPs that are no longer authoritative are moved from the printed Manual into Appendix H – Superseded SSAPs and Nullified Interpretations, which is posted for public reference on the Statutory Accounting Principles (E) Working Group web page at https://content.naic.org/cmte_e_app_sapwg.htm.

Edit 3: Table of Contents (How to use this Manual), Volume I, Page xviii

New paragraph proposed (To be inserted between the paragraphs starting with "As indicated by the Statutory Hierarchy...” and “The cover page of each SSAP...”

Prior to (adoption date), the term used to describe a new SAP concept or a new SAP concept in an existing SSAP was “substantive” and the term used to describe a SAP clarification was “nonsubstantive.” The new terms will be reflected in materials to describe revisions to statutory accounting principles on a prospective basis and historical documents will not be updated to reflect the revised terms.

Edit 4: Table of Contents (How to use this Manual), Volume I, Page xviii

AFFECTS/AFFECTED BY – A useful tool for tracking relationships between statements and interpretations is contained within these sections. The “affects” section is used when a SSAP has previously been substantively amended to reflect new SAP concepts or superseded by other or superseded previously issued SSAPs. Nullified INTs are also noted in this section. Readers are referenced to another SSAP in the “affected by” section if the SSAP has been substantively amended or superseded or amended with a new SAP concept or with the issuance of a new SSAP. Text within paragraphs substantively amended with new SAP concepts or superseded may also be “shaded” to notify readers that revised guidance is available.

Edit 5: Table of Contents (How to use this Manual), Volume I, Page xviii

Refer to the Relevant Literature and Effective Date and Transition sections of each SSAP for details of the development of new SSAPs or new SAP concepts, as well as changes as the result of SAP clarifications substantive and nonsubstantive changes.

Edit 6: Summary of Changes, Volume I, Page xxiii

Section 1 summarizes substantive revisions that result with a new SSAP or new SAP concept to statutory accounting principles. Substantive Revisions that introduce original or modified accounting principles and can be reflected in an existing or new SSAP, the effective date is identified in the Status section, and the revised text within is depicted by underlines (new language) and strikethroughs (removed language). This tracking will not be shown in subsequent manuals. New SSAPs and new SAP concepts that revise existing substantively revised SSAPs are
commonly accompanied by a corresponding issue paper that reflects the revisions for historical purposes. If language in an existing SSAP is superseded, that language is shaded and the new or substantively revised SSAP is referenced. Completely superseded SSAPs and nullified interpretations are included in Appendix H.

**Edit 7: Summary of Changes, Volume I, Page xxiii**

Section 2 summarizes the nonsubstantive revisions that clarify existing statutory accounting principles. Nonsubstantive revisions are characterized as language clarifications which do not modify the original intent of a SSAP, or changes to reference material. Nonsubstantive revisions are depicted by underlines (new language) and strikethroughs (removed language) and will not be tracked in subsequent manuals. Nonsubstantive Revisions that clarify existing statutory accounting principles are effective when adopted unless a specific effective date is noted.

**Edit 8: Summary of Changes (heading in table), Volume I, Page xxiii**

1. **Substantive** Revisions that resulted in a new SSAP or a new SAP concept – Statutory Accounting Principles

2. **Nonsubstantive** Revisions that resulted in a SAP clarification – Statutory Accounting Principles

**Edit 10: Preamble, Volume I, Page P-5**

23. The Accounting Practices and Procedures (E) Task Force will accomplish its mission through charges assigned to the following working groups:

- **Statutory Accounting Principles (E) Working Group:** Responsible for developing and adopting substantive and nonsubstantive revisions to the Statements of Statutory Accounting Principles (SSAPs). Statutory accounting principles provide the basis for insurers to prepare financial statements for financial regulation purposes, and SSAPs are considered level 1 (highest authority) in the statutory accounting hierarchy. Refer to the Statutory Accounting Principles (E) Working Group Web page ([http://www.naic.org/cmte_e_app_sapwg.htm](http://www.naic.org/cmte_e_app_sapwg.htm)) for specific information and charges.

- **Blanks (E) Working Group:** Considers improvements and revisions to various annual/quarterly statement blanks to conform to changes made in other areas of the NAIC to promote uniformity in reporting of financial information by insurers and develop reporting formats for other entities subject to the jurisdiction of state insurance departments. Refer to the Blanks (E) Working Group webpage ([http://www.naic.org/cmte_e_app_blanks.htm](http://www.naic.org/cmte_e_app_blanks.htm)) for specific information and charges.

**Edit 11: Preamble, Volume I, Page P-9**

47. Once promulgated, statements will only be amended or superseded through the issuance of new SSAP pronouncements. If it is necessary to introduce a new SAP concept that will substantially modify or augment the guidance in an existing SSAP, a new statement will be promulgated and/or the statement will be reissued with "revised" in the title. Non-substantial changes as a result of clarifying an existing SAP will be included in the existing statement with changes tracked (i.e., new text will be underlined and deleted text as strikethrough) in the next printing of the Manual. Then no changes will be shown after the initial year. A useful tool for tracking the relationships between statements is contained in the "Status" section of each statement which includes sections labeled "Affects" and "Affected By." As SSAPs are issued in the future that modify or augment the guidance previously provided, these sections will identify the relationships between statements.

**Edit 12: Table of Contents (How to use this Manual), Volume II, Page xvii**

**Summary of Changes:**

The Summary of Changes outlines changes made to the prior edition of the Manual to create the current year’s version. It is divided into three sections: 1) the development of new SSAPs or new SAP concepts to existing SSAPs; substantive revisions to statutory accounting principles; 2) SAP clarifications; nonsubstantive revisions to statutory accounting principles; and 3) revisions to the appendices included in the Manual. The Summary of Changes is a key resource for readers who are looking to identify changes from the prior edition.
Statements of Statutory Accounting Principles:

As indicated by the Statutory Hierarchy, the Statements of Statutory Accounting Principles (SSAPs) are the primary authoritative statutory accounting practices and procedures promulgated by the NAIC. These statements are the result of issue papers that have been exposed for public comment and finalized. Finalized issue papers are found in Appendix E and ARE NOT authoritative. While it is not intended that there be any significant differences between an underlying issue paper and the resultant SSAP, if differences exist, the SSAP prevails and shall be considered definitive. Readers may use the NAIC website to keep abreast of adopted revisions to the SSAPs. Completely superseded SSAPs that are no longer authoritative are moved from the printed Manual into Appendix H – Superseded SSAPs and Nullified Interpretations, which is posted for public reference on the Statutory Accounting Principles (E) Working Group webpage at https://content.naic.org/cmte_e_app_sapwg.htm.

New paragraph proposed (To be inserted between the paragraphs starting with "As indicated by the Statutory Hierarchy...") and "The cover page of each SSAP...")

Prior to (adoption date), the term used to describe a new SAP concept or a new SAP concept in an existing SSAP was “substantive” and the term used to describe a SAP clarification was “nonsubstantive.” The new terms will be reflected in materials to describe revisions to statutory accounting principles on a prospective basis and historical documents will not be updated to reflect the revised terms.

Section 1 summarizes substantive revisions that result with a new SSAP or new SAP concept to statutory accounting principles. Substantive Revisions that introduce original or modified accounting principles and can be reflected in an existing or new SSAP. When substantive revisions that result in a new SAP concept are made to an existing SSAP, the effective date is identified in the Status section, and the revised text within is depicted by underlines (new language) and strikethroughs (removed language). This tracking will not be shown in subsequent manuals. New SSAPs and new SAP concepts that revise existing substantively revised SSAPs are commonly accompanied by a corresponding issue paper that reflects the revisions for historical purposes. If language in an existing SSAP is superseded, that language is shaded and the new or substantively revised SSAP is referenced. Completely superseded SSAPs and nullified interpretations are included in Appendix H.

Section 2 summarizes the nonsubstantive revisions that clarify existing to statutory accounting principles. Nonsubstantive These revisions are characterized as language clarifications which do not modify the original intent of a SSAP, or changes to reference material. NonsubstantiveSuch revisions are depicted by underlines (new language) and strikethroughs (removed language) and will not be tracked in subsequent manuals. Nonsubstantive Revisions that clarify existing statutory accounting principles are effective when adopted unless a specific effective date is noted.

Section 3 summarizes the nonsubstantive revisions that result in a new SSAP or new SAP concept to statutory accounting principles. Substantive These revisions are characterized as language clarifications which do not modify the original intent of a SSAP, or changes to reference material. NonsubstantiveSuch revisions are depicted by underlines (new language) and strikethroughs (removed language) and will not be tracked in subsequent manuals. Nonsubstantive Revisions that clarify existing statutory accounting principles are effective when adopted unless a specific effective date is noted.

Edit 18: Summary of Changes, Volume II, Page xxiii

Section 2 summarizes the nonsubstantive revisions that clarify existing to statutory accounting principles. Nonsubstantive These revisions are characterized as language clarifications which do not modify the original intent of a SSAP, or changes to reference material. NonsubstantiveSuch revisions are depicted by underlines (new language) and strikethroughs (removed language) and will not be tracked in subsequent manuals. Nonsubstantive Revisions that clarify existing statutory accounting principles are effective when adopted unless a specific effective date is noted.

Edit 19: Summary of Changes (heading in table), Volume II, Page xxiii

1. Substantive Revisions that resulted in a new SSAP or a new SAP concept – Statutory Accounting Principles

Edit 20: Summary of Changes (heading in table), Volume II, Page xxiii

2. Nonsubstantive Revisions that resulted in a SAP clarification – Statutory Accounting Principles

3. Information and issues can be presented to the Working Group in a variety of ways. Issues can be recommended or forwarded from 1) other NAIC committees, task forces or working groups; 2) interested parties; 3) interested regulators; and 4) NAIC staff. Also, if any guidance within the Generally Accepted Accounting Principles (GAAP) Hierarchy (see § V of the Preamble to the Accounting Practices and Procedures Manual (AP&P Manual)) is added or revised, those changes must be considered by the Working Group for potential revisions to SAP. In order for an issue to be placed on the Pending Listing, the recommending party must complete a Statutory Accounting Principles Maintenance Agenda Submission Form (Form A) and submit it to the Working Group support staff no later than 20 business days prior to the next scheduled Working Group meeting. NAIC staff will prepare a submission form for all GAAP pronouncements that have not been previously addressed by the Working Group. NAIC staff will update the Pending Listing before each national meeting and will notify the recommending party of such action. If the Working Group does not wish to address the issue (e.g., issue deemed not applicable to statutory accounting) or rejects the position presented, then the Working Group may move the item to the Rejected Listing. Should the Working Group choose to address an issue, it is moved to the Active Listing where it is prioritized and categorized as a new SSAP concept, clarification of an existing SSAP, Substantive, Nonsubstantive or an Interpretation agenda item.


4. The Active Listing identifies agenda items that are in the process of development and includes the following:

   a. **New SAP Concept Substantive**: These agenda items address the development of new SSAPs and/or the introduction of a new and substantially revised SSAP’s concept as defined in the NAIC Policy Statement on Maintenance of Statutory Accounting Principles.
   
   b. **Clarification of an Existing SSAP Nonsubstantive**: These agenda items address the development of nonsubstantive revisions which clarify an existing SSAP as defined in the NAIC Policy Statement on Maintenance of Statutory Accounting Principles.
   
   c. **Interpretations**: These agenda items address the development of interpretations to SAP as defined in the NAIC Policy Statement on Maintenance of Statutory Accounting Principles. If SSAP revisions are subsequently deemed necessary, the Working Group shall re-categorize the agenda item as either a **New SAP concept**, or a **clarification of an existing SSAP substantial** or **nonsubstantive**, as applicable, and follow the appropriate process to consider and adopt revisions.


5. After review of the agenda item (including any interested party comments), at its discretion, the Working Group makes the ultimate determination of whether an agenda item is categorized (or re-categorized) as a new SAP concept, clarification of an existing SSAP substantive (either as a new SSAP or substantially-revised SSAP), nonsubstantive or an interpretation.


8. NAIC staff will maintain the following on the Working Group Web page (http://naic.org/cmte_e_app_sapwg.htm): 1) A blank Form A (Attachment A to this policy statement); 2) The current Maintenance Agenda, and 3) Current statutory substantive, nonsubstantive and/or interpretation revisions exposed for public comment. Attachment B to this policy statement will be attached to all exposures with proposed substantive revisions that result in a new SAP concept and serves as the request for written comment and notice of a public hearing.

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

Check (applicable entity):

<table>
<thead>
<tr>
<th>Modification of Existing SSAP</th>
<th>P/C</th>
<th>Life</th>
<th>Health</th>
</tr>
</thead>
<tbody>
<tr>
<td>New Issue or SSAP</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interpretation</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

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

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

The main provisions of this ASU are:

1. An entity should treat a modification of the terms or conditions or an exchange of a freestanding equity-classified written call option that remains equity classified after modification or exchange as an exchange of the original instrument for a new instrument.

2. An entity should measure the effect of a modification or an exchange of a freestanding equity-classified written call option that remains equity classified after modification or exchange as follows:

   a. For a modification or an exchange that is a part of or directly related to a modification or an exchange of an existing debt instrument or line-of-credit or revolving-debt arrangements (hereinafter, referred to as a “debt” or “debt instrument”), as the difference between the fair value of the modified or exchanged written call option and the fair value of that written call option immediately before it is modified or exchanged.

   b. For all other modifications or exchanges, as the excess, if any, of the fair value of the modified or exchanged written call option over the fair value of that written call option immediately before it is modified or exchanged.

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

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

SSAP No. 72:

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

SSAP No. 15:

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

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): None

Information or issues (included in Description of Issue) not previously contemplated by the Working Group: None


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

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

Proposed revisions to SSAP No. 72:

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

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

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

On April 4, 2022, the Statutory Accounting Principles (E) Working Group adopted SAP clarifications to SSAP No. 72—Surplus and Quasi-Reorganizations to reject ASU 2021-04 for statutory accounting while incorporating guidance that modifications of terms, conditions or exchanges of free-standing equity-classified written call options shall be treated as an exchange, as detailed below. The adopted revisions included additional changes to the exposed language in paragraph 29, which interested parties requested.

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

29. This statement also rejects Accounting Research Bulletin No. 43, Restatement and Revision of Accounting Research Bulletins, “Chapter 1, Prior Opinions,” paragraph 12 of APB 10, and FASB Technical Bulletin No. 85-6, Accounting for a Purchase of Treasury Shares at a Price Significantly in Excess of the Current Market Price of the Shares and the Income Statement Classification of Costs Incurred in Defending against a Takeover Attempt and Accounting Standard Update (ASU) 2021-04, Earnings Per Share (Topic 260), Debt—Modifications and Extinguishments (Subtopic 470-50), Compensation—Stock Compensation (Topic 718), and Derivatives and Hedging—Contracts in Entity's Own Equity (Subtopic 815-40)—Issuer's Accounting for Certain Modifications or Exchanges of Freestanding Equity-Classified Written Call Options, while incorporating guidance that clarifies that an entity shall treat a modification of the terms or conditions or an exchange of a freestanding equity-classified written call option as an exchange of the original instrument for a new instrument.

Issue: ASU 2021-03, Intangibles – Goodwill and Other (Topic 350) – Accounting Alternative for Evaluating Triggering Events

Check (applicable entity):

- Modification of Existing SSAP: ☒
- New Issue or SSAP:
  - P/C: ☐
  - Life: ☒
  - Health: ☒

Description of Issue:
In March 2021, the Financial Accounting Standards Board (FASB) issued Accounting Standard Update (ASU) 2021-03, Intangibles – Goodwill and Other – Accounting Alternative for Evaluating Triggering Events to provide private companies and not-for-profit entities with an optional accounting alternative for the performance of a goodwill impairment triggering evaluation. Goodwill impairment guidance requires entities to evaluate if the fair value of a reporting entity (that possesses goodwill) is less than its carrying value. Under guidance prior to this ASU, if it were deemed that it was more likely than not that goodwill was impaired, goodwill was tested for impairment using the triggering event date as the measurement date.

Several concerns regarding triggering event evaluations were raised by certain entities, specifically that the cost and complexity to evaluate interim triggering events was burdensome and operationally many private entities likely only evaluate impairment at the end of a reporting period. With these circumstances, the ASU referenced that it may be unduly difficult for these entities to determine a specific triggering date or even identify that a triggering event had occurred. Additionally, the temporary variability in values as a result of the COVID-19 pandemic likely exacerbated this issue.

Accordingly, the amendments in this ASU allow an accounting alternative to perform a goodwill impairment triggering event evaluation only as of the end of a reporting period, regardless of if that is an interim or an annual period. If an entity elects this alternative, they will only evaluate goodwill for impairment as of each reporting date. As a key note, this election is permitted for private and not-for-profit entities regardless of which U.S. GAAP accounting treatment was elected for goodwill (i.e., impairment only or straight-line amortization).

Existing Authoritative Literature:

**Staff note** – while the calculation of goodwill differs between U.S. GAAP and Statutory Accounting, the foundation of goodwill is similar. For completeness of this document, applicable goodwill references, as well as impairment guidance, have been included herein. Certain relevant items have been bolded for emphasis.

**SSAP No. 68—Business Combinations and Goodwill**

**Statutory Purchases of SCA Investments**
3. The statutory purchase method of accounting is defined as accounting for a business combination as the acquisition of one entity by another. It shall be used for all purchases of SCA entities including partnerships, joint ventures, and limited liability companies. The acquiring reporting entity shall record its investment at cost. Cost is defined as the sum of: (a) any cash payment, (b) the fair value of other assets distributed, (c) the fair value of any liabilities assumed, and (d) any direct costs of the acquisition. Contingent consideration issued in a purchase business combination that is embedded in a security or that is in the form of a separate financial instrument shall be recorded by the issuer at fair value at the acquisition date.
4. For those acquired SCA entities accounted for in accordance with paragraphs 8.b.i., 8.b.ii., 8.b.iii. or 8.b.iv. of SSAP No. 97, and joint venture, partnership or limited liability company entities accounted for in accordance with paragraph 8 of SSAP No. 48, goodwill is defined as the difference between the cost of acquiring the entity and the reporting entity’s share of the book value of the acquired entity. When the cost of the acquired entity is greater than the reporting entity’s share of the book value, positive goodwill exists. When the cost of the acquired entity is less than the reporting entity’s share of the book value, negative goodwill exists. Goodwill resulting from assumption reinsurance shall be recorded as a separate write-in for other-than-invested assets. All other goodwill shall be reported in the carrying value of the investment.

5. A business combination accounted for under the statutory purchase method and in which the acquired entity is valued in accordance with paragraphs 8.b.ii., 8.b.iii. or 8.b.iv. of SSAP No. 97 shall determine the amount of positive goodwill or negative goodwill created by the combination using the reporting entity’s share of the GAAP net book value of the acquired entity, adjusted to a statutory basis of accounting in accordance with paragraph 9 of SSAP No. 97 in the case of acquired entities valued in accordance paragraphs 8.b.ii. or 8.b.iv. of SSAP No. 97. Business combinations accounted for under the statutory purchase method and in which the acquired entity is valued in accordance with, paragraph 8.b.i. of SSAP No. 97 shall determine the amount of positive or negative goodwill created by the business combination using the insurer’s share of the statutory book value of the acquired entity.

6. For those acquired SCA entities accounted for in accordance with paragraph 8.b.i. of SSAP No. 97 under the statutory purchase method, the historical bases of the acquired entity shall continue to be used in preparing its statutory financial statements. Therefore, pushdown accounting is not permitted.

7. Positive goodwill recorded under the statutory purchase method of accounting shall be admitted subject to the following limitation: Positive goodwill from all sources, including life, accident and health, and deposit-type assumption reinsurance and goodwill resulting from the acquisition of an SCA by the insurance reporting entity that is reported on the SCA’s financial statements (resulting from the application of pushdown accounting), is limited in the aggregate to 10% of the acquiring entity’s capital and surplus as required to be shown on the statutory balance sheet of the reporting entity for its most recently filed statement with the domiciliary state commissioner adjusted to exclude any net positive goodwill, EDP equipment and operating system software, and net deferred tax assets. Additionally, all positive goodwill shall be nonadmitted when the underlying investment in the SCA or partnership, joint venture and limited liability company is nonadmitted. When negative goodwill exists, it shall be recorded as a contra-asset.

8. Positive or negative goodwill resulting from the purchase of an SCA, joint venture, partnership or limited liability company shall be amortized to unrealized capital gains and losses on investments over the period in which the acquiring entity benefits economically, not to exceed 10 years. Positive or negative goodwill resulting from life, accident and health, and deposit-type assumption reinsurance shall be amortized to operations as a component of general insurance expenses over the period in which the assuming entity benefits economically, not to exceed 10 years. Goodwill shall be evaluated separately for each transaction. (INT 01-18)

Impairment

9. For any decline in the fair value of an entity, acquired through a purchase, that is other than temporary (INT 06-07), the investment shall be written down to fair value as the new cost basis and the amount of the write down shall be accounted for as a realized loss. The write down shall first be considered as an adjustment to any portion of the investment that is nonadmitted (e.g., nonadmitted goodwill). The new cost basis shall not be changed for subsequent recoveries in fair value. Future declines in fair value, which are determined to be other than temporary, shall be recorded as realized losses. A long-lived asset shall be tested for recoverability whenever events or changes in circumstances indicate that its carrying amount may not be recoverable. The following are examples of such triggering events or changes in circumstances:

a. A significant decrease in the fair value of a long-lived asset
b. A significant adverse change in the extent or manner in which a long-lived asset is being used or in its physical condition

c. A significant adverse change in legal factors or in the business climate that could affect the value of a long-lived asset, including an adverse action or assessment by a regulator

d. An accumulation of costs significantly in excess of the amount originally expected for the acquisition or construction of a long-lived asset

e. A current period operating or cash flow loss combined with a history of operating or cash flow losses or a projection or forecast that demonstrates continuing losses associated with the use of a long-lived asset

f. A current expectation that, more likely than not, a long-lived asset will be sold or otherwise disposed of significantly before the end of its previously estimated useful life

10. An impairment shall be considered to have occurred if it is probable that the reporting entity will be unable to recover the carrying amount of the investment or there is evidence indicating inability of the investee to sustain earnings which would justify the carrying amount of the investment. A fair value of an investment that is below the carrying amount based on the statutory equity method or the existence of investee operating losses may indicate a loss in value; however, they are not necessarily indicative of a loss in value that is other than temporary.

**Staff note:** In addition to the guidance in SSAP No. 68, INT 06-07: Definition of Phrase “Other Than Temporary” also provides authoritative guidance for when an impairment has occurred. While INT 06-07 has been included below, with certain relevant items bolded for emphasis, the requirement for impairment is an assessment if an impairment indicator is present. Thus, it does not permit the delaying of an impairment assessment until a reporting period, nor does it permit assessment differentiation based on entity type (public vs. private or a not-for-profit entity).

**INT 06-07: Definition of Phrase “Other than Temporary”**

1. The Accounting Practices and Procedures Manual contains guidance for determining when an investment is considered impaired within each of the above identified statements. Those statements should also be used to determine the measurement of an impairment loss. Each of the above statements also makes reference to an “other than temporary” decline in fair value. This interpretation is designed to address questions related to that phrase, as well as summarize the statutory accounting process for determining when an investment is considered impaired.

**Step 1: Determine Whether an Investment Is Impaired**

2. The decision for determining when an investment is considered impaired is dictated by the applicable SSAP and the respective impairment indicators included in each of the SSAPs. **If an impairment indicator is present, the determination of an impairment shall be assessed at the individual security or investment level as reported in the annual statement and supporting schedules.** For those SSAPs that require the reporting entity to use the fair value to determine if an impairment has occurred, the determination of that value shall be consistent with how the term fair value is defined within SSAP No. 100—Fair Value. Once a reporting entity has determined that an impairment indicator is present, the reporting entity shall continue to evaluate whether the investment is impaired each subsequent reporting period until either (a) the investment experiences a recovery of the fair value up to (or beyond) its carrying value or (b) the investor recognizes an other-than-temporary impairment loss.

**Step 2: Evaluate Whether an Impairment Is Other Than Temporary**

3. **There are numerous factors to be considered when determining whether an impairment is other than temporary and their relative significance will vary from case to case.** The Emerging Accounting Issues (E) Working Group (Working Group) has been asked if the phrase “other than temporary” should be interpreted to mean “permanent.” The Working Group believes the Statutory Accounting Principles (E) Working Group consciously chose the phrase “other than temporary” as the analysis was not
intended to determine whether an individual security or investment was “permanently impaired.” The fair value of assets may decline for various reasons. The market price may be affected by general market conditions, which reflect prospects for the economy as a whole, or by specific information pertaining to an industry or an individual company. Such declines require further investigation by management. Acting upon the premise that a write-down may be required, management should consider all available evidence to evaluate the fair value of its investment.

4. The Working Group believes that the following items are only a few examples of the factors, which, individually or in combination, indicate that a security’s decline in value is specific to an issuer’s fundamental credit difficulties, or that a non-interest related decline is other than temporary and that a write-down of the carrying value is required:
   a. The length of time and the extent to which the fair value has been less than cost;
   b. The financial condition and short-term prospects of the issuer, including any specific events that may influence the operations of the issuer, such as changes in technology, that may impair the earnings potential of the asset or the discontinuance of a segment of the business that may affect the future earnings potential; or
   c. The intent and ability of the holder to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in value.

5. An interest related impairment should be deemed other-than-temporary when an investor has the intent to sell an investment, at the reporting date, before recovery of the cost of the investment. The investor should consider whether its cash or working capital requirements and contractual or regulatory obligations indicate that the investment may need to be sold before the forecasted recovery occurs. The term “interest related” includes a declining value due to both increases in the risk free interest rate and general credit spread widening. Credit spreads can widen or contract for a variety of reasons, including supply/demand imbalances in the marketplace or perceived higher/lower risk of an entire sector. If the declining value is caused, in whole or in part, due to credit spreads widening, but not due to fundamental credit problems of the issuer, the change in credit spreads is deemed to be interest related. Fundamental credit problems exist with the issuer when there is evidence of financial difficulty that may result in the issuer being unable to pay principal or interest when due.

6. Unless evidence exists to support the assertion that the decline in fair value below carrying value is temporary, a write-down, accounted for as a realized loss, should be recorded. In accordance with the guidance of the SSAPs, such loss should be recognized in income for the period in which other than temporary impairment is determined to have occurred. The adjusted carrying value reflecting the impairment loss of the individual security or investment shall be the new cost basis of the individual security or investment.

7. The Working Group has also been asked if it is appropriate for reporting entities, independent auditors or state examiners to apply predefined thresholds to the phrase “other than temporary”? The Working Group is aware that certain insurers, independent auditors and state examiners, over time, have developed quantitative thresholds as “rules of thumb” to assist in the evaluation of asset impairment. One rule of thumb in particular suggests that if the fair value is less than its carrying value by 20 percent or more, then it is considered to be other than temporarily impaired. Another suggests that an asset is other than temporarily impaired if the fair value has been less than cost for more than 6 months. The use of a numerical threshold may provide the basis for a preliminary assumption that – without considering all relevant circumstances – an impairment may have occurred. Identifying the impairment is only the beginning of the analysis; it cannot appropriately be used as a substitute for a full analysis of all relevant qualitative considerations. Exclusive reliance on such thresholds removes the ability of management to apply its judgment, a concept inherent to the impairment model.
Step 3: If the Impairment is Other Than Temporary, the Cost Basis of the Individual Asset Shall Be Written Down to a New Cost Basis and the Amount of the Write-Down Is Accounted for as a Realized Loss

8. If an impairment is considered other than temporary, the cost or carrying value of the asset should be written down to reflect its value in accordance with the relevant SSAP. A company’s management should follow the impairment guidance in the SSAP pertaining to that particular asset class while considering various factors on a case-by-case basis in determining the amount of the realized loss that should be recorded.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): None

Information or issues (included in Description of Issue) not previously contemplated by the Working Group: None


Staff Recommendation:
NAIC staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to SSAP No. 68—Business Combinations and Goodwill to reject ASU 2021-03, Intangibles – Goodwill and Other (Topic 350) – Accounting Alternative for Evaluating Triggering Events for statutory accounting. Rejecting this ASU will result with continuation of existing guidance from INT 06-07, which does not permit delays in impairment assessment or variations in assessment based on type of entity.

Proposed revisions to SSAP No. 68 (Relevant Literature section – paragraph 22):


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

Status:
On December 11, 2021, the Statutory Accounting Principles (E) Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to SSAP No. 68—Business Combinations and Goodwill to reject ASU 2021-03, Intangibles – Goodwill and Other (Topic 350) – Accounting Alternative for Evaluating Triggering Events for statutory accounting.

On April 4, 2022, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed revisions, as illustrated above, to SSAP No. 68—Business Combinations and Goodwill rejecting ASU 2021-03, Intangibles – Goodwill and Other (Topic 350) – Accounting Alternative for Evaluating Triggering Events for statutory accounting.

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

Issue: ASU 2021-05, Leases (Topic 842), Lessors—Certain Leases with Variable Lease Payments

Check (applicable entity):

- Modification of Existing SSAP
- New Issue or SSAP
- Interpretation

P/C  ❑  Life  ❑  Health  ❑

Description of Issue: In July 2021, the Financial Accounting Standards Board (FASB) issued Accounting Standard Update (ASU) 2021-05, Leases (Topic 842), Lessors—Certain Leases with Variable Lease Payments. This ASU was issued as part of FASB’s post-implementation review to address issues that have been found during the implementation of the new lease guidance from ASU 2016-02, Leases (Topic 842). The guidance in ASU 2021-05 applies to lessors with lease contracts that: 1) have variable lease payments that do not depend on a reference index or rate, and/or 2) would have resulted in the lessor being required to recognize a day one selling loss (at lease commencement) if those leases were classified as sales-type or direct financing. The changes to Topic 842 will require a lessor to classify a lease with variable lease payments that do not depend on an index or a rate as an operating lease at lease commencement if classifying the lease as a sales-type lease or a direct financing lease would result in the recognition of a selling loss. SSAP No. 22R—Leases requires nearly all leases to be treated as operating leases for statutory accounting, so adoption of this guidance would be redundant and unnecessary.

Existing Authoritative Literature:
The ASUs related to Topic 842 have previously been rejected in SSAP No. 22R—Leases.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): None

Information or issues (included in Description of Issue) not previously contemplated by the Working Group: None

Convergence with International Financial Reporting Standards (IFRS): ASC Topic 842 was the result of a joint project between FASB and the International Accounting Standards Board.

Recommendation: Staff recommends the Working Group move this agenda item to the active listing, categorized as nonsubstantive and expose revisions to reject ASU 2021-05 in SSAP No. 22R—Leases. Under statutory accounting almost all leases are classified as operating leases, thus this U.S. GAAP guidance is not necessary.

Proposed Revision to SSAP No. 22R (Relevant Literature section – paragraph 52):

i. ASU 2021-05, Leases (Topic 842), Lessors—Certain Leases with Variable Lease Payments
(Rejected in its entirety.)

Staff Review Completed by: Jake Stultz, NAIC Staff – August 2021

Status:
On December 11, 2021, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to reject ASU 2021-05 in SSAP No. 22R.

On April 4, 2022, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed revisions, as illustrated above, to reject ASU 2021-05, Leases (Topic 842), Lessors—Certain Leases with Variable Lease Payments in SSAP No. 22R—Leases.

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

Issue: ASU 2021-06—Amendments to SEC Paragraphs in Topic 205, Topic 942 and Topic 946

Check (applicable entity):

<table>
<thead>
<tr>
<th>Modification of Existing SSAP</th>
<th>P/C</th>
<th>Life</th>
<th>Health</th>
</tr>
</thead>
<tbody>
<tr>
<td>New Issue or SSAP</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interpretation</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Description of Issue:
The Financial Accounting Standards Board issued Accounting Standard Update (ASU) 2021-06, Presentation of Financial Statements (Topic 205), Financial Services—Depository and Lending (Topic 942), and Financial Services—Investment Companies (Topic 946), Amendments to SEC Paragraphs Pursuant to SEC Final Rule Releases No. 33-10786, Amendments to Financial Disclosures about Acquired and Disposed Businesses, and No. 33-10835, Update of Statistical Disclosures for Bank and Savings and Loan Registrants, which effects only SEC paragraphs in Topic 205, Topic 942 and Topic 946. These edits are predominantly formatting and paragraph references, with new guidance duplicated from SEC requirements on the presentation of financial statements for funds acquired or to be acquired.

Existing Authoritative Literature:
Generally, all SEC guidance from ASUs is rejected as not applicable for statutory accounting in Appendix D—Nonapplicable GAAP Pronouncements.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): None

Information or issues (included in Description of Issue) not previously contemplated by the Working Group: None

Convergence with International Financial Reporting Standards (IFRS): None

Staff Recommendation: NAIC staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive, and expose revisions to Appendix D—Nonapplicable GAAP Pronouncements to reject ASU 2021-06, Presentation of Financial Statements (Topic 205), Financial Services—Depository and Lending (Topic 942), and Financial Services—Investment Companies (Topic 946), Amendments to SEC Paragraphs Pursuant to SEC Final Rule Releases No. 33-10786, Amendments to Financial Disclosures about Acquired and Disposed Businesses, and No. 33-10835, Update of Statistical Disclosures for Bank and Savings and Loan Registrants as not applicable to statutory accounting.

This item is proposed to be rejected as not applicable as ASU 2021-06 is specific to deletion and modification of SEC paragraphs, which are not applicable for statutory accounting purposes.

Staff Review Completed by: Jake Stultz, November 2021

Status:
On December 11, 2021, the Statutory Accounting Principles (E) Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to Appendix D—Nonapplicable GAAP Pronouncements to reject ASU 2021-06 as not applicable to statutory accounting.
On April 4, 2022, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed revisions to *Appendix D—Nonapplicable GAAP Pronouncements* to reject ASU 2021-06 as not applicable to statutory accounting.

Revisions to the
As of March 2022, Accounting Practices and Procedures Manual

On May 24, 2022, the Statutory Accounting Principles (E) Working Group adopted the following revisions to the As of March 2022 Accounting Practices and Procedures Manual. Documents associated with these revisions are linked to the reference items in bold text.

<table>
<thead>
<tr>
<th>Ref #</th>
<th>SSAP/Appendix</th>
<th>Title</th>
<th>Summary</th>
</tr>
</thead>
<tbody>
<tr>
<td>2021-21</td>
<td>SSAP No. 25 &amp; SSAP No. 43R</td>
<td>Related Party Reporting</td>
<td>Revisions clarify guidance and incorporates new disclosure requirements to identify investments that involve related parties. Adoption also expressed support for a corresponding Blanks (E) Working Group proposal (2021-22BWG), which adds related party reporting codes to various investment schedules effective for year-end 2022.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>SAP Clarification</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Effective Immediately</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>(May 24, 2022)</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Reporting codes in investment schedules required Dec. 31, 2022</td>
<td></td>
</tr>
<tr>
<td>2022-03</td>
<td>SSAP No. 97 &amp; SSAP No. 107</td>
<td>Premium Adjustments Allocated to Jurisdictions</td>
<td>Agenda item did not result in statutory revisions; however, adoption expressed support for the corresponding Blanks (E) Working Group exposure (2022-10BWG), which modifies the instructions for Schedule T, the State Page and Accident and Health Policy Experience Exhibit (AHPEE), clarifying the guidance for premium adjustments.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>No Statutory Revisions</td>
<td></td>
</tr>
<tr>
<td>2022-08</td>
<td>SSAP No. 43R</td>
<td>INT 22-01: Freddie Mac When-Issued K-Deal (WI Trust) Certificates</td>
<td>Revisions adopted INT 22-01 to clarify that investments in the Freddie Mac “When Issued K-Deal” (WI) Program are in scope of SSAP No. 43R—Loan-Backed and Structured Securities from the date of initial acquisition.</td>
</tr>
<tr>
<td></td>
<td>INT 22-01</td>
<td>SAP Clarification</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Effective Immediately</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>(May 24, 2022)</td>
<td></td>
</tr>
</tbody>
</table>

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

Issue: Related Party Reporting

Check (applicable entity):

<table>
<thead>
<tr>
<th>Modification of Existing SSAP</th>
<th>P/C</th>
<th>Life</th>
<th>Health</th>
</tr>
</thead>
<tbody>
<tr>
<td>New Issue or SSAP</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interpretation</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Description of Issue: This agenda item has been drafted in response to recent discussions on the reporting and disclosure requirements for investments with related parties. This agenda item intends to encompass two main goals:

1. Clarify the reporting of affiliate transactions within existing reporting lines in the investment schedules. This clarification intends to be consistent with the definition of an “affiliate” pursuant to the Insurance Holding Company System Regulatory Act (Model #440), SSAP No. 25—Affiliates and Other Related Parties and SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities.

2. Incorporate new reporting requirements for investment transactions with related parties. Pursuant to recent discussions, regulators desire additional information on investment transactions involving related parties, regardless of whether the related party is “affiliated” pursuant to Model #440. To preserve the affiliate definition and reporting categories, these additional proposed reporting elements will be captured outside of the current affiliate reporting requirements.

Affiliate Definition and Identified Reporting Issues:

The Insurance Holding Company System Regulatory Act (Model #440) defines “affiliate” and “control” as:

- **Affiliate**: An “affiliate” of, or person “affiliated” with, a specific person, is a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, the person specified.

- **Control**: The term "control" (including the terms “controlling,” “controlled by” and “under common control with”) means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract other than a commercial contract for goods or nonmanagement services, or otherwise, unless the power is the result of an official position with or corporate office held by the person. Control shall be presumed to exist if any person, directly or indirectly, owns, controls, holds with the power to vote, or holds proxies representing, ten percent (10%) or more of the voting securities of any other person. This presumption may be rebutted by a showing made in the manner provided by Section 4K that control does not exist in fact. The commissioner may determine, after furnishing all persons in interest notice and opportunity to be heard and making specific findings of fact to support the determination, that control exists in fact, notwithstanding the absence of a presumption to that effect.

The guidance / concepts from Model #440 are reflected in SSAP No. 25, paragraphs 5-7 and SSAP No. 97, paragraphs 5-7 and are summarized as follows:

- An affiliate is defined as an entity that is within the holding company system or a party that, directly or indirectly, through one or more intermediaries, controls, is controlled by, or is under common control with the reporting entity. An affiliate includes a parent or subsidiary and may also include partnerships, joint ventures, and limited liability companies as defined in SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies. An affiliate is any person that is directly or indirectly, owned or
controlled by the same person or by the same group of persons, that, directly or indirectly, own or control the reporting entity.

- Control is defined as the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of the investee, whether through the (a) ownership of voting securities, (b) by contract other than a commercial contract for goods or nonmanagement services, (c) by contract for goods or nonmanagement services where the volume of activity results in a reliance relationship (d) by common management, or (e) otherwise. Control shall be presumed to exist if a reporting entity and its affiliates directly or indirectly, own, control, hold with the power to vote, or hold proxies representing 10% or more of the voting interests of the entity.

- Control shall be measured at the holding company level. For example, if one member of an affiliated group has a 5% interest in an entity and a second member of the group has an 8% interest in the same entity, the total interest is 13%, and therefore, each member of the affiliated group shall be presumed to have control. This presumption will stand until rebutted by an evaluation of all the facts and circumstances relating to the investment based on the criteria in *FASB Interpretation No. 35, Criteria for Applying the Equity Method of Accounting for Investments in Common Stock, an Interpretation of APB Opinion No. 18*. The corollary is required to demonstrate control when a reporting entity owns less than 10% of the voting securities of an investee. The insurer shall maintain documents substantiating its determination for review by the domiciliary commissioner. Examples of situations where the presumption of control may be in doubt include the following:

1. Any limited partner investment in a limited partnership, unless the limited partner is affiliated with the general partner.

2. An entity where the insurer owns less than 50% of an entity and there is an unaffiliated individual or group of investors who own a controlling interest.

3. An entity where the insurer has given up participation rights as a shareholder to the investee.

The Annual Statement Instructions identifies what is captured in the reporting lines for “Parent, Subsidiary and Affiliates” as “Defined by SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities.”

Under the existing guidance, the following investments would likely not be reported as affiliated unless a domiciliary state has directed otherwise:

- Qualifying affiliated investments for which the domiciliary state has approved a disclaimer of affiliation or disclaimer of control from the affiliated entity. Once a disclaimer has been granted, the qualifying affiliate relationship is no longer considered an affiliate and any investments issued or held from the entity would not be reported as affiliated.

- Investments held from entities that do not qualify as affiliates, even if the entity qualifies as a related party. The determination of an affiliate is based on direct or indirect control. If the control determinants are not met, investments held from related parties are not reported as affiliated.

- Any investments acquired that were sponsored / originated by an affiliate, but the actual investment is not in the affiliate or other companies within the controlled holding company structure.

Model #440 explicitly excludes the purchase of securities solely for investment purposes from the determination of a change in control, so long as the securities are not used by voting or otherwise to cause or attempt to cause the substantial lessening of competition in any insurance market in the state. This guidance further states that if the purchase of securities results in a presumption of control, then the acquisition of securities would not be considered solely for investment purposes unless the commissioner of the insurer’s state of domicile accepts a disclaimer of control of affirmatively finds that control does not exist.
Proposed Related Party Revisions

Although the affiliate definition may preclude certain investments from being captured in the “affiliated” reporting lines, there is a regulator desire to have improved information on investments with non-affiliated related parties as well as investments acquired from affiliates and non-affiliated related parties that do not reflect an investment within the affiliate/related party. For example, if the affiliate/related party was to sponsor or originate the investment, such investment would likely not be captured in the designated affiliate reported lines. This agenda item proposes revisions to SSAP No. 25 and SSAP No. 43R, as well as proposed concepts for an annual statement reporting change to capture information on these investments. Additionally, the proposed revisions would provide clarity, consistent with the existing affiliate definition, on scenarios that would qualify as affiliated transactions.

As an additional item, the existing reference in SSAP No. 25 to FASB Interpretation No. 35, Criteria for Applying the Equity Method of Accounting for Investments in Common Stock, an Interpretation of APB Opinion No. 18 (FIN 35) has been proposed to be removed. Although the intent was to originally update the U.S. GAAP reference to reflect the current Accounting Standards Codification (ASC) citations, it was noted that the original provisions in FIN 35 (captured now in ASC 323-10-15-8, 323-10-15-10 and 323-10-15-11) only reiterate that the presumption that the investor has the ability to exercise significant influence over the investee’s operating and financial policies based on ownership of voting stock stands until overcome by prominent evidence to the contrary. The ASC includes the following indicators originally in FIN 35 for when investors would be unable to exercise significant influence over the operating and financial policies of an investee:

- Opposition by the investee, such as litigation or complaints to government regulatory authorities, challenges the investor’s ability to exercise significant influence.
- The investor and investee sign an agreement (such as a standstill agreement) under which the investor surrenders significant rights as a shareholder.
- Majority ownership of the investee is concentrated among a small group of shareholders who operate the investee without regards to the views of the investor.
- The investor wants or needs more financial information to apply the equity method than is available to the investee’s other shareholders, tries to obtain that information, and fails. (The ASC example is a request for quarterly info when the investee only provides public information annually.)
- The investor tries and fails to obtain representation on the investee’s board of directors.

The ASC also notes that these situations are just indicators and are not all-inclusive and that none of the individual circumstances are necessarily conclusive that the investee is unable to exercise significant influence over the investee’s operating and financial policies. Rather, if any of these situations exist, an investor with controlling voting ownership shall evaluate all facts and circumstances related to the investment to reach a judgment about whether the presumption that the investor has the ability to exercise significant influence over the investee’s operating and financial policies is overcome. Furthermore, the guidance indicates that it may be necessary to evaluate the facts and circumstances over a period of time before reaching a judgment.

After a review of the ASC / FIN 35 guidance, it is proposed that the reference be deleted from SSAP No. 25. The general concepts for a review of all facts and circumstances, as well as example indicators, are already reflected directly in SSAP No. 25. Lastly, the reference to FIN 35 / ASC could be confusing as U.S. GAAP utilizes a different (higher) percentage of voting ownership than statutory accounting.
Existing Authoritative Literature:

- **Insurance Holding Company System Regulatory Act (Model #440)** – This model is an accreditation standard and is adopted by all states in a substantially similar manner. Only the territories of America Samoa, Guam and the Northern Mariana Islands do not have this model adopted.

- **SSAP No. 25—Affiliates and Other Related Parties** establishes statutory accounting principles and disclosure requirements for related party transactions. This statement shall be followed for all related party transactions, even if the transaction is also governed by other statutory accounting principles. As detailed in paragraph 1, related party transactions are subject to abuse as reporting entities may be induced to enter transactions that may not reflect economic realities or may not be fair and reasonable to the reporting entity or its policyholders. As such, related party transactions require specialized accounting rules and increased regulatory scrutiny. The guidance in paragraphs 4-8 include the definition of related parties and affiliates:

  4. Related parties are defined as entities that have common interests as a result of ownership, control, affiliation or by contract. Related parties shall include but are not limited to the following:

  a. Affiliates of the reporting entity, as defined in paragraph 5;

   b. Trusts for the benefit of employees, such as pension and profit-sharing trusts and Employee Stock Ownership Plans that are managed by or under the trusteeship of management of the reporting entity, its parent or affiliates;

   c. The principal owners, directors, officers of the reporting entity;

   d. Any immediate family member of a principal owner, director or executive officer of the reporting entity, which means any child, stepchild, parent, stepparent, spouse, sibling, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law, or individual related by blood or marriage whose close association is equivalent to a family relationship of such director, executive officer or nominee for director, or any person (other than a tenant or employee) sharing the household of such director, executive officer or nominee for director;

   e. Companies and entities which share common control, such as principal owners, directors, or officers, including situations where principal owners, directors, or officers have a controlling stake in another reporting entity;

   f. Any direct or indirect ownership greater than 10% of the reporting entity results in a related party classification regardless of any disclaimer of control or disclaimer of affiliation;

   g. The management of the reporting entity, its parent or affiliates (including directors);

   h. Members of the immediate families of principal owners and management of the reporting entity, its parent or affiliates and their management;

   i. Parties with which the reporting entity may deal if either party directly or indirectly controls or can significantly influence the management or operating policies of the other to an extent that one of the transacting parties might be prevented from fully pursuing its own separate interest;

   j. A party which can, directly or indirectly, significantly influence the management or operating policies of the reporting entity, which may include a provider who is contracting with the reporting entity. This is not intended to suggest that all provider contracts create related party relationships;
k. A party which has an ownership interest in one of the transacting parties and can significantly influence the other to an extent that one or more of the transacting parties might be prevented from fully pursuing its own separate interests;

l. Attorney-in-fact of a reciprocal reporting entity or any affiliate of the attorney-in-fact; and

m. A U.S. manager of a U.S. Branch or any affiliate of the U.S. manager of a U.S. Branch.

5. An affiliate is defined as an entity that is within the holding company system or a party that, directly or indirectly, through one or more intermediaries, controls, is controlled by, or is under common control with the reporting entity. An affiliate includes a parent or subsidiary and may also include partnerships, joint ventures, and limited liability companies as defined in SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies. Those entities are accounted for under the guidance provided in SSAP No. 48, which requires an equity method for all such investments. An affiliate is any person that is directly or indirectly, owned or controlled by the same person or by the same group of persons, that, directly or indirectly, own or control the reporting entity.

6. Control is defined as the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of the investee, whether through the (a) ownership of voting securities, (b) contract other than a commercial contract for goods or nonmanagement services, (c) by contract for goods or nonmanagement services where the volume of activity results in a reliance relationship (d) by common management, or (e) otherwise. Control shall be presumed to exist if a reporting entity and its affiliates directly or indirectly, own, control, hold with the power to vote, or hold proxies representing 10% or more of the voting interests of the entity.

7. Control as defined in paragraph 6 shall be measured at the holding company level. For example, if one member of an affiliated group has a 5% interest in an entity and a second member of the group has an 8% interest in the same entity, the total interest is 13%, and therefore, each member of the affiliated group shall be presumed to have control. This presumption will stand until rebutted by an evaluation of all the facts and circumstances relating to the investment based on the criteria in FASB Interpretation No. 35, Criteria for Applying the Equity Method of Accounting for Investments in Common Stock, an Interpretation of APB Opinion No. 18. The corollary is required to demonstrate control when a reporting entity owns less than 10% of the voting securities of an investee. The insurer shall maintain documents substantiating its determination for review by the domiciliary commissioner. Examples of situations where the presumption of control may be in doubt include the following:

   a. Any limited partner investment in a limited partnership, unless the limited partner is affiliated with the general partner.

   b. An entity where the insurer owns less than 50% of an entity and there is an unaffiliated individual or group of investors who own a controlling interest.

   c. An entity where the insurer has given up participation rights as a shareholder to the investee.

   d. Agreements where direct or indirect non-controlling ownership interest is less than 10% where the parties have structured the arrangement in this structure to avoid the 10% threshold in paragraph 4.f. and paragraph 8.

8. Any direct or indirect ownership interest of the reporting entity greater than 10% results in a related party classification regardless of any disclaimer of control or disclaimer of affiliation. The Insurance Holding Company System Regulatory Act (#440) and the Insurance Holding Company System Model Regulation (#450) include a provision that allows for the disclaimer of affiliation and/or the disclaimer of control for

---

1 The term "participating rights" refers to the type of rights that allows an investor to effectively participate in significant decisions related to an investee's ordinary course of business and is distinguished from the more limited type of rights referred to as "protective rights". Refer to the sections entitled: “Protective Rights” and “Substantive Participating Rights” in EITF 96-16, Investor's Accounting for an Investee When the Investor Owns a Majority of the Voting Stock but the Minority Shareholder or Shareholders Have Certain Approval or Veto Rights. The term “participating rights” shall be used consistent with the discussion of substantive participating rights in this EITF.
members of an insurance holding company system. The disclaimer must be filed with the state insurance commissioner. Entities whose relationship is subject to a disclaimer of affiliation or a disclaimer of control are related parties and are subject to the related party disclosures within this statement. Such a disclaimer does not eliminate a “related party” distinction or disclosure requirements for material transactions pursuant to SSAP No. 25.

- **SSAP No. 48**—**Joint Ventures, Partnerships and Limited Liability Companies** establishes guidance for these investments. The guidance in this SSAP provides different guidance when there is a “more than minor” or “minor ownership interest.” Pursuant to existing guidance, reporting entities must also identify whether the investment is a related-party transaction.

9. Investments in these ventures, except for joint ventures, partnerships and limited liability companies with a minor ownership interest, shall be reported using an equity method as defined in **SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities**, paragraphs 8.b.i. through 8.b.iv. (The equity method calculation may result with a negative valuation of the investment; therefore, the SSAP No. 97 equity method calculation shall occur regardless of whether the investment is supported by an audit and the reporting entity will nonadmit the investment.) A reporting entity whose shares of losses in a SSAP No. 48 entity exceeds its investment in the SSAP No. 48 entity shall disclose the information required by SSAP No. 97, paragraph 35.a.

**Footnote:** With the identification of whether the reporting entity has a minor ownership interest, reporting entities must also identify whether the investment is a related-party transaction. Pursuant to the concepts reflected in **SSAP No. 25—Affiliates and Other Related Parties**, consideration shall be given to the substance of the transaction and the parties whose action or performance materially impacts the insurance reporting entity holding the security. For example, if the underlying assets within a SSAP No. 48 entity represent assets issued by an affiliate, then the SSAP No. 48 entity shall be considered a related party (affiliate) investment, with the transaction subject to the accounting and reporting provisions of SSAP No. 25. As identified in SSAP No. 25, it is erroneous to conclude that the inclusion of a non-related intermediary, or the presence of non-related assets in a structure predominantly comprised of related party investments, eliminates the requirement to identify and assess the investment transaction as a related party arrangement.

- **SSAP No. 97**—**Investments in Subsidiary, Controlled and Affiliated Entities** establishes statutory accounting principles for investments in subsidiaries, controlled and affiliated entities. The guidance in paragraphs 3-6 include the definitions for parent, subsidiary, and affiliate. (The definition for an affiliate and control is identical to SSAP No. 25.) (As noted, the Annual Statement reporting lines for “Parent, Subsidiary and Affiliates” refers to the definition within SSAP No. 97. If an investment is held for an entity that does not meet the SSAP No. 97 definitions, or for which a disclaimer of control or affiliation has been received, then the investment would not be captured within the Parent, Subsidiary or Affiliate reporting line.)

3. Parent and subsidiary are defined as follows:
   a. Parent—An entity that directly or indirectly owns and controls the reporting entity;
   b. Subsidiary—An entity that is, directly or indirectly, owned and controlled by the reporting entity.

4. An affiliate is defined as an entity that is within the holding company system or a party that, directly or indirectly, through one or more intermediaries, controls, is controlled by, or is under common control with the reporting entity. An affiliate includes a parent or subsidiary and may also include partnerships, joint ventures, and limited liability companies as defined in **SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies**. Those entities are accounted for under the guidance provided in SSAP No. 48, which requires an equity method for all such investments.

5. Control is defined as the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of the investee, whether through the (a) ownership of voting
securities, (b) by contract other than a commercial contract for goods or nonmanagement services, (c) by common management, or (d) otherwise. Control shall be presumed to exist if a reporting entity and its affiliates directly or indirectly, own, control, hold with the power to vote, or hold proxies representing 10% or more of the voting interests of the entity.

6. Control as defined in paragraph 5 shall be measured at the holding company level. For example, if one member of an affiliated group has a 5% interest in an entity and a second member of the group has an 8% interest in the same entity, the total interest is 13% and therefore each member of the affiliated group shall be presumed to have control. This presumption will stand until rebutted by an evaluation of all the facts and circumstances relating to the investment based on the criteria in FASB Interpretation No. 35, Criteria for Applying the Equity Method of Accounting for Investments in Common Stock, an Interpretation of APB Opinion No. 18. The corollary is required to demonstrate control when a reporting entity owns less than 10% of the voting securities of an investee. The insurer shall maintain documents substantiating its determination for review by the domiciliary commissioner. An investment in an SCA entity may fall below the level of ownership described in paragraph 5, in which case, the reporting entity would discontinue the use of the equity method, as prescribed in paragraph 13.g. Additionally, through an increase in the level of ownership, a reporting entity may become qualified to use the equity method of accounting (paragraph 8.b.), in which case, the reporting entity shall add the cost of acquiring additional interest to the current basis of the previously held interest and shall apply the equity method prospectively, as of the date the investment becomes qualified for equity method accounting. Examples of situations where the presumption of control may be in doubt include the following:

a. Any limited partner investment in a limited partnership, unless the limited partner is affiliated with the general partner.

b. An entity where the insurer owns less than 50% of an entity and there is an unaffiliated individual or group of investors who own a controlling interest.

c. An entity where the insurer has given up participating rights as a shareholder to the investee.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups):

In March 2021, the Statutory Accounting Principles (E) Working Group adopted revisions to SSAP No. 25 pursuant to agenda item 2019-34: Related Parties, Disclaimers of Affiliation and Variable Interest Entities. Additionally, a new reporting Schedule Y, Part 3 was adopted by the Blanks (E) Working Group in proposal 2020-37BWG, with an initial effective date of Dec. 31, 2021, to capture information on all entities with ownership greater than 10%, the ultimate controlling parties of those owners and other entities that the ultimate controlling party controls.

---

2 Investments in an exchange traded fund (ETF) or a mutual fund (as defined by the SEC) does not reflect ownership in an underlying entity, regardless of the ownership percentage the reporting entity (or the holding company group) has of the ETF or mutual fund unless ownership of the ETF actually results in “control” with the power to direct or cause the direction of management of an underlying company. ETFs and mutual funds are comprised of portfolios of securities subject to the regulatory requirements of the federal securities laws. ETFs and mutual funds held by a reporting entity shall be reported as common stock, unless the ETF qualifies for bond or preferred stock treatment per the Purposes and Procedures Manual of the NAIC Investment Analysis Office. Reporting entities are not required to verify that SCAs (subject to SSAP No. 97) are represented in the portfolio of securities held in ETFs or mutual funds or to adjust the value of SCAs as a result of investments in ETFs or mutual funds.

3 The term “participating rights” refers to the type of rights that allows an investor to effectively participate in significant decisions related to an investee's ordinary course of business and is distinguished from the more limited type of rights referred to as “protective rights”. Refer to the sections entitled: “Protective Rights” and “Substantive Participating Rights” in EITF 96-16, Investor's Accounting for an Investee When the Investor Has a Majority of the Voting Interest but the Minority Shareholder or Shareholders Have Certain Approval or Veto Rights. The term “participating rights” shall be used consistent with the discussion of substantive participating rights in this EITF.
The adopted revisions to SSAP No. 25 from agenda item 2019-34 are summarized as follows:

- Clarify the identification of related parties and ensure that any related party identified under U.S. GAAP or SEC reporting requirements would be considered a related party under statutory accounting principles.

- Clarify that non-controlling ownership over 10% results in a related party classification regardless of any disclaimer of control or disclaimer of affiliation.

- Clarify the impact of a disclaimer of control or disclaimer of affiliate under SAP. As detailed, such disclaimers impact holding company group allocation and reporting as an SCA under SSAP No. 97, but do not eliminate the classification as a “related party” and the disclosure of material transactions as required under SSAP No. 25.

- Rejected several U.S. GAAP standards addressing variable interest entities.

Information or issues (included in Description of Issue) not previously contemplated by the Working Group: None


Staff Recommendation:
NAIC staff recommends that the Working Group move this item to the active listing, categorized as a nonsubstantive change, and expose revisions to SSAP No. 25 and SSAP No. 43R to clarify application of the existing affiliate definition as well as to incorporate new disclosure requirements for investments acquired through, or in, related parties, regardless of if they meet the affiliate definition. (Staff Note: Pursuant to the NAIC Policy Statement on Maintenance of Statutory Accounting Principles, new disclosures and modifications to existing disclosures are considered nonsubstantive changes.)

Proposed edits to SSAP No. 25: (New paragraph 9. Remaining paragraphs would be renumbered.)

This new paragraph 9 clarifies the application of the existing affiliate and control definitions to limited partnerships, trusts and other special purpose entities when control is held by an affiliated general partner, servicer or other arrangement. (The proposed deletion of FIN 35 is discussed earlier in the agenda item, but is noted as not necessary with the existing statutory accounting guidance.)

5. An affiliate is defined as an entity that is within the holding company system or a party that, directly or indirectly, through one or more intermediaries, controls, is controlled by, or is under common control with the reporting entity. An affiliate includes a parent or subsidiary and may also include partnerships, joint ventures, and limited liability companies as defined in SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies. Those entities are accounted for under the guidance provided in SSAP No. 48, which requires an equity method for all such investments. An affiliate is any person that is directly or indirectly, owned or controlled by the same person or by the same group of persons, that, directly or indirectly, own or control the reporting entity.

6. Control is defined as the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of the investee, whether through the (a) ownership of voting securities, (b) by contract other than a commercial contract for goods or nonmanagement services, (c) by contract for goods or nonmanagement services where the volume of activity results in a reliance relationship (d) by common management, or (e) otherwise. Control shall be presumed to exist if a reporting entity and its affiliates directly or indirectly, own, control, hold with the power to vote, or hold proxies representing 10% or more of the voting interests of the entity.

7. Control as defined in paragraph 6 shall be measured at the holding company level. For example, if one member of an affiliated group has a 5% interest in an entity and a second member of the group has an 8% interest in the same entity, the total interest is 13%, and therefore, each member of the affiliated group
shall be presumed to have control. This presumption will stand until rebutted by an evaluation of all the facts and circumstances relating to the investment based on the criteria in FASB Interpretation No. 35, Criteria for Applying the Equity Method of Accounting for Investments in Common Stock, an Interpretation of APB Opinion No. 18. The corollary is required to demonstrate control when a reporting entity owns less than 10% of the voting securities of an investee. The insurer shall maintain documents substantiating its determination for review by the domiciliary commissioner. Examples of situations where the presumption of control may be in doubt include the following:

a. Any limited partner investment in a limited partnership, unless the limited partner is affiliated with the general partner.

b. An entity where the insurer owns less than 50% of an entity and there is an unaffiliated individual or group of investors who own a controlling interest.

c. An entity where the insurer has given up participation rights as a shareholder to the investee.

8. Any direct or indirect ownership interest of the reporting entity greater than 10% results in a related party classification regardless of any disclaimer of control or disclaimer of affiliation. The Insurance Holding Company System Regulatory Act (#440) and the Insurance Holding Company System Model Regulation (#450) include a provision that allows for the disclaimer of affiliation and/or the disclaimer of control for members of an insurance holding company system. The disclaimer must be filed with the state insurance commissioner. Entities whose relationship is subject to a disclaimer of affiliation or a disclaimer of control are related parties and are subject to the related party disclosures within this statement. Such a disclaimer does not eliminate a “related party” distinction or disclosure requirements for material transactions pursuant to SSAP No. 25.

9. For entities not controlled by voting interests, such as limited partnerships, trusts and other special purpose entities, control may be held by a general partner, servicer, or by other arrangements. The ability of the reporting entity or its affiliates to direct the management and policies of an entity through such arrangements shall constitute control as defined in paragraph 6. Additionally, a reporting entity or its affiliates may have indirect control of other entities through such arrangements. For example, if a limited partnership were to be controlled by an affiliated general partner, and that limited partnership held greater than 10% of the voting interests of another company, indirect control shall be presumed to exist. If direct or indirect control exists, whether through voting securities, contracts, common management or otherwise, the arrangement is considered affiliated under paragraph 5. Consistent with paragraph 8, a disclaimer of affiliation does not eliminate a “related party” distinction or disclosure requirements for material transactions pursuant to SSAP No. 25.

Proposed edits to SSAP No. 43R:

These revisions move the existing guidance in paragraph 4.a. to paragraph 6 and notes the requirement to identify related party investments in the investment schedules. (Note Footnote 5 is just moved to a new paragraph.)

4. Loan-backed securities are issued by special-purpose corporations or trusts (issuer) established by a sponsoring organization. The assets securing the loan-backed obligation are acquired by the issuer and pledged to an independent trustee until the issuer’s obligation has been fully satisfied. The investor only has direct recourse to the issuer’s assets, but may have secondary recourse to third parties through insurance or guarantee for repayment of the obligation. As a result, the sponsor and its other affiliates may have no financial obligation under the instrument, although one of those entities may retain the responsibility for servicing the underlying assets. Some sponsors do guarantee the performance of the underlying assets.

---

4 The term "participating rights" refers to the type of rights that allows an investor to effectively participate in significant decisions related to an investee's ordinary course of business and is distinguished from the more limited type of rights referred to as "protective rights". Refer to the sections entitled: “Protective Rights” and “Substantive Participating Rights” in EITF 96-16, Investor's Accounting for an Investee When the Investor Owns a Majority of the Voting Stock but the Minority Shareholder or Shareholders Have Certain Approval or Veto Rights. The term “participating rights” shall be used consistent with the discussion of substantive participating rights in this EITF.
a. In determining whether a loan-backed structure is a related party investment, consideration should be given to the substance of the transaction, and the parties whose action or performance materially impacts the insurance reporting entity holding the security. For example, although a loan-backed security may be acquired from a non-related issuer, if the assets held in trust predominantly reflect assets issued by affiliates of the insurance reporting entity, and the insurance reporting entity only has direct recourse to the assets held in trust, the transaction shall be considered an affiliated investment, and the transaction shall also subject to the accounting and reporting provisions in SSAP No. 25—Affiliates and Other Related Parties.

5. Mortgage-referenced securities do not meet the definition of a loan-backed or structured security but are explicitly captured in scope of this statement. In order to qualify as a mortgage-referenced security, the security must be issued by a government sponsored enterprise or by a special purpose trust in a transaction sponsored by a government sponsored enterprise in the form of a "credit risk transfer" in which the issued security is tied to a referenced pool of mortgages and the payments received are linked to the credit and principal payment risk of the underlying mortgage loan borrowers captured in the referenced pool of mortgages. For these instruments, reporting entity holders may not receive a return of their full principal as principal repayment is contingent on repayment by the mortgage loan borrowers in the referenced pool of mortgages. Unless specifically noted, the provisions for loan-backed securities within this standard apply to mortgage-referenced securities.

6. Investments within the scope of this statement issued by a related party or acquired through a related party transaction or arrangement are also subject to the provisions, admittance assessments, and disclosure requirements of SSAP No. 25. In determining whether a security is a related party investment, consideration should be given to the substance of the transaction, and the parties whose action or performance materially impacts the insurance reporting entity holding the security if the SSAP No. 43R transaction is a related party arrangement. Loan-backed and structured securities 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 and SSAP No. 25.

a. Although a loan-backed or structured security may be acquired from a non-related issuer, if the assets held in trust predominantly reflect assets issued by affiliates of the insurance reporting entity, and the insurance reporting entity only has direct recourse to the assets held in trust, the transaction shall be considered an affiliated investment. In such situations where the underlying collateral assets are issued by related parties that do not qualify as affiliates, these securities shall be identified as related party investments in the investment schedules.

b. A loan-backed or structured security may involve a relationship with a related party but not be considered an affiliated investment. This may be because the relationship does not result in direct

---

5 In applying this guidance, a reporting entity is not required to complete a detailed review of the assets held in trust to determine the extent, if any, the assets were issued by related parties. Rather, this guidance is a principle concept intended to prevent situations in which related party transactions (particularly those involving affiliates) is knowingly captured in a SSAP No. 43R structure and not identified as a related party transaction (or not reported as an affiliated investment on the investment schedule) because of the involvement of a non-related trustee or SSAP No. 43R security issuer. As identified in SSAP No. 25—Affiliates and Other Related Parties, it is erroneous to conclude that the inclusion of a non-related intermediary, or the presence of non-related assets in a structure predominantly comprised of related party investments, eliminates the requirement to identify and assess the investment transaction as a related party arrangement.

6 Currently, only Fannie Mae and Freddie Mac are the government sponsored entities that either directly issue qualifying mortgage-referenced securities or sponsor transactions in which a special purpose trust issues qualifying mortgage-reference securities. However, this guidance would apply to mortgage-referenced securities issued by any other government sponsored entity that subsequently engages in the transfer of mortgage credit risk.

8 In applying this guidance, a reporting entity is not required to complete a detailed review of the assets held in trust to determine the extent, if any, the assets were issued by related parties. Rather, this guidance is a principle concept intended to prevent situations in which related party transactions (particularly those involving affiliates) is knowingly captured in a SSAP No. 43R structure and not identified as a related party transaction (or not reported as an affiliated investment on the investment schedule) because of the involvement of a non-related trustee or SSAP No. 43R security issuer. As identified in SSAP No. 25—Affiliates and Other Related Parties, it is erroneous to conclude that the inclusion of a non-related intermediary, or the presence of non-related assets in a structure predominantly comprised of related party investments, eliminates the requirement to identify and assess the investment transaction as a related party arrangement.
Proposed Annual Statement Reporting Changes: *(These will be captured in a blanks proposal.)*

*These reflect a new electronic-only column for the investment schedules and the related instructions.*

**Column XX: Investments Involving Related Parties:**

*Required for all investments involving related parties including, but not limited to, those captured as affiliate investments. This disclosure intends to capture information on investments held that reflect interactions involving related parties, regardless of whether the related party meets the affiliate definition, or the reporting entity has received domiciliary state approval to disclaim control / affiliation.*

Enter one of the following codes to identify the role of the related party in the investment.

1. **Direct loan or direct investment (excluding securitizations) in a related party, for which the related party represents a direct credit exposure.**

2. **Securitization or similar investment involving a relationship with a related party as sponsor, originator, manager, servicer, or other similar influential role and for which 50% or more of the underlying collateral represents investments in or direct credit exposure to related parties.**

3. **Securitization or similar investment involving a relationship with a related party as sponsor, originator, manager, servicer, or other similar influential role and for which less than 50% (including 0%) of the underlying collateral represents investments in or direct credit exposure to related parties.**

4. **Securitization or similar investment in which the structure reflects an in-substance related party transaction but does not involve a relationship with a related party as sponsor, originator, manager, servicer, or other similar influential role.**

5. **The investment is identified as related party, but the role of the related party represents a different arrangement than the options provided in choices 1-4.**

**Staff Review Completed by:** Julie Gann, NAIC Staff – October 2021

**Status:**

On December 11, 2021, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to SSAP No. 25 and SSAP No. 43R, as illustrated above, to clarify application of the existing affiliate definition and incorporate disclosure requirements for all investments that involve related parties, regardless of if they meet the affiliate definition. In addition, draft annual statement reporting revisions were also exposed, in anticipation of incorporating those revisions into a Blanks (E) Working Group proposal.

On April 4, 2022, the Statutory Accounting Principles (E) Working Group exposed this agenda item, incorporating proposed revisions after considering comments from interested parties shown highlighted in gray below. The changes from the prior exposure only clarify previous components of the proposed revisions. Similar changes to the blanks proposal are also concurrently exposed by the Blanks (E) Working Group in their corresponding agenda
item (2021-22BWG) to allow for a year-end 2022 effective date. This item was exposed with a shortened comment period ending May 6.

**Proposed edits to SSAP No. 25: (New paragraph 9. Remaining paragraphs would be renumbered.)**

This new paragraph 9 clarifies the application of the existing affiliate and control definitions to limited partnerships, trusts and other special purpose entities when control is held by an affiliated general partner, servicer or other arrangement. (The proposed deletion of FIN 35 is discussed earlier in the agenda item, but is noted as not necessary with the existing statutory accounting guidance.)

5. An affiliate is defined as an entity that is within the holding company system or a party that, directly or indirectly, through one or more intermediaries, controls, is controlled by, or is under common control with the reporting entity. An affiliate includes a parent or subsidiary and may also include partnerships, joint ventures, and limited liability companies as defined in SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies. Those entities are accounted for under the guidance provided in SSAP No. 48, which requires an equity method for all such investments. An affiliate is any person that is directly or indirectly, owned or controlled by the same person or by the same group of persons, that, directly or indirectly, own or control the reporting entity.

6. Control is defined as the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of the investee, whether through the (a) ownership of voting securities, (b) by contract other than a commercial contract for goods or nonmanagement services, (c) by contract for goods or nonmanagement services where the volume of activity results in a reliance relationship (d) by common management, or (e) otherwise. Control shall be presumed to exist if a reporting entity and its affiliates directly or indirectly, own, control, hold with the power to vote, or hold proxies representing 10% or more of the voting interests of the entity.

7. Control as defined in paragraph 6 shall be measured at the holding company level. For example, if one member of an affiliated group has a 5% interest in an entity and a second member of the group has an 8% interest in the same entity, the total interest is 13%, and therefore, each member of the affiliated group shall be presumed to have control. This presumption will stand until rebutted by an evaluation of all the facts and circumstances relating to the investment based on the criteria in FASB Interpretation No. 35, Criteria for Applying the Equity Method of Accounting for Investments in Common Stock, an Interpretation of APB Opinion No. 18. The corollary is required to demonstrate control when a reporting entity owns less than 10% of the voting securities of an investee. The insurer shall maintain documents substantiating its determination for review by the domiciliary commissioner. Examples of situations where the presumption of control may be in doubt include the following:

   a. Any limited partner investment in a limited partnership, unless the limited partner is affiliated with the general partner.

   b. An entity where the insurer owns less than 50% of an entity and there is an unaffiliated individual or group of investors who own a controlling interest.

   c. An entity where the insurer has given up participation rights as a shareholder to the investee.

8. Any direct or indirect ownership interest of the reporting entity greater than 10% results in a related party classification regardless of any disclaimer of control or disclaimer of affiliation. The Insurance Holding Company System Regulatory Act (#440) and the Insurance Holding Company System Model Regulation (#450) include a provision that allows for the disclaimer of affiliation and/or the disclaimer of control for members of an insurance holding company system. The disclaimer must be filed with the state insurance

---

9 The term “participating rights” refers to the type of rights that allows an investor to effectively participate in significant decisions related to an investee’s ordinary course of business and is distinguished from the more limited type of rights referred to as “protective rights”. Refer to the sections entitled: “Protective Rights” and “Substantive Participating Rights” in EITF 96-16, Investor's Accounting for an Investee When the Investor Owns a Majority of the Voting Stock but the Minority Shareholder or Shareholders Have Certain Approval or Veto Rights. The term “participating rights” shall be used consistent with the discussion of substantive participating rights in this EITF.
commissioner. Entities whose relationship is subject to a disclaimer of affiliation or a disclaimer of control are related parties and are subject to the related party disclosures within this statement. Such a disclaimer does not eliminate a “related party” distinction or disclosure requirements for material transactions pursuant to SSAP No. 25.

9. For entities not controlled by voting interests, such as limited partnerships, trusts and other special purpose entities, control may be held by a general partner, servicer, or by other arrangements. The ability of the reporting entity or its affiliates to direct the management and policies of an entity through such arrangements shall constitute control as defined in paragraph 6. Additionally, a reporting entity or its affiliates may have indirect control of other entities through such arrangements. For example, if a limited partnership were to be controlled by an affiliated general partner, and that limited partnership held greater than 10% of the voting interests of another company, indirect control shall be presumed to exist unless the presumption of control can be overcome as detailed in paragraph 7. If direct or indirect control exists, whether through voting securities, contracts, common management or otherwise, the arrangement is considered affiliated under paragraph 5. Consistent with paragraph 8, a disclaimer of affiliation does not eliminate a “related party” distinction or disclosure requirements for material transactions pursuant to SSAP No. 25.

Proposed edits to SSAP No. 43R:

These revisions move the existing guidance in paragraph 4.a. to paragraph 6 and notes the requirement to identify related party investments in the investment schedules. (Note Footnote 5 is just moved to a new paragraph.)

4. Loan-backed securities are issued by special-purpose corporations or trusts (issuer) established by a sponsoring organization. The assets securing the loan-backed obligation are acquired by the issuer and pledged to an independent trustee until the issuer’s obligation has been fully satisfied. The investor only has direct recourse to the issuer’s assets, but may have secondary recourse to third parties through insurance or guarantee for repayment of the obligation. As a result, the sponsor and its other affiliates may have no financial obligation under the instrument, although one of those entities may retain the responsibility for servicing the underlying assets. Some sponsors do guarantee the performance of the underlying assets.

a. In determining whether a loan-backed structure is a related party investment, consideration shall be given to the substance of the transaction, and the parties whose action or performance materially impacts the insurance reporting entity holding the security. For example, although a loan-backed security may be acquired from a non-related issuer, if the assets held in trust predominantly reflect assets issued by affiliates of the insurance reporting entity, and the insurance reporting entity only has direct recourse to the assets held in trust, the transaction shall be considered an affiliated investment, and the transaction shall also subject to the accounting and reporting provisions in SSAP No. 25—Affiliates and Other Related Parties.

5. Mortgage-referenced securities do not meet the definition of a loan-backed or structured security but are explicitly captured in scope of this statement. In order to qualify as a mortgage-referenced security,
the security must be issued by a government sponsored enterprise\textsuperscript{12} or by a special purpose trust in a transaction sponsored by a government sponsored enterprise in the form of a “credit risk transfer” in which the issued security is tied to a referenced pool of mortgages and the payments received are linked to the credit and principal payment risk of the underlying mortgage loan borrowers captured in the referenced pool of mortgages. For these instruments, reporting entity holders may not receive a return of their full principal as principal repayment is contingent on repayment by the mortgage loan borrowers in the referenced pool of mortgages. Unless specifically noted, the provisions for loan-backed securities within this standard apply to mortgage-referenced securities.

6. Investments within the scope of this statement \textit{issued by a related party or acquired through a related party transaction or arrangement} are also subject to the provisions, admittance assessments and disclosure requirements of SSAP No. 25. In determining whether a security is a related party investment, consideration should be given to the substance of the transaction, and the parties whose action or performance materially impacts the insurance reporting entity holding the security, if the SSAP No. 43R transaction is a related party arrangement\textsuperscript{13}. Loan-backed and structured securities meet the definition of assets as defined in SSAP No. 4—\textit{Assets and Nonadmitted Assets} and are admitted assets to the extent they conform to the requirements of this standard and SSAP No. 25.

\begin{itemize}
  \item[a.] Although a loan-backed or structured security may be acquired from a non-related issuer, if the assets held in trust predominantly\textsuperscript{14} reflect assets issued by affiliates of the insurance reporting entity, and the insurance reporting entity only has direct recourse to the assets held in trust, the transaction shall be considered an affiliated investment. In such situations where the underlying collateral assets are issued by related parties that do not qualify as affiliates, these securities shall be identified as related party investments in the investment schedules.
  \item[b.] A loan-backed or structured security may involve a relationship with a related party but not be considered an affiliated investment. This may be because the relationship does not result in direct or indirect control of the issuer or because there is an approved disclaimer of control or affiliation. Regardless of whether investments involving a related party relationship are captured in the affiliated investment reporting lines, these securities shall be identified as related party investments in the investment schedules. Examples of related party relationships would include involvement of a related party in sponsoring or originating the loan-backed or structured security or any type of underlying servicing arrangement. For the avoidance of doubt, investments from any arrangement that results in direct or indirect control, including control through a servicer or other controlling arrangement, shall be reported as affiliated in accordance with SSAP No. 25—\textit{Affiliates and Other Related Parties}.
\end{itemize}

Proposed Annual Statement Reporting Changes: \textit{(These in a blanks proposal 2021-22BWG.)}

These reflect a new electronic-only column for the investment schedules and the related instructions.

\textsuperscript{12} Currently, only Fannie Mae and Freddie Mac are the government sponsored entities that either directly issue qualifying mortgage-referenced securities or sponsor transactions in which a special purpose trust issues qualifying mortgage-reference securities. However, this guidance would apply to mortgage-referenced securities issued by any other government sponsored entity that subsequently engages in the transfer of mortgage credit risk.

\textsuperscript{13} As discussed in paragraph 4.a. of this statement, a SSAP No. 43R security may still be considered a related party transaction even if the asset trustee or security issuer is a non-related party.

\textsuperscript{14} In applying this guidance, a reporting entity is not required to complete a detailed review of the assets held in trust to determine the extent, if any, the assets were issued by related parties. Rather, this guidance is a principle concept intended to prevent situations in which related party transactions (particularly those involving affiliates) is knowingly captured in a SSAP No. 43R structure and not identified as a related party transaction (or not reported as an affiliated investment on the investment schedule) because of the involvement of a non-related trustee or SSAP No. 43R security issuer. As identified in SSAP No. 25—\textit{Affiliates and Other Related Parties}, it is erroneous to conclude that the inclusion of a non-related intermediary, or the presence of non-related assets in a structure predominantly comprised of related party investments, eliminates the requirement to identify and assess the investment transaction as a related party arrangement.
**Column XX: Investments Involving Related Parties:**

Required for all investments involving related parties including, but not limited to, those captured as affiliate investments. This disclosure intends to capture information on investments held that reflect interactions involving related parties, regardless of whether the related party meets the affiliate definition, or the reporting entity has received domiciliary state approval to disclaim control / affiliation.

Enter one of the following codes to identify the role of the related party in the investment:

1. Direct loan or direct investment (excluding securitizations) in a related party, for which the related party represents a direct credit exposure.

2. Securitization or similar investment vehicles such as mutual funds, limited partnerships and limited liability companies involving a relationship with a related party as sponsor, originator, manager, servicer, or other similar influential role and for which 50% or more of the underlying collateral represents investments in or direct credit exposure to related parties.

3. Securitization or similar investment vehicles such as mutual funds, limited partnerships and limited liability companies involving a relationship with a related party as sponsor, originator, manager, servicer, or other similar influential role and for which less than 50% (including 0%) of the underlying collateral represents investments in or direct credit exposure to related parties.

4. Securitization or similar investment vehicles such as mutual funds, limited partnerships and limited liability companies in which the structure reflects an in-substance related party transaction but does not involve a relationship with a related party as sponsor, originator, manager, servicer, or other similar influential role.

5. The investment is identified as related party, but the role of the related party represents a different arrangement than the options provided in choices 1-4.

On May 24, 2022, the Statutory Accounting Principles (E) Working Group took the following actions:

1. Adopted, as final, the exposed revisions to SSAP No. 25 and SSAP No. 43R, as illustrated below, to clarify application of the existing affiliate definition and incorporate disclosure requirements for all investments that involve related parties, regardless of if they meet the affiliate definition. The revisions to SSAP No. 43R also included additional minor edits to paragraph 6.b., clarifying that the investments from any arrangements that results in direct or indirect control, which include but are not limited to control through a servicer, shall be reported as affiliated investments.

2. In addition, to the adopted revisions, the Statutory Accounting Principles (E) Working Group expressed support for the corresponding Blanks (E) Working Group proposal (2021-22BWG), which will incorporate 6 reporting codes to identify the role of the related party in any investment, on any reporting line, in schedules: B – Mortgage Loans, D – Long-Term Bonds, DB – Derivatives, BA – Other Long-Term Invested Assets, DA – Short-Term Investments, E2 – Cash Equivalents, and DL – Securities Lending Collateral Assets, with an effective date of December 31, 2022.

3. Direct NAIC staff to draft the following for future Working Group discussion: 1) possible footnote revisions pursuant to interested parties’ comments, and 2) examples for possible inclusion in SSAP No. 43R, to further clarify investments that should be classified as affiliated. and

4. Send a referral to the Valuation of Securities (E) Task Force, notifying of this adopted agenda item, and to assess whether corresponding edits are needed to the Practices and Procedures Manual of the NAIC Investment Analysis Office regarding CLO investments that may now be classified as affiliated.
Adopted revisions to SSAP No. 25: (New paragraph 9. Remaining paragraphs would be renumbered.)

This new paragraph 9 clarifies the application of the existing affiliate and control definitions to limited partnerships, trusts and other special purpose entities when control is held by an affiliated general partner, servicer or other arrangement. (The proposed deletion of FIN 35 is discussed earlier in the agenda item, but is noted as not necessary with the existing statutory accounting guidance.)

5. An affiliate is defined as an entity that is within the holding company system or a party that, directly or indirectly, through one or more intermediaries, controls, is controlled by, or is under common control with the reporting entity. An affiliate includes a parent or subsidiary and may also include partnerships, joint ventures, and limited liability companies as defined in SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies. Those entities are accounted for under the guidance provided in SSAP No. 48, which requires an equity method for all such investments. An affiliate is any person that is directly or indirectly, owned or controlled by the same person or by the same group of persons, that, directly or indirectly, own or control the reporting entity.

6. Control is defined as the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of the investee, whether through the (a) ownership of voting securities, (b) by contract other than a commercial contract for goods or nonmanagement services, (c) by contract for goods or nonmanagement services where the volume of activity results in a reliance relationship (d) by common management, or (e) otherwise. Control shall be presumed to exist if a reporting entity and its affiliates directly or indirectly, own, control, hold with the power to vote, or hold proxies representing 10% or more of the voting interests of the entity.

7. Control as defined in paragraph 6 shall be measured at the holding company level. For example, if one member of an affiliated group has a 5% interest in an entity and a second member of the group has an 8% interest in the same entity, the total interest is 13%, and therefore, each member of the affiliated group shall be presumed to have control. This presumption will stand until rebutted by an evaluation of all the facts and circumstances relating to the investment based on the criteria in FASB Interpretation No. 35, Criteria for Applying the Equity Method of Accounting for Investments in Common Stock, an Interpretation of APB Opinion No. 18. The corollary is required to demonstrate control when a reporting entity owns less than 10% of the voting securities of an investee. The insurer shall maintain documents substantiating its determination for review by the domiciliary commissioner. Examples of situations where the presumption of control may be in doubt include the following:

a. Any limited partner investment in a limited partnership, unless the limited partner is affiliated with the general partner.

b. An entity where the insurer owns less than 50% of an entity and there is an unaffiliated individual or group of investors who own a controlling interest.

c. An entity where the insurer has given up participation rights15 as a shareholder to the investee.

8. Any direct or indirect ownership interest of the reporting entity greater than 10% results in a related party classification regardless of any disclaimer of control or disclaimer of affiliation. The Insurance Holding Company System Regulatory Act (#440) and the Insurance Holding Company System Model Regulation (#450) include a provision that allows for the disclaimer of affiliation and/or the disclaimer of control for members of an insurance holding company system. The disclaimer must be filed with the state insurance commissioner. Entities whose relationship is subject to a disclaimer of affiliation or a disclaimer of control are related parties and are subject to the related party disclosures within this statement. Such a disclaimer

---

15 The term "participating rights" refers to the type of rights that allows an investor to effectively participate in significant decisions related to an investee's ordinary course of business and is distinguished from the more limited type of rights referred to as "protective rights". Refer to the sections entitled: "Protective Rights" and "Substantive Participating Rights" in EITF 96-16, Investor's Accounting for an Investee When the Investor Owns a Majority of the Voting Stock but the Minority Shareholder or Shareholders Have Certain Approval or Veto Rights. The term "participating rights" shall be used consistent with the discussion of substantive participating rights in this EITF.
Currently, only Fannie Mae and Freddie Mac are the government sponsored entities that either directly issue qualifying mortgage-referenced securities or sponsor transactions in which a special purpose trust issues qualifying mortgage-reference securities. However, this guidance would apply to mortgage-referenced securities issued by any other government sponsored entity that subsequently engages in the transfer of mortgage credit risk.

9. For entities not controlled by voting interests, such as limited partnerships, trusts and other special purpose entities, control may be held by a general partner, servicer, or by other arrangements. The ability of the reporting entity or its affiliates to direct the management and policies of an entity through such arrangements shall constitute control as defined in paragraph 6. Additionally, a reporting entity or its affiliates may have indirect control of other entities through such arrangements. For example, if a limited partnership were to be controlled by an affiliated general partner, and that limited partnership held greater than 10% of the voting interests of another company, indirect control shall be presumed to exist unless the presumption of control can be overcome as detailed in paragraph 7. If direct or indirect control exists, whether through voting securities, contracts, common management or otherwise, the arrangement is considered affiliated under paragraph 5. Consistent with paragraph 8, a disclaimer of affiliation does not eliminate a “related party” distinction or disclosure requirements for material transactions pursuant to SSAP No. 25.

**Adopted revisions SSAP No. 43R:**

These revisions move the existing guidance in paragraph 4.a. to paragraph 6 and notes the requirement to identify related party investments in the investment schedules. (Note Footnote 5 is just moved to a new paragraph.)

4. Loan-backed securities are issued by special-purpose corporations or trusts (issuer) established by a sponsoring organization. The assets securing the loan-backed obligation are acquired by the issuer and pledged to an independent trustee until the issuer’s obligation has been fully satisfied. The investor in a loan-backed structure is a related party investment, consideration shall be given to the substance of the transaction, and the parties whose action or performance materially impacts the insurance reporting entity holding the security. For example, although a loan-backed security may be acquired from a non-related issuer, if the assets held in trust predominantly reflect assets issued by affiliates of the insurance reporting entity, and the insurance reporting entity only has direct recourse to the assets held in trust, the transaction shall be considered an affiliated investment, and the transaction shall also subject to the accounting and reporting provisions in SSAP No. 25—Affiliates and Other Related Parties.

5. Mortgage-referenced securities do not meet the definition of a loan-backed or structured security but are explicitly captured in scope of this statement. In order to qualify as a mortgage-referenced security, the security must be issued by a government sponsored enterprise or by a special purpose trust in a

---

17 In applying this guidance, a reporting entity is not required to complete a detailed review of the assets held in trust to determine the extent, if any, the assets were issued by related parties. Rather, this guidance is a principle concept intended to prevent situations in which related party transactions (particularly those involving affiliates) in knowingly captured in a SSAP No. 43R structure and not identified as a related party transaction (or not reported as an affiliated investment on the investment schedule) because of the involvement of a non-related entity or SSAP No. 43R security issuer, as described in SSAP No. 25—Affiliates and Other Related Parties. It is erroneous to conclude that the inclusion of a non-related intermediary, or the presence of non-related assets in a structure predominantly comprised of related party investments, eliminates the requirement to identify and assess the investment transaction as a related party arrangement.

18 Consistent with SSAP No. 97, footnote 1, investments in an exchange traded fund (ETF) or a mutual fund (as defined by the SEC) does not reflect ownership in an underlying entity, regardless of the ownership percentage the reporting entity (or the holding company group) has of the ETF or mutual fund unless ownership of the ETF actually results in “control” with the power to direct or cause the direction of management of an underlying company. ETFs and mutual funds are comprised of portfolios of securities subject to the regulatory requirements of the federal securities laws.
transaction sponsored by a government sponsored enterprise in the form of a “credit risk transfer” in which the issued security is tied to a referenced pool of mortgages and the payments received are linked to the credit and principal payment risk of the underlying mortgage loan borrowers captured in the referenced pool of mortgages. For these instruments, reporting entity holders may not receive a return of their full principal as principal repayment is contingent on repayment by the mortgage loan borrowers in the referenced pool of mortgages. Unless specifically noted, the provisions for loan-backed securities within this standard apply to mortgage-referenced securities.

6. Investments within the scope of this statement issued by a related party or acquired through a related party transaction or arrangement are also subject to the provisions, admittance assessments, and disclosure requirements of SSAP No. 25. In determining whether a security is a related party investment, consideration should be given to the substance of the transaction, and the parties whose action or performance materially impacts the insurance reporting entity holding the security if the SSAP No. 43R transaction is a related party arrangement.

Loan-backed and structured securities 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 and SSAP No. 25.

a. Although a loan-backed or structured security may be acquired from a non-related issuer, if the assets held in trust predominantly reflect assets issued by affiliates of the insurance reporting entity, and the insurance reporting entity only has direct recourse to the assets held in trust, the transaction shall be considered an affiliated investment. In such situations where the underlying collateral assets are issued by related parties that do not qualify as affiliates, these securities shall be identified as related party investments in the investment schedules.

b. A loan-backed or structured security may involve a relationship with a related party but not be considered an affiliated investment. This may be because the relationship does not result in direct or indirect control of the issuer or because there is an approved disclaimer of control or affiliation. Regardless of whether investments involving a related party relationship are captured in the affiliated investment reporting lines, these securities shall be identified as related party investments in the investment schedules. Examples of related party relationships would include involvement of a related party in sponsoring or originating the loan-backed or structured security or any type of underlying servicing arrangement. For the avoidance of doubt, investments from any arrangement that results in direct or indirect control, which include but are not limited to control through a servicer or other controlling arrangement, shall be reported as affiliated in accordance with SSAP No. 25—Affiliates and Other Related Parties.

Supported Annual Statement Reporting Changes: (Reflected in 2021-22BWG.)

These reflect a new electronic-only column for the investment schedules and the related instructions.

Column XX: Investments Involving Related Parties:

Required for all investments involving related parties including, but not limited to, those captured as affiliate investments. This disclosure intends to capture information on investments held that reflect interactions involving

---

20 In applying this guidance, a reporting entity is not required to complete a detailed review of the assets held in trust to determine the extent, if any, the assets were issued by related parties. Rather, this guidance is a principle concept intended to prevent situations in which related party transactions (particularly those involving affiliates) is knowingly captured in a SSAP No. 43R structure and not identified as a related party transaction (or not reported as an affiliated investment on the investment schedule) because of the involvement of a non-related trustee or SSAP No. 43R security issuer. As identified in SSAP No. 25—Affiliates and Other Related Parties, it is erroneous to conclude that the inclusion of a non-related intermediary, or the presence of non-related assets in a structure predominantly comprised of related party investments, eliminates the requirement to identify and assess the investment transaction as a related party arrangement.
related parties, regardless of whether the related party meets the affiliate definition, or the reporting entity has received domiciliary state approval to disclaim control / affiliation.

Enter one of the following codes to identify the role of the related party in the investment.

1. Direct loan or direct investment (excluding securitizations) in a related party, for which the related party represents a direct credit exposure.

2. Securitization or similar investment vehicles such as mutual funds, limited partnerships and limited liability companies involving a relationship with a related party as sponsor, originator, manager, servicer, or other similar influential role and for which 50% or more of the underlying collateral represents investments in or direct credit exposure to related parties.

3. Securitization or similar investment vehicles such as mutual funds, limited partnerships and limited liability companies involving a relationship with a related party as sponsor, originator, manager, servicer, or other similar influential role and for which less than 50% (including 0%) of the underlying collateral represents investments in or direct credit exposure to related parties.

4. Securitization or similar investment vehicles such as mutual funds, limited partnerships and limited liability companies in which the structure reflects an in-substance related party transaction but does not involve a relationship with a related party as sponsor, originator, manager, servicer, or other similar influential role.

5. The investment is identified as related party, but the role of the related party represents a different arrangement than the options provided in choices 1-4.

6. The investment does not involve a related party.
Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A

Issue: Premium Adjustments Allocated to Jurisdictions

Check (applicable entity):

<table>
<thead>
<tr>
<th>Modification of Existing SSAP</th>
<th>P/C</th>
<th>Life</th>
<th>Health</th>
</tr>
</thead>
<tbody>
<tr>
<td>New Issue or SSAP</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interpretation</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Description of Issue:
This agenda item has been drafted to propose blanks instructional changes primarily to Schedule T which reflects premiums, allocated by states and territories. NAIC staff received inquiries from 3 states in the fourth quarter of 2021 regarding a minor number of entities that primarily wrote health business related to the Affordable Care Act (ACA) which are believed to have not properly allocated premium adjustments by jurisdiction on the statutory financial statement. The states identified that a minority of entities reported some portion of their U.S.-based premium in the category of “aggregate other alien.” The aggregate other alien line is for non-U.S. premium therefore, reporting U.S.-based ACA premium as alien is problematic. The purpose of this agenda item is to add additional annual statement instructions to address this reporting inconsistency. Regardless of the cause of this specific issue, the proposed revisions intend to clarify that premium adjustments (both increases and decreases) shall be reflected in the appropriate jurisdiction. This proposal is to address this current issue as well as future situations.

The specific premium identified is understood to be ACA premium written in the U.S. and its territories. Based on the descriptions provided, most of the amounts are presumed to be from premium redistribution as a result of the risk adjustment program of the ACA. All of the premium adjustments from the ACA risk adjustment program, and the risk corridor program, are noted as premium in SSAP No. 107—Risk-Sharing Provisions of the Affordable Care Act. (Although the risk corridor program ended in 2016, distributions related to 2015-2016 plan years have been received in the last two years due to a U.S. Supreme Court decision.)

The ACA risk adjustment premium redistribution calculations are calculated by plan and by jurisdiction. Therefore, the jurisdictions are known. The ACA risk adjustment program redistributes premium from plans that have relatively healthier insureds and gives to plans with relatively less healthy insureds based on risk scores. SSAP No. 107 directs reporting the premium adjustments in the ACA risk adjustment program as premium subject to redetermination, which requires accruing the adjustments based on policy experience as described in the authoritative literature section below.

NAIC staff understanding is that most states would treat the premium after adjustments (both increases and decreases) as the amount subject to premium tax. However, preliminary conversations some health entities have asserted that they believe their state only subjects the premium prior to adjustment to premium tax. In the statutory annual statement, the premium including adjustments should be reported as premium subject to redetermination as identified in SSAP No. 107. If a jurisdiction treats premium differently for tax purposes, that would be addressed on the jurisdiction’s premium tax return.

Because of the way the ACA risk adjustment program premium adjustments calculation works, an insurer can have both payables and receivables in different plans in the same jurisdiction. For example, they could be a receiver in the bronze plan in state A and a payor in the silver plan in state A. Total premium in the state is redistributed among plans at the same level in the state, no new funds are added. In the examples below the total premium columns are what is reported in the state A and B lines of Schedule T.
Existing Authoritative Literature (bolding added for emphasis):

- **Uniform Deposit Law Model 300:**

  “Alien insurer” means an insurer incorporated or organized under the laws of any country other than the United States.

- **SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities:**

  8.b.iv. Investments in foreign insurance SCA entities shall be recorded based on the underlying U.S. GAAP equity from the audited U.S. GAAP basis financial statements, adjusted to a limited statutory basis of accounting in accordance with paragraph 9, if available. If the audited U.S. GAAP basis financial statements are not available, the investment can be recorded on the audited foreign statutory basis financial statements of the respective entity adjusted to a limited statutory basis of accounting in accordance with paragraph 9 and adjusted for reserves of the foreign insurance SCA with respect to the business it assumes directly and indirectly from a U.S. insurer using the statutory accounting principles promulgated by the NAIC in the Accounting Practices and Procedures Manual. The audited foreign statutory basis financial statements must include an audited footnote that reconciles net income and equity on the foreign statutory basis of accounting to the U.S. GAAP basis. Foreign insurance SCA entities are defined as alien insurers formed according to the legal requirements of a foreign country.

- **SSAP No. 107—Risk-Sharing Provisions of the Affordable Care Act:**

  **Risk Adjustment Program – Accounting Treatment**

  14. Premium adjustments pursuant to the risk adjustment program will be based upon the risk scores (health status) of enrollees, participating in risk adjustment covered plans rather than the actual loss experience of the insured. This program bears some similarities to the Medicare Advantage risk adjustment program\(^1\) under which the plan receives additional funding (or pays additional amounts) based on adjustments to risk scores of enrollees (see *INT 05-05: Accounting for Revenues Under Medicare Part D Coverage*).

  15. **The risk adjustment payables and receivables shall be accounted for as premium adjustments subject to redetermination as specified in this statement.** Effective beginning with 2018 benefit plan years, the risk adjustment assessments and distributions are calculated including the high-cost risk pool aspect of this program and should be reported on a net basis.

---

\(^1\) The ACA program also has significant differences from the Medicare Advantage risk adjustment program, which is retrospective, administered as a single national program, with most enrollees administered by the federal government. By contrast, the ACA risk adjustment is not retrospective, and is administered by each entity by state and by plan.
a. Risk adjustment payables meet the definition of liabilities as set forth in SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets. Risk adjustment receivables meet the definition of an asset and are admissible to the extent that they meet all of the criteria in this statement.

b. Risk adjustment payables and receivables shall be estimated based on experience to date. The method used to estimate the payables and receivables shall be reasonable and consistent between reporting periods. Reporting entities shall be aware of the significant uncertainties involved in preparing estimates and be both diligent and conservative in their estimations. In exercising the judgment required to prepare reasonable estimates for the financial reporting of risk adjustment program payables and receivables, the statutory accounting concept of conservatism shall be followed. In addition, reporting entities are required to have sufficient data to determine a reasonable estimate. Ensuring sufficient data requires that the reporting entity’s estimate is based on demonstrated knowledge of the marketplace and annual information which includes patient encounter and diagnosis code data to determine the differences in the actuarial risk profile of the reporting entity’s insureds versus the market participants in the particular market and state risk pool. Sufficient data shall incorporate patient default scores, if applicable, under the terms of the risk adjustment program. In addition, the estimates shall be consistent with other financial statement assertions and the pricing scenarios used by the reporting entity.

c. Premium revenue adjustments for the risk adjustment program are estimated for the portion of the policy period that has expired and shall be reported as an immediate adjustment to premium. Accrued risk adjustment receivables shall be recorded in premium and considerations receivable, with a corresponding entry to written premiums. Accrued risk adjustment payables shall be recorded as a liability2 with a corresponding entry to written premiums. Reporting entities shall record additions or reductions to revenue resulting from the risk adjustment program in the period in which the changes in risk scores of enrollees result in reasonably estimable additions or reductions. The risk adjustment program receivables shall be reported gross of payables.

d. The risk adjustment receivables are administered through a federal governmental program. Once amounts are collected by the governmental entity, there is an obligation to distribute the funds. Amounts over 90 days due shall not cause the receivable to be treated as a nonadmitted asset based solely on aging.

e. Provided that the risk adjustment receivables due the reporting entity are determined in a manner that is consistent with the requirements of this statement, the receivables are admitted assets until determination of impairment or payment denial is received from the governmental entity or government-sponsored entity administering the program. Upon notification that payments to be paid to the reporting entity will be less than the recorded receivables, any amount in excess of the confirmed amount shall be written off and charged to income, except for amounts that are under appeal. Any receivable for risk adjustment amounts under appeal shall be reflected as a nonadmitted asset.

f. Evaluation of the collectibility of all amounts receivable from the risk adjustment program shall be made for each reporting period. If, in accordance with SSAP No. 5R, it is probable that the risk adjustment receivables are uncollectible, any uncollectible receivable shall be written off and charged to income in the period the determination is made. If it is reasonably possible that a portion of the balance determined in

---

2 The annual statement liability lines will vary by the type of annual statement the reporting entity files. Managed care/accident and health reporting entities report as aggregate health policy reserves; life and accident and health reporting entities report as aggregate reserves for accident and health contracts; and property and casualty reporting entities report as aggregate write-ins for liabilities.
accordance with this paragraph is not anticipated to be collected and is therefore not written off, the disclosure requirements outlined in SSAP No. 5R shall be followed.

Risk Adjustment Program – High-Cost Risk Pool – Accounting Treatment

16. The individual and small group high-cost risk pools of the ACA risk adjustment program shall be accounted for consistent with the rest of the ACA risk adjustment program. Reporting entity issuers in the individual or small group markets need to account for the following risk adjustment payables and receivables including the impairment and aging guidance reflected in paragraph 15 and paragraph 16:

   a. The high-cost risk pool assessment payable by the reporting entity, which is the percent-of-premium charge to the issuer in order to fund reimbursements across all issuers of claims above the high cost risk pool threshold, shall be accounted for as decreases to written premium subject to redetermination.

   b. High-cost risk pool distributions, which represent proportionate reimbursement for the issuer’s claims above the high cost risk pool threshold, would be accounted for as increases to written premium subject to redetermination.

   c. As the risk adjustments and distributions described in paragraphs 4-9 are calculated after excluding the percentage of costs above the threshold specified in the high-cost risk pool aspect of this program, the payments described in paragraphs 4-9 will continue to be accounted for consistent with guidance in paragraph 15 and paragraph 16 (i.e., as a premium adjustment subject to redetermination).

Note that Schedule T, part 1 has slightly different names by annual statement type, but it reflects premiums, allocated by states and territories. Schedule T, Part 2 Interstate Compact- Exhibit of Premiums Written Allocated By States and Territories is the same name for all annual statement types.

- Annual Statement Instructions Schedule T, Part 1 – Premiums and Other Considerations Allocated By States and Territories – Health:

Details of Write-ins Aggregated at Line 58 for Other Alien
List separately each alien jurisdiction for which there is no pre-printed line on Schedule T.

If the premium from an alien jurisdiction is due to relocation of current policyholders, the amount may be aggregated and reported as “Other Alien.” Premiums from jurisdictions in which there is active writing must be reported by jurisdiction and include premium from relocated policyholders residing in the respective jurisdiction.

Identify each alien jurisdiction by using a three-character (ISO Alpha 3) country code followed by the name of the country (e.g., DEU Germany). For premium that can be aggregated and reported as “Other Alien” as stated in the previous paragraph, use “ZZZ” for the country code and “Other Alien” for the country name. A comprehensive listing of country codes is available in the appendix of these instructions.

Include summary of remaining write-ins for Line 58 from the Overflow page on the separate line indicated.

- Annual Statement Instructions Schedule T, Part 1 – Premiums and Annuity Considerations Allocated By States and Territories Life and Fraternal:

Line 58 – Aggregate Other Alien
Enter the total of the write-ins listed in schedule “Details of Write-ins Aggregated at Line 58 for Other Alien.” All U.S. business must be allocated by state regardless of license status.
Details of Write-ins Aggregated on Line 58 for Other Alien
List separately each alien jurisdiction for which there is no pre-printed line on Schedule T.

If the premium from an alien jurisdiction is due to relocation of current policyholders, the amount may be aggregated and reported as “Other Alien.” Premiums from jurisdictions in which there is active writing must be reported by jurisdiction and include premium from relocated policyholders residing in the respective jurisdiction.

Identify each alien jurisdiction by using a three-character (ISO Alpha 3) country code followed by the name of the country (e.g., DEU Germany). For premium that can be aggregated and reported as “Other Alien” as stated in the previous paragraph, use “ZZZ” for the country code and “Other Alien” for the country name. A comprehensive listing of country codes is available in the appendix of these instructions.

Include summary of remaining write-ins for Line 58 from the Overflow page on the separate line indicated.

Annual Statement Instructions Schedule T, Part 1 – Property and Casualty:

Line 58 – Aggregate Other Alien
Enter the total of the write-ins listed in Schedule Details of Write-ins Aggregated at Line 58 for Other Alien.

All U.S. business must be allocated by state regardless of license status.

Details of Write-ins Aggregated at Line 58 for Other Alien
List separately each alien jurisdiction for which there is no pre-printed line on Schedule T.

If the premium from an alien jurisdiction is due to relocation of current policyholders, the amount may be aggregated and reported as “Other Alien.” Premiums from jurisdictions in which there is active writing must be reported by jurisdiction and include premium from relocated policyholders residing in the respective jurisdiction.

Identify each alien jurisdiction by using a three-character (ISO Alpha 3) country code followed by the name of the country (e.g., DEU Germany). For premium that can be aggregated and reported as “Other Alien” as stated in the previous paragraph, use “ZZZ” for the country code and “Other Alien” for the country name. A comprehensive listing of country codes is available in the appendix of these instructions.

Include summary of remaining write-ins for Line 58 from the Overflow page on the separate line indicated.

Schedule T, Part 2 Uniform instructions:

Line 58 – Aggregate Other Alien
Enter the total of all alien business in the appropriate columns. Details by countries are not required.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): None

Information or issues (included in Description of Issue) not previously contemplated by the Working Group: None
Convergence with International Financial Reporting Standards (IFRS): Not applicable

Staff Recommendation: NAIC staff recommends that the Working Group move this item to the active listing, categorized as a SAP clarification, and concurrently expose an annual statement blanks proposal for 2022 annual reporting. The sponsored blanks proposal has been forwarded to the Blanks (E) Working Group to modify the instructions for Schedule T, the State Page and Accident and Health Policy Experience Exhibit (AHPEE) to clarify guidance for premium adjustments to ensure that entities are reporting premium by jurisdiction. This agenda item does not result in SSAP revisions. The proposed additions to the blanks instructions are shown below.

1. Schedule T, part 1 annual statement instructions for Health (This revision will make Health instructions consistent with the property casualty and life fraternal annual statement instructions.)

   **Line 58 – Aggregate Other Alien**

   **Enter the total of the write-ins listed in schedule “Details of Write-ins Aggregated at Line 58 for Other Alien.” All U.S. business shall be allocated by state regardless of license status.**

   Details of Write-ins Aggregated at Line 58 for Other Alien
   List separately each alien jurisdiction for which there is no pre-printed line on Schedule T.

   If the premium from an alien jurisdiction is due to relocation of current policyholders, the amount may be aggregated and reported as “Other Alien.” Premiums from jurisdictions in which there is active writing must be reported by jurisdiction and include premium from relocated policyholders residing in the respective jurisdiction.

   Identify each alien jurisdiction by using a **three-character (ISO Alpha 3) country code followed by the name of the country** (e.g., DEU Germany). For premium that can be aggregated and reported as “Other Alien” as stated in the previous paragraph, use “ZZZ” for the country code and “Other Alien” for the country name. A comprehensive listing of country codes is available in the appendix of these instructions.

2. Schedule T, part 1 annual statement instructions for Health; Life and Fraternal and Property and Casualty

   **Add to general instructions:**

   **All premium adjustments (both increases and decreases), including but not limited to Affordable Care Act (ACA) premium adjustments related to the risk adjustment program, shall be allocated as premium in the respective jurisdiction.**

3. Schedule T, Part 2 Uniform instructions:

   **Line 58 – Aggregate Other Alien**

   Enter the total of all alien business in the appropriate columns. Details by countries are not required.

   **All premium adjustments (both increases and decreases), including but not limited to Affordable Care Act (ACA) premium adjustments related to the risk adjustment program, shall be allocated as premium in the respective jurisdiction.**

4. Add additional instructions to line 58 - Aggregate Other Alien to the annual statement instructions for Health; Life and Fraternal and Property and Casualty

   **All premium adjustments (both increases and decreases), including but not limited to Affordable Care Act (ACA) premium adjustments related to the risk adjustment program, shall be allocated as premium in the respective jurisdiction.**
5. State Page - general instructions to the annual statement instructions for Health; Life and Fraternal and Property and Casualty

All premium adjustments (both increases and decreases), including but not limited to Affordable Care Act (ACA) premium adjustments related to the risk adjustment program, shall be allocated as premium in the respective jurisdiction.

6. Accident and Health Policy Experience Exhibit (AHPEE) to the annual statement instructions for Health; Life and Fraternal and Property and Casualty

All premium adjustments (both increases and decreases), including but not limited to Affordable Care Act (ACA) premium adjustments related to the risk adjustment program, shall be allocated as premium in the respective jurisdiction.

Staff Review Completed by: Robin Marcotte– NAIC Staff, February 2022

Recommendation:
NAIC staff recommends that the Working Group move this item to the active listing, categorized as a SAP clarification, and concurrently expose an annual statement blanks proposal for 2022 annual reporting. The sponsored blanks proposal has been forwarded to the Blanks (E) Working Group to modify the instructions for Schedule T, the State Page and Accident and Health Policy Experience Exhibit (AHPEE) to clarify guidance for premium adjustments. This agenda item does not result in SSAP revisions. The proposed additions to the blanks instructions are shown in the agenda item, but the primary instructional revision is as follows:

All premium adjustments (both increases and decreases), including but not limited to Affordable Care Act (ACA) premium adjustments related to the risk adjustment program, shall be allocated as premium in the respective jurisdiction.

Status:
On April 4, 2022, the Statutory Accounting Principles (E) Working Group moved this item to the active listing and exposed proposed revisions to be incorporated into a Blanks (E) Working Group proposal (2022-10BWG) which would modify the instructions for Schedule T, the State Page and Accident and Health Policy Experience Exhibit (AHPEE). The proposed revisions clarify that all premium adjustments shall be allocated as premium in each respective jurisdiction. This agenda item did not propose statutory revisions. This item was exposed with a shortened comment period ending May 6 to permit consideration for a year-end 2022 effective date of the reporting revisions.

On May 24, 2022, the Statutory Accounting Principles (E) Working Group adopted this agenda item, which did not result in statutory accounting revisions, however the adoption expressed support for the corresponding Blanks (E) Working Group exposure (2022-10BWG), which modifies the instructions for Schedule T, the State Page and the Accident and Health Policy Experience Exhibit (AHPEE), clarifying the guidance for premium adjustments.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2022/5-24-22/Adoptions/22-03 - Premium Adj by Jurisdiction.docx
Issue: Treatment of Freddie Mac WI Certificates

Check (applicable entity):  
- Modification of existing SSAP  
- New Issue or SSAP  
- Interpretation  

P/C | Life | Health  
---|---|---  
☐ | ☑ | ☑  
☐ | ☑ | ☑  
☐ | ☑ | ☑  

Description of Issue:  
Freddie Mac “When Issued K-Deal” certificates ("WI") are backed by an asset pool held in trust, but those assets do not initially include any mortgages or mortgage-backed assets. Rather these assets include cash from the sale of the WI certificates and a commitment by Freddie Mac to deliver one or more structured pass through certificates (SPCs) in exchange for the WI trust’s cash within approximately 90 days of settlement. The date on which this delivery occurs is referred to as the “Subsequent Transfer Date.”

Prior to the Subsequent Transfer Date, the WI trusts pay fixed coupons to certificate holders which are funded from a Freddie Mac guarantee on the WI certificates. After the Subsequent Transfer Date the WI trust will hold the promised SPCs which are backed by mortgages and guaranteed by Freddie Mac. Additionally, after this date the WI trust becomes a pass-through of the underlying trust. The WI certificates have an optional exchange right where they can be exchanged for the underlying SPCs, but if not exchanged, the WI certificates after the Subsequent Transfer Date will still be backed by the SPCs.

The issue is the statutory accounting treatment of WI certificates prior to the Subsequent Transfer Date.

Existing Authoritative Literature:  
SSAP No. 43R—Loan-Backed and Structured Securities, paragraphs 2-4:

2. Loan-backed securities are defined as securitized assets not included in structured securities, as defined below, for which the payment of interest and/or principal is directly proportional to the payments received by the issuer from the underlying assets, including but not limited to pass-through securities, lease-backed securities, and equipment trust certificates.

3. Structured securities are defined as loan-backed securities which have been divided into two or more classes for which the payment of interest and/or principal of any class of securities has been allocated in a manner which is not proportional to payments received by the issuer from the underlying assets.

4. Loan-backed securities are issued by special-purpose corporations or trusts (issuer) established by a sponsoring organization. The assets securing the loan-backed obligation are acquired by the issuer and pledged to an independent trustee until the issuer’s obligation has been fully satisfied. The investor only has direct recourse to the issuer’s assets, but may have secondary recourse to third parties through insurance or guarantee for repayment of the obligation. As a result, the sponsor and its other affiliates may have no financial obligation under the instrument, although one of those entities may retain the responsibility for servicing the underlying assets. Some sponsors do guarantee the performance of the underlying assets.

SSAP No. 86—Derivatives. Key excerpts from SSAP No. 86 are as follows:

The definition of a derivative instrument and forwards from SSAP No. 86, paragraph 4 and 5d:

4. “Derivative instrument” means an agreement, option, instrument or a series or combination thereof:
a. To make or take delivery of, or assume or relinquish, a specified amount of one or more underlying interests, or to make a cash settlement in lieu thereof; or

b. That has a price, performance, value or cash flow based primarily upon the actual or expected price, level, performance, value or cash flow of one or more underlying interests.

5.d. “Forwards” are agreements (other than futures) between two parties that commit one party to purchase and the other to sell the instrument or commodity underlying the contract at a specified future date. Forward contracts fix the price, quantity, quality, and date of the purchase and sale. Some forward contracts involve the initial payment of cash and may be settled in cash instead of by physical delivery of the underlying instrument.

Guidance on TBAs from the Annual Statement Instructions:

“‘To Be Announced” securities (commonly referred to as TBAs) are to be reported in Schedule D unless the structure of the security more closely resembles a derivative, as defined within SSAP No. 86—Derivatives, in which case the security should be reported on Schedule DB. The exact placement of TBAs in the investment schedules depends upon how a company uses TBA.

Excerpt from Annual Statement Instructions, Schedule D, Part 3 and 4 on Disposals / Acquisitions:

This schedule should include a detailed listing of all securities that were purchased/acquired during the current reporting year that are still owned as of the end of the current reporting year (amounts purchased and sold during the current reporting year are reported in detail on Schedule D, Part 5 and only in subtotal in Schedule D, Part 3). This should include all transactions that adjust the cost basis of the securities. Thus, it should not be used for allocations of TBAs to specific pools subsequent to initial recording in Schedule D, Part 3 or other situations such as CUSIP number changes.

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):

Reporting entity has filed a RTAS with the NAIC SVO.

Information or issues (included in Description of Issue) not previously contemplated by the Working Group:

The inaugural offering was the WI-K132 transaction (CUSIP: 3137H2NM2) which settled on September 28th, 2021 with the promised K-deal certificates being the K-132’s AM class. The K-132 class AM certificates (CUSIP: 3137H3EW8) were settled and delivered to the WI-K132 trust on October 14th, 2021. The purpose of this request is to evaluate the structure of the WI offering more broadly but the WI-K132 transaction may serve as a helpful example for evaluation. To that end the offering documents for both the WI-K132 and the related K-132’s certificate offerings are linked below. The webpage housing the base offering documents for the WI and K-Deal programs are also linked for ease of reference along with informational materials further detailing the WI program.

WI/K-Deal Base Offering Documents: http://capitalmarkets.freddiemac.com/mbs/legal/

WI Program Page: https://mf.freddiemac.com/investors/when-issued-k-deals.html
Video Overview of the WI Program: https://www.youtube.com/watch?v=Lv7YaPvNsop&feature=youtu.be
**Recommended Conclusion or Future Action on Issue:**
Sponsoring entity requests statutory accounting guidance to confirm that WI Trust SPCs shall be reported in scope of SSAP No. 43R—Loan-Backed and Structured Securities and not as a forward contract under SSAP No. 86—Derivatives.

**Recommended Party:**
State Farm Mutual Automobile Insurance Company
Mark Ludy, Staff Finance Analyst
Mark.E.Ludy.GC98@StateFarm.Com
March 8, 2022

**Staff Recommendation:**
NAIC staff recommends that the Working Group expose a tentative statutory accounting interpretation to clarify that investments in the Freddie Mac WI Program shall be captured in scope of SSAP No. 43R—Loan-Backed and Structured Securities from initial acquisition. Key elements for this recommendation include:

- The WI Program is fully guaranteed by Freddie Mac and ensures that the investor will receive pass-through certificates, backed by mortgage loans held in trust, that reflect the terms of the investment set at original acquisition. In the event that the K-Deal certificates cannot be acquired, Freddie Mac is guaranteed to provide payment to the investor that reflects the full principal and interest per the original terms of the agreement, which reflects the payments that would have been received overtime if K-Deal certificates had been acquired.

- The definition of a forward contract in SSAP No. 86 reflects an agreement between two parties that commit one party to purchase and another party to sell the instrument underlying the contract at a specified future date. With the WI Trust Program, the investor does not have a future commitment to acquire securities, as the investor acquires the WI Trust certificate on day one of the transaction and the investor is not required to convert the WI Trust certificates at any time. This WI Trust certificate is not a derivative instrument, as at the time of acquisition, the certificate reflects a tradeable investment in a trust structure backed by cash and a Freddie Mac guarantee of cash flows in accordance with terms established at original acquisition. In addition to having no variation to the investor as a result of an underlying interest, there is no requirement on the investor to take delivery of a different investment. The ability to convert the WI Trust certificate to a K-Deal certificate is strictly an election to the investor and is not a requirement to receive the pass-through cash flows per the terms of the initial investment.

- The WI Program, and resulting obligation of Freddie Mac, ultimately reflects an investment where the investor receives pass-through cash flows generated from mortgage loans acquired and held in trust. This is within the scope of SSAP No. 43R—Loan-Backed and Structured Securities, paragraphs 2-4.

- The WI Program, and treatment as a SSAP No. 43R security, is consistent with the current guidance for TBA securities when an insurer intends to take possession of the resulting mortgage-backed security. A TBA security reflects the pre-purchase of mortgage-backed securities prior to the finalization of the security issuance. Pursuant to the annual statement instructions, TBA securities are to be reported on Schedule D-1: Long-Term Bonds unless the structure more closely resembles a derivative. This determination depends on how a company uses the TBA. (For example, if a company intended to assume the mortgage-backed security once issued, the TBA would be captured on Schedule D-1 at initial acquisition. If a reporting entity was to continually trade/roll TBA exposures, this would be more characteristics of a derivative and would be captured on Schedule DB as a derivative.)
Staff Review Completed by: Julie Gann, NAIC Staff – March 14, 2022

Status:
On April 4, 2022, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing and exposed a tentative interpretation INT 22-01: Freddie Mac When-Issued K-Deal (WI Trust) Certificates to clarify that investments in the Freddie Mac “When Issued K-Deal” (WI) Program are in scope of SSAP No. 43R. This item has a shortened comment deadline of May 6.

On May 24, 2022, the Statutory Accounting Principles (E) Working Group adopted INT 22-01: Freddie Mac When-Issued K-Deal (WI Trust) Certificates to clarify that investments in the Freddie Mac “When Issued K-Deal” (WI) Program are in scope of SSAP No. 43R—Loan-Backed and Structured Securities from the date of initial acquisition.

https://naiconline.sharepoint.com/teams/frsstatutoryaccounting/national meetings/a. national meeting materials/2022/5-24-22/adoptions/22-08 - wi trust.docx
Interpretation of the
Statutory Accounting Principles (E) Working Group

INT 22-01: Freddie Mac When-Issued K-Deal (WI Trust) Certificates

INT 22-01 Dates Discussed

April 4, 2022; May 24, 2022

INT 22-01 References

SSAP No. 43R—Loan-Backed and Structured Securities
SSAP No. 86—Derivatives

INT 22-01 Issue

1. This interpretation is to address questions on the accounting and reporting for Freddie Mac “When-Issued K-Deal (WI Trust) Certificates” (WI Program). Ultimately, the question is whether the structure should be initially captured in scope of SSAP No. 43R—Loan-Backed and Structured Securities or as a forward contract in scope of SSAP No. 86—Derivatives.

2. The design of the WI Program is summarized as follows:

   a. Investor acquires WI Trust certificates, which are backed by cash held in the WI Trust and pay a fixed coupon amount funded from a Freddie Mac guarantee.

   b. Within 90 days, the trust uses the cash to acquire newly issued K-Deal structured pass-through certificates (SPCs) meeting certain pooling parameters laid out in the respective WI Offering Circular Supplement. K-Deal SPC(s) are Freddie Mac-issued structured pass-through certificates backed by the corresponding class of certificates issued by a separate REMIC trust that holds multifamily fixed-rate mortgage loans. The cash flows from the mortgage loans held by the REMIC trust provide pass-through payments to holders of the K-Deal SPCs.

   c. An investor can choose to continue to hold the WI Trust certificates or exchange dollar-for-dollar their WI-securities into the underlying K-Deal SPCs. In either case, the investor receives a pass-through of cash flows generated by the mortgages held in the REMIC trust and the performance of the K-Deal SPCs is guaranteed by Freddie Mac. If continuing to hold the WI Trust certificates – rather than convert the certificates to K-deal SPCs – the K-Deal SPCs are held by the WI Trust, who in turn passes the cashflows to WI Trust investors. The WI Trust certificates benefit from Freddie Mac payment guarantee which guarantees that any cashflows collected from the K-Deal SPCs will be paid to the WI certificate holders.

3. Additional characteristics on this program include the following:

   a. The WI Trust certificates are public securities and tradeable shortly after pricing.

   b. The WI Trust certificates are backed by a Freddie Mac guarantee from acquisition.

   c. From acquisition of the WI Trust certificates, the investor receives fixed coupon amounts reflective of the investment terms of the K-Deal SPCs.
d. The WI Trust is obligated to acquire, and Freddie Mac is required to sell, the K-Deal SPCs at the amount stated at the time of initial investment. Meaning, the investor is not at a risk of loss, nor will experience any variation in outcome due to underlying variables that occur from the time of initial investment in the WI Trust until the K-Deal SPCs are acquired. If market forces change the purchase price of the K-Deal SPCs during the 90-days after initial acquisition of the WI Trust certificates, then Freddie Mac is still required to sell the K-Deal certificates at the terms agreed to at original investment. Ultimately, the investor is guaranteed an investment in K-Deal SPCs that reflects the notional value of the WI Trust-certificates and coupon terms at initial acquisition. (For example, if the investor acquired $100 million of WI Trust certificates at acquisition, when the K-Deals are subsequently acquired, the entity will receive $100 million of K-Deal SPCs with the same payment terms regardless of any market impacts.)

e. In the event that Freddie Mac is unable to acquire the K-Deal SPCs within the 90-day period, Freddie Mac is required to return the principal to the investor as well as provide a yield maintenance payment calculated using the full coupon payments that would have been received over the course of the investment.

f. In the event that the investor elects to exchange the WI Trust certificates to the K-Deal SPCs, the investor receives an equivalent principal amount of the K-Deal SPCs of the same class. Although the investment will have a change in CUSIP, any such exchange is not deemed to be a taxable event as described in the respective Offering Circular Supplements for the WI Certificates. As such investors will not recognize a gain or loss on the exchange and investors will be treated as continuing to own the interests that were owned immediately prior to the exchange. Stated differently, any gains or losses on the exchanged WI-Certificates are “rolled into” the investors’ new K-Deal Certificate position.

4. The question of whether the structure is a loan-backed or structured security, or a derivative is primarily focused on the initial acquisition and the 90-day (or less) timeframe before the WI Trust acquires K-Deal certificates. The question is whether the initial 90-day acquisition of the WI Trust certificate, prior to the trust’s acquisition of the K-Deal certificates, represents a forward contract required to be accounted for under SSAP No. 86—Derivatives. Key excerpts from SSAP No. 86 are as follows:

a. The definition of a derivative instrument from SSAP No. 86, paragraph 4:

   4. “Derivative instrument” means an agreement, option, instrument or a series or combination thereof:

   a. To make or take delivery of, or assume or relinquish, a specified amount of one or more underlying interests, or to make a cash settlement in lieu thereof; or

   b. That has a price, performance, value or cash flow based primarily upon the actual or expected price, level, performance, value or cash flow of one or more underlying interests.

b. The definition of a forward contract from SSAP No. 86, paragraph 5.d.:

   5.d. “Forwards” are agreements (other than futures) between two parties that commit one party to purchase and the other to sell the instrument or commodity underlying the contract at a specified future date. Forward contracts fix the price, quantity, quality, and date of the purchase and sale. Some forward contracts involve the initial payment of cash and may be settled in cash instead of by physical delivery of the underlying instrument.
5. This interpretation intends to clarify whether investments in the Freddie Mac WI Program shall be initially captured in scope of SSAP No. 86—Derivatives or captured in scope of SSAP No. 43R—Loan-Backed and Structured Securities.

INT 21-01 Discussion

6. This interpretation clarifies that investments in the Freddie Mac WI Program shall be captured in scope of SSAP No. 43R—Loan-Backed and Structured Securities from initial acquisition, and not as a derivative forward contract, for the following reasons:

   a. The WI Program is fully guaranteed by Freddie Mac and ensures that the investor will receive pass-through certificates, backed by mortgage loans held in trust, that reflect the terms of the investment set at original acquisition. In the event that the K-Deal certificates cannot be acquired, Freddie Mac is guaranteed to provide payment to the investor that reflects the full principal and interest per the original terms of the agreement, which reflects the payments that would have been received overtime if K-Deal certificates had been acquired.

   b. The definition of a forward contract in SSAP No. 86 reflects an agreement between two parties that commit one party to purchase and another party to sell the instrument underlying the contract at a specified future date. With the WI Trust Program, the investor does not have a future commitment to acquire securities, as the investor acquires the WI Trust certificate on day one of the transaction and the investor is not required to convert the WI Trust certificates at any time. This WI Trust certificate is not a derivative instrument, as at the time of acquisition, the certificate reflects a tradeable investment in a trust structure backed by cash and a Freddie Mac guarantee of cash flows in accordance with terms established at original acquisition. In addition to having no variation to the investor as a result of an underlying interest, there is no requirement on the investor to take delivery of a different investment. The ability to convert the WI Trust certificate to a K-Deal certificate is strictly an election to the investor and is not a requirement to receive the pass-through cash flows per the terms of the initial investment.

   c. The WI Program, and resulting obligation of Freddie Mac, ultimately reflects an investment where the investor receives pass-through cash flows generated from mortgage loans acquired and held in trust. This investment dynamic is within the scope of SSAP No. 43R—Loan-Backed and Structured Securities, paragraphs 2-4:

2. Loan-backed securities are defined as securitized assets not included in structured securities, as defined below, for which the payment of interest and/or principal is directly proportional to the payments received by the issuer from the underlying assets, including but not limited to pass-through securities, lease-backed securities, and equipment trust certificates.

3. Structured securities are defined as loan-backed securities which have been divided into two or more classes for which the payment of interest and/or principal of any class of securities has been allocated in a manner which is not proportional to payments received by the issuer from the underlying assets.

4. Loan-backed securities are issued by special-purpose corporations or trusts (issuer) established by a sponsoring organization. The assets securing the loan-backed obligation are acquired by the issuer and pledged to an independent trustee until the issuer’s obligation has been fully satisfied. The investor only has direct recourse to the issuer’s assets, but may have secondary recourse to third parties through insurance or guarantee for repayment of the obligation. As a result, the sponsor and its other affiliates may have no financial obligation under the instrument, although one of those entities may retain the responsibility for servicing...
the underlying assets. Some sponsors do guarantee the performance of the underlying assets.

d. The WI Program, and treatment as a SSAP No. 43R security, is consistent with the current guidance for TBA securities when an insurer intends to take possession of the resulting mortgage-backed security. A TBA security reflects the pre-purchase of mortgage-backed securities prior to the finalization of the security issuance. Pursuant to the annual statement instructions, TBA securities are to be reported on Schedule D-1: Long-Term Bonds unless the structure more closely resembles a derivative. This determination depends on how a company uses the TBA. (For example, if a company intended to assume the mortgage-backed security once issued, the TBA would be captured on Schedule D-1 at initial acquisition. If a reporting entity was to continually trade/roll TBA exposures, this would be more characteristics of a derivative and would be captured on Schedule DB as a derivative.)

INT 22-01 Consensus

5. The Statutory Accounting Principles (E) Working Group reached a consensus that investments in the WI Trust Program shall be captured in scope of SSAP No. 43R—Loan-Backed and Structured Securities from initial acquisition.

6. If a reporting entity elects to convert WI Trust SPC securities into K-Deal SPC securities, the guidance in the Annual Statement Instructions, Schedule D, Part 3 and Part 4 shall be followed. Per that guidance, the transition from a WI Trust to a K-Deal shall not be reported as a disposal or acquisition. As the terms and cost basis of the SPC certificates would be identical, and the change would only reflect a CUSIP number change, a disposal and reacquisition shall not be recorded.

7. Excerpt from Annual Statement Instructions, Schedule D, Part 3 and 4:

This schedule should include a detailed listing of all securities that were purchased/acquired during the current reporting year that are still owned as of the end of the current reporting year (amounts purchased and sold during the current reporting year are reported in detail on Schedule D, Part 5 and only in subtotal in Schedule D, Part 3). This should include all transactions that adjust the cost basis of the securities. Thus, it should not be used for allocations of TBAs to specific pools subsequent to initial recording in Schedule D, Part 3 or other situations such as CUSIP number changes.

INT 22-01 Status

8. No further discussion is planned.

This page intentionally left blank.
On August 10, 2022, the Statutory Accounting Principles (E) Working Group adopted the following revisions to the As of March 2022 Accounting Practices and Procedures Manual. Documents associated with these revisions are linked to the reference items in bold text.

<table>
<thead>
<tr>
<th>Ref #</th>
<th>SSAP/Appendix</th>
<th>Title</th>
<th>Summary</th>
</tr>
</thead>
</table>
| 2021-20 | Exhibit A Excluded Components | Effective Derivatives - ASU 2017-12  
New SAP Concept | Revisions result with a new Exhibit A, replacing both Exhibit A and Exhibit B of SSAP No. 86—Derivatives that adopts with modification U.S. GAAP guidance in determining hedge effectiveness, and measurement guidance for excluded components. |
| 2022-01 | Preamble and SSAP No. 4  
SSAP No. 48  
SSAP No. 24 | Conceptual Framework - Updates  
SAP Clarification  
Effective Immediately (August 10, 2022) | Revisions incorporate updates from FASB Concepts Statement No. 8, Conceptual Framework for Financial Reporting—Chapter 4, Elements of Financial Statements, which updates the definitions of an asset. Also adopted Issue Paper No. 166—Updates to the Definition of an Asset to document the revisions. |
| 2022-02 | SSAP No. 48  
SSAP No. 24 | SSAP No. 48 - Alternative Valuation of Minority Ownership Interests  
SAP Clarification  
Effective Immediately (August 10, 2022) | Revisions clarify that the audit of an entity utilizing the U.S. tax basis equity valuation exception shall occur at the investee level. |
| 2022-04 | SSAP No. 24 | ASU 2021-10, Government Assistance  
SAP Clarification  
Effective Immediately (August 10, 2022) | Revisions incorporate certain disclosures from ASU 2021-10, Government Assistance, Disclosures by Business Entities about Government Assistance regarding terms and provisions of assistance received. |
| 2022-05 | SSAP No. 22R | ASU 2021-09, Leases, Discount Rates for Lessees  
SAP Clarification  
Effective Immediately (August 10, 2022) | Revisions reject ASU 2021-09, Leases Discount Rate for Lessees That Are Not Public Business Entities for statutory accounting. |
<table>
<thead>
<tr>
<th>Ref #</th>
<th>SSAP/Appendix</th>
<th>Title</th>
<th>Summary</th>
</tr>
</thead>
<tbody>
<tr>
<td>2022-06</td>
<td>SSAP No. 104R</td>
<td>ASU 2021-07, Compensation - Stock Compensation</td>
<td>Revisions incorporate the practical expedient from <em>ASU 2021-07, Compensation – Stock Compensation, Determining the Current Price of an Underlying Share for Equity-Classified Share-Based Awards</em> for the current price input, a required component for option-pricing models utilized in determining fair value for share-based payments.</td>
</tr>
<tr>
<td></td>
<td></td>
<td><em>SAP Clarification</em></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Effective Immediately (August 10, 2022)</td>
<td></td>
</tr>
<tr>
<td>2022-07</td>
<td>SSAP No. 47 SSAP No. 68</td>
<td>ASU 2021-08, Business Combinations</td>
<td>Revisions reject <em>ASU 2021-08, Business Combinations, Accounting for Contract Assets and Contract Liabilities from Contracts with Customers</em> for statutory accounting. Revisions in SSAP No. 68 also note that rejection does not impact the determination of U.S. GAAP book value in an acquired entity.</td>
</tr>
<tr>
<td></td>
<td></td>
<td><em>SAP Clarification</em></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Effective Immediately (August 10, 2022)</td>
<td></td>
</tr>
</tbody>
</table>

https://naiconline.sharepoint.com/teams/frsstatutoryaccounting/national meetings/a. national meeting materials/2022/7-summer nm/adoptions/adoptions 8.10.2022 toc.docx
Issue: Effective Derivatives – ASU 2017-12

Check (applicable entity):

<table>
<thead>
<tr>
<th>Modification of existing SSAP</th>
<th>P/C</th>
<th>Life</th>
<th>Health</th>
</tr>
</thead>
<tbody>
<tr>
<td>New Issue or SSAP</td>
<td></td>
<td>☒</td>
<td>☒</td>
</tr>
<tr>
<td>Interpretation</td>
<td>☒</td>
<td>☒</td>
<td>☒</td>
</tr>
</tbody>
</table>

Description of Issue:
To be consistent with what is permitted under U.S. GAAP, this agenda item has been prepared to consider expanding the statutory accounting principles (SAP) guidance in SSAP No. 86—Derivatives in the determination of highly effective hedging derivatives. In 2017, the FASB issued Accounting Standard Update (ASU) 2017-12: Derivatives and Hedging: Targeted Improvements to Accounting for Hedging Activities to reduce complexity and align hedge accounting with risk management activities. The Working Group previously considered limited revisions from this ASU, mostly on documentation requirements, which occurred in agenda item 2018-30: SSAP No. 86 – Hedge Effectiveness Documentation. That agenda item was identified as limited-scope and noted further consideration of ASU 2017-12, potentially in a broader derivative project, would subsequently occur. With the focus of other projects, and COVID-19 impacts, this broader derivative project is still pending.

NAIC staff have been contacted by industry and regulators requesting further consideration of ASU 2017-12, particularly with regards to the permitted derivative arrangements that U.S. GAAP allows as highly effective hedges. Due to the revisions from ASU 2017-12, there is a disconnect between U.S. GAAP and SAP regarding certain types of effective hedging relationships. This is problematic as it results in inconsistent documentation of hedging transactions, as well as hinders reporting entities in electing to enter hedging transactions as the benefits are not currently permitted to be reflected in statutory financials.

Although NAIC staff agree that the determination of whether a hedge is highly effective should be consistent between U.S. GAAP and SAP, it is important to highlight that accounting for effective hedges varies greatly between U.S. GAAP and SAP. The effective hedging relationships permitted under ASU 2017-12 have been identified to expand upon these differences and could result with reporting elements that were not originally intended with the statutory accounting guidance adopted under SSAP No. 86. Although consistent effective hedge assessments between U.S. GAAP and SAP are desired, NAIC staff note that it is appropriate to identify how the expanded U.S. GAAP effective hedge assessments would be reflected within statutory financials and identify areas where clarifications or modifications may be needed as part of the process to consider the expanded effective hedge provisions. To be clear, the expanded hedge relationships permitted within ASU 2017-12 do not create the statutory accounting issues identified within this agenda item, however, the expanded effective hedging relationships would exacerbate the reporting issues within SSAP No. 86. (For example, although existing SAP guidance permits derivative adjustments to the hedged item, which can be a liability, such transactions are currently limited as the maturity of the hedging instruments (derivative) likely mirrors the hedged item’s maturity. This is because the matching of maturities under the current SAP guidance facilitates an easier effective hedge determination.) With the ASU’s expanded provisions for “partial term hedges” (as discussed within), adjustments will occur to the hedged item prior to its maturity, resulting in direct impacts to the presentation of the hedged item in statutory financial statements – which may not be easily identifiable to users.)
Overview of U.S. GAAP and SAP Derivative Reporting:

Under U.S. GAAP, the decision to document a hedge as effective has no impact on the balance sheet measurement of the derivative. Under U.S. GAAP, all derivatives are always reported at fair value; therefore, there is no “off-balance sheet” derivative risk exposure. As highly effective hedging derivatives are an income-statement matching tool, when a fair value hedge is effective, the change in fair value of the derivative offsets the change in fair value of the hedged item in the income statement. For cash flow hedges, changes in the fair value of the derivative are reported through other comprehensive income (OCI) and amortized into earnings. When a derivative is not identified as highly effective, the matching of changes through the income statement simply does not occur. Regardless of whether a derivative is used in a highly effective hedge, under U.S. GAAP all derivatives are fully recognized on the balance sheet with fair value changes or cash flows from the derivatives fully recognized either to income or OCI.

Under SAP, the determination of an effective hedge has a significant impact on the reported value of derivatives and the presentation of derivatives in the financial statements. As the statutory guidance permits derivatives to mirror the measurement method of the hedged item, if the hedged item is reported at amortized cost, then a highly effective derivative is also reported at amortized cost. (Under U.S. GAAP, the reporting basis of the hedged item in a fair value hedge is made to match the derivative (i.e., fair value). The opposite is true under SAP.) It should be noted that SSAP No. 86 was originally drafted based on an assumption that it would predominantly be used for the hedging of assets reported at amortized cost or fair value. Hedges of liabilities, particularly reserve liabilities valued using statutory reserve requirements, do not fit neatly into the amortized cost or fair value framework permitted by SSAP No. 86. Such liabilities are not valued using either fair value or amortized cost, therefore reporting the hedging instrument at amortized cost still creates reporting mismatches. Furthermore, adjustments to the hedged item, as permitted under SSAP No. 86, can result with a financial statement presentation that appears to show a reduction of a liability, although the reporting entity’s contractual obligation has not been reduced.

If using an amortized cost measurement method, the initial recognition of the derivative is at cost (which could be zero), and subsequent changes in the fair value of the derivative are not recognized. So, if the fair value of the derivative was to move to a liability position (effectively offsetting a fair value increase in a hedged item), the derivative liability is not recognized. The derivative side of this transaction is considered an off-balance sheet surplus risk that exists until the hedging relationship expires. If a hedging relationship was no longer highly effective, the derivative would be recognized at fair value. At that time, the financial statements would reflect the derivative position that was outstanding. (For a derivative in a liability position, this would be a negative impact to surplus.) As one last point, the determination of a highly effective hedge generally permits a range between 80-125%. As such, a derivative instrument’s fair value that is expected to move in conjunction within a range of 20-25% of the underlying hedged item’s fair value is considered an effective hedge. Under the SAP guidance, this means that if the fair value of the hedged asset was to increase 100 and the fair value of the hedging derivative was to decrease 120, the hedge would still be considered effective and the change in the derivative fair value would not be recognized in the financial statements. At the time the asset matured, and the derivative was closed, the reporting entity would have an additional liability of $20 that was not previously recognized on the financial statements and not offset by the corresponding increase in the hedged item.

While it is important that the impact of the SAP hedging guidance be clearly understood, as initially noted, NAIC staff agree that assessments of hedge effectiveness are preferred to be consistent between U.S. GAAP and SAP. However, by expanding the SAP guidance to permit effective hedges allowed under ASU 2017-12, pursuant to the existing measurement provisions within SSAP No. 86, there would be an increase to the off-balance sheet surplus risk noted above from the hedging activity. Also note, this increase in off-balance sheet exposure does not necessarily correlate to an increase in economic risk, as the hedging relationships allowed under the GAAP ASU are expected to allow for prudent risk management strategies that would be expected to decrease economic risk. In addition, other nuances in SAP reporting have the potential to be more pronounced under the expanded effective hedge assessments. As detailed within the recommendation section, NAIC staff recommend review, with possible modification, of certain elements within SSAP No. 86 as part of this review of ASU 2017-12. However, these
recommendations do not initially include a fundamental change in the SAP provisions that permit an amortized cost measurement method for highly effective derivatives if hedging an item not reported at fair value. Regulator and industry comments are welcome on whether a fundamental change to the measurement and reporting of derivatives should be considered to be consistent with U.S. GAAP. If there is support for a fair value measurement approach for all derivatives, then consideration of offsetting surplus adjustments for the fair value volatility – similar to what is permitted in SSAP No. 108—Derivatives Hedging Variable Annuity Guarantees would also be considered.

**Review of Effect Hedge Arrangements Permitted Under ASU 2017-12:**

The derivative arrangements / changes permitted under U.S. GAAP through ASU 2017-12 and addressed within this agenda item are identified as follows:

- Partial Term Hedging
- Last of Layer
- Hedges of Interest Rate Risk When the Hedged Item Can be Settled Before Scheduled Maturity
- Expansion of Excluded Derivative Components in Assessment of Hedge Effectiveness

**Partial Term Hedging:**

This provision allows reporting entities to enter into fair value hedges of interest rate risk for only a portion of the term of the hedged financial instrument. Prior to the ASU, these sorts of arrangements were not successful in being identified as highly effective due to offsetting changes in the fair value as a result of the difference in timing between the hedged item’s principal repayment and the maturity date of the hedging derivative. Under ASU 2017-12, an entity may measure the change in the fair value of the hedged item attributable to changes in the benchmark interest rate by “using an assumed term that begins when the first hedged cash flow begins to accrue and ends when the last hedged cash flow is due and payable.” Also, the hedged item’s assumed maturity will be the date on which the last hedged cash flow is due and payable, therefore a principal payment will be assumed to occur at the end of the specified partial term.

The example provided under U.S. GAAP involves outstanding fixed rate debt. So, if an entity was to issue $100 million of five-year, noncallable, fixed-rate debt, the entity could designate a two-year, receive-fixed, pay variable, $100 million notional interest rate swap as a fair value hedge of the interest rate risk for the first two years of the debt’s term. When calculating the change in the fair value of the debt attributable to changes in interest rate risk, the entity may assume that 1) the term of the hedged debt is two years, and 2) repayment of the outstanding debt occurs at the end of the second year. The ASU also permits use of the shortcut method to these partial-term fair value hedges of interest rate risk.

**SAP Assessment** – With the differences in reporting between U.S. GAAP/SAP, the key issue to highlight is that with SAP’s amortized cost approach at the conclusion of the hedged period, the reporting entity would close the derivative with an offsetting entry that adjusts the basis of the hedged item. When hedging a liability (such as issued debt), if the derivative were in a liability position (satisfied with a credit to cash), the mechanics would result in an offsetting entry to reduce the debt (debit to the issued debt). However, this reduction to the debt does not reflect an actual reduction of the liability that the entity is legally obligated to pay, it just reduces the amount reported as outstanding debt in the financial statements. The debt would accrete back up to the full liability with increased entries to interest expense over the remaining term of the debt. (Ultimately, under GAAP, the fair value change in the derivative and debt are recognized concurrently in the income statement. Since SAP does not report these items at fair value, the change reduces the debt at the time of derivative close, and then the debt obligation accretes back up over time with an offsetting entry to interest expense.) Although this is in line with existing SSAP No. 86 guidance, under the past effective hedge provisions, the debt obligation maturity would likely be matched with the derivative term, so there would be no lingering financial statement impact to the debt obligation after the derivative transaction closed. With the partial term hedge, reporting entities have the potential to present an improved financial statement presentation over the remaining life of the hedge item (e.g., debt instrument) until accreted back to the full amount. The SAP guidance also has an alternative to take the adjustment directly to IMR (instead of to the
hedged item). There is uncertainty on which approach is used in practice, and whether it varies based on the hedged item (e.g., hedging an asset or liability). Although there is a limited information in Schedule DB on adjustments to the hedged item, that information is only for the current year, and it does not provide detailed information on the overall impact to the financial statements.

**Items to Consider:** Although the current guidance in SSAP No. 86 is explicit that the effective hedge adjusts the basis of the hedged item (or is reflected in IMR), the Working Group may want to consider revising this guidance to prevent a presentation that shows a reduced outstanding liability when in fact there has been no actual reduction of the obligation. Consideration could be given to directing these derivative adjustments to a specific reporting line. Although this would not change the overall financial statements, (a more favorable presentation could still exist), the debt obligation (or any liability hedged) would still be presented as the amount that corresponds to the obligation outstanding and not reflect the impact of derivative transactions. Furthermore, if a specific line was utilized, the impact of these derivative transactions would be identifiable within the financial statements. As noted, this dynamic exists under the current SSAP No. 86 guidance, but is less pronounced as the derivative term most commonly matches the debt’s obligation term. As such, the final resulting entries all occur (generally) at debt maturity. With the increased ability to establish effective hedges that do not mature at the same time as the hedged item, the impact from these derivative transactions would increase situations in which liabilities are presented that do not reflect the full outstanding obligation.

*Staff Note – The adjustment to the hedged item also occurs when effectively hedging an asset item. However, in that dynamic for a fair value hedge, the assets would only be increased to reflect the fair value change. (The offsetting entry in response to a derivative in a liability position would be a debit to the hedged asset.) Although the use of effective derivatives may facilitate an ability to increase the reported value of assets to current fair value, the amount reported for the asset would still be subject to impairment and collectability assessments. NAIC staff view this dynamic differently than a hedge of a liability when the resulting transaction reduces the amount shown as an obligation on the financial statements (debit to the liability) as nothing has occurred that has actually reduced the reporting entity’s obligation.*

**Last of Layer / Portfolio Method**

Under the “last of layer” hedge method, for a closed portfolio of prepayable financial assets, the entity may designate as the hedged item, a stated amount of the asset or assets that are not expected to be affected by prepayments, defaults and other factors affecting the timing and amount of cash flows if the designation is made in conjunction with the partial term hedging election. The “last of layer” hedge provision is permitted only for a closed portfolio of prepayable financial assets, or one or more beneficial interests secured by a portfolio of prepayable financial instruments (e.g., mortgage-backed securities). Industry comment letters to FASB have requested that liabilities, particularly insurance liabilities, be added to the scope, but that is not currently permitted under U.S. GAAP.

For this option, as part of the initial hedge documentation, an analysis shall be completed and documented to support the entity’s expectation that the hedged item (that is, the designated last of layer), is anticipated to be outstanding as of the hedged item’s assumed maturity date in accordance with the entity’s partial-term hedge election. That analysis shall incorporate the entity’s current expectations of prepayments, defaults, and other events affecting the timing and amount of cash flows associated with the closed portfolio of prepayable financial assets or beneficial interests secured by a portfolio of prepayable financial instruments. For purposes of the analysis, the entity may assume that as prepayments, defaults, and other events affecting the timing and amount of cash flows occur, they first will be applied to the portion of the closed portfolio of prepayable financial assets or one or more beneficial interest that is not part of the hedged item - (i.e., not part of the designated last layer.)

Proposed amendments to the ASU are currently being considered by the FASB to provide additional clarifying guidance. One of those elements clarifies that a closed portfolio is not limited to a single hedge. Rather, there can be multiple-layer hedges utilized in a closed portfolio. In response to this proposed clarification, the FASB is changing the name of “last of layer” and renaming it the “portfolio layer method.” Also, since the hedged item reflects a closed portfolio of assets, the FASB has clarified that the change in fair value (gain or loss) of the hedged
item (portfolio of assets) attributed to the hedged risk shall not adjust the carrying value of the individual assets in the portfolio. Instead, that amount shall be maintained on a closed portfolio basis and amortized to earnings, with amortization beginning when the hedged item ceases to be adjusted for changes in its fair value attributable to the risk being hedged. However, the gain or loss shall be fully amortized prior to the assumed maturity date of the hedged item. (Note: FASB has identified that allocating adjustments to individual assets may lead to uneconomic results if an asset is sold or removed from a closed portfolio. They have also noted that an allocation election would lead to a lack of comparability across entities and potential for earning management.)

A key aspect to note is that the GAAP guidance will allow a single derivative to hedge different portfolio layers. In the event one layer was to no longer be considered highly effective, the portion of the derivative to hedge that layer would be removed, and the effective hedge for the remaining layers could continue.

SAP Assessment: For the last of layer / portfolio method, the overall accounting guidance under U.S. GAAP is consistent with existing derivative structures, just expanded on what can be designated as the hedged item and an exception that the entity shall not adjust the basis of the individual items combined into the portfolio. The biggest aspect with this change will be the assessment and documentation to confirm hedge effectiveness. This hedging option will require more work and documentation than a hedge of a single asset. However, if a reporting entity is effectively hedging under GAAP, without the SAP provisions for hedge accounting, then a reporting entity would have to recognize the hedging derivatives at fair value, which would create surplus volatility in their SAP financials.

Items to Consider: Although it seems that the derivative transaction is generally consistent with what would be anticipated under SSAP No. 86, except on a portfolio basis, there are key elements that should be addressed to facilitate the application of these methods under SAP:

- Incorporating the last of layer / portfolio method into SAP will require discussion (and likely revisions) to ensure that individual assets are not adjusted at hedge termination, and that a portfolio approach is utilized. This would be consistent with the current direction of FASB to clarify the guidance in a subsequent ASU. If revisions are not incorporated to have a “portfolio” basis for adjustment, then revisions will be needed on how to allocate the resulting gain/loss to the individual assets within the closed portfolio.

- Guidance should be considered to limit this derivative strategy to the same scope permitted under U.S. GAAP. This would require an explicit prohibition of the last of layer / portfolio method to liabilities, including insurance liabilities. Although the “framework” of U.S. GAAP derivative guidance is adopted in SSAP No. 86, statutory accounting guidance permits hedging transactions to be classified as highly effective when they would not be permitted that classification under U.S. GAAP. As such, limiting application to the same parameters of U.S. GAAP would be a new addition to SSAP No. 86.

- A key aspect of this proposed method (and of the excluded components expansion discussed below) is that under U.S. GAAP derivatives are permitted to be bifurcated in terms of effectiveness. That is, if a portion of a derivative were deemed to be highly effective in hedging an item, the fair value change related to that portion would be recognized in the income statement to match the fair value change of the hedged item. Fair value changes to other portions of the derivative that were not highly effective would still be recognized, but without the matching concept to the same reporting location as the fair value changes of the hedged item. Under SSAP No. 86, the guidance is explicit that a derivative is not bifurcated as to hedge effectiveness. So, a derivative shall be either classified as an effective hedge and permitted for amortized cost reporting (if consistent with the valuation of the hedged item) or classified as an ineffective hedge and reported at fair value. To mirror U.S. GAAP on the ability to designate a portion of a derivative, revisions would need to be considered to the current SSAP No. 86 guidance. If revisions permit the bifurcating of derivatives, then consideration would have to occur on how bifurcated derivatives would be reported in the Schedule DB – Derivative Instruments. (Particularly, on whether the derivative BACV should reflect a combined fair value (FV) and amortized cost (AC) reported value or whether the derivative shall be divided and reported separately based on portions held at FV and AC.) NAIC staff have heard that bifurcating
derivatives does already occur in practice, as the guidance in SSAP No. 86 - Exhibit B for the exclusion of the time value of money implies that it should be permitted. From initial information received from industry, in those limited situations it is believed that the derivative is reported on a single line with a combined BACV that reflects a combination of FV and AC. However, NAIC staff believe these instances are uncommon, but would become more prominent if the last of layer / portfolio method approach was adopted for statutory accounting.

- Lastly, it is proposed that this method only be incorporated once the proposed ASU is finalized. (The last of layer is detailed in the 2017 ASU, but the clarifying guidance is in a current proposed ASU which is expected to be finalized by the end of the year.)

**Fair Value Hedges of Interest Rate Risk in Which the Hedged Item Can be Settled Before Scheduled Maturity:**
Under these U.S. GAAP revisions, an entity may consider only how changes in the benchmark interest rate affect the decision to settle the hedged item before its scheduled maturity. (For example, an entity may consider only how changes in the benchmark interest rate affect an obligor’s decision to call a debt instrument - when it has a right to do so.) The entity need not consider other factors that would affect this decision (for example, credit risk) when assessing hedge effectiveness.

With this provision, U.S. GAAP guidance has also been added to specify the measurement of the hedged item. This guidance indicates that the factors incorporated for the purpose of adjusting the carrying amount of the hedged item shall be the same factors that the entity incorporated for the purpose of assessing hedge effectiveness. For example, if an entity considers only how changes in the benchmark interest rate affect an obligor’s decision to prepay a debt instrument when assessing hedge effectiveness, it shall also only consider that factor when adjusting the carrying amount of the hedged item. The election to consider only how changes in the benchmark interest rate affect an obligor’s decision to prepay a debt instrument does not affect an entity’s election to use either the full contractual coupon cash flows or the benchmark rate component of the contractual coupon cash flows determined at hedge inception for purposes of measuring the change in fair value of the hedged item. With this guidance, an investor is not required to consider all factors that will affect the decision to settle the financial instrument before its scheduled maturity when assessing hedge effectiveness and measuring the change in fair value of the debt attributed to changes in the benchmark interest rate. This change was made as estimating the fair value of the prepayment option to the level of precision required in the current reporting and regulatory environment is virtually impossible because an entity is required to incorporate credit and all other idiosyncratic factors that would affect the prepayment option. It was noted that allowing a prepayment option to be modeled considering only the change in the benchmark interest rate more closely aligns the accounting for those hedges with an entity’s risk management activities and more accurately reflects the change in the fair value of the hedged item attributable to interest rate risk.

**SAP Assessment:** Existing guidance in SSAP No. 86 incorporates the prior criteria for fair value hedges from U.S. GAAP, which includes guidance that has been eliminated in the ASU. The U.S. GAAP guidance has been expanded to specifically capture elements related to assessing effectiveness of prepayable instruments.

**Items to Consider:** Like other elements, the change in assessment of effectiveness, and determining the measurement / adjustment to the hedged item will require SAP consideration as to the offsetting measurement aspects and how those should be recognized in the financial statements.

**Expansion of Excluded Derivative Components from Assessment of Hedge Effectiveness**
Industry has also requested consideration of the FASB guidance that expands the ability to exclude components of a derivative from the assessment of hedge effectiveness. Under prior U.S. GAAP (which is adopted in SSAP No. 86), the guidance permitted the exclusion of the time value of money, and the guidance in the ASU has expanded that prior capability to also allow exclusion of the portion of the fair value of a currency swap attributable to a cross-currency basis spread.

© 2022 National Association of Insurance Commissioners
**SAP Assessment:** The current guidance in SSAP No. 86, Exhibit B – Assessment of Hedging Effectiveness incorporates U.S. GAAP guidance from FAS 133, with a significant portion addressing the exclusion of a hedging instrument’s time value from the assessment of hedging effectiveness. This old U.S. GAAP guidance has been revised from ASU 2017-12, to expand the potential exclusions and update the related guidance. As previously noted, the existing guidance in Exhibit B appears to contradict the guidance in SSAP No. 86 that specifically indicates that derivatives shall not be bifurcated for effectiveness. (The guidance in Exhibit B notes that changes in the excluded components would be included in unrealized gains and losses – which would represent a fair value measurement for these pieces, even if the derivative was classified as highly effective and reported at amortized cost.)

**Items to Consider:** Although the SSAP No. 86 Exhibit B guidance has incorporated prior U.S. GAAP guidance for excluding components, the guidance for these permissions does not align with the guidance in the body of SSAP No. 86. To ensure clear and consistent application, revisions would need to be considered to specify the reporting when changes in the fair value of a derivative are separated and treated differently.

**Existing Authoritative Literature:**
SSAP No. 86—Derivatives is the authoritative source of guidance for determining hedge effectiveness and reporting derivatives for statutory accounting. Key aspects to highlight from this SSAP for consideration as part of this agenda item:

- U.S. GAAP and SAP differ with regards to the reporting of derivatives. Under U.S. GAAP, all derivatives are reported at fair value. When a derivative represents a highly effective hedge, the process to recognize changes in fair value through the income statement in earnings or OCI is designed to mirror the recognition of fair value changes in the hedged item. (Under U.S. GAAP, highly effective hedges result in an income statement matching mechanism.) Under SAP, derivatives are reported differently based on whether they are used in a highly effective hedge. If highly effective, then the derivative measurement method mirrors the measurement method of the hedged item – which could be amortized cost. If not highly effective, then the derivative measurement method is fair value.

- Under U.S. GAAP, a fair value hedge approach requires that the hedged item be reported at fair value. (This allows for the matching of fair value changes of the hedged item and the hedging instrument (derivative) through the income statement.) This is not a required element under SAP. This GAAP-to-SAP difference makes sense as it allows companies that have highly effective hedges under U.S. GAAP to also identify those relationships as highly effective under SAP even though SAP uses an amortized cost (or other non-fair value) measurement method for hedged items.

- Assessment and determination of hedge effectiveness has generally been consistent between U.S. GAAP and SAP. The guidance in SSAP No. 86, Exhibit B – Assessment of Hedging Effectiveness, identifies the intent to remain consistent with U.S. GAAP with respect to assessing hedge effectiveness.

- Although the guidance in SSAP No. 86 prescribes the general concepts for hedges, as well as the measurement guidance for derivatives based on whether they are (or not) highly effective, the application guidance is detailed in Exhibit C – Specific Hedge Accounting Procedures for Derivatives. These procedures are SAP specific due to the fundamental differences in measurement and recognition of derivatives between U.S. GAAP and SAP.

**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 2018-30: SSAP No. 86 – Hedge Effectiveness Documentation considered the revised hedge effectiveness documentation provisions incorporated within ASU 2017-12, Derivatives and hedging. The
revisions from this agenda item were adopted Nov. 15, 2018 and were effective Jan. 1, 2019, with early adoption permitted. U.S. GAAP filers could only early adopt if they also early-adopted ASU 2017-12.

- Agenda item 2017-33 was drafted to continue the overall accounting and reporting changes in ASU 2017-12 as potential substantive revisions. This item is still pending for statutory accounting. Although still pending, it is recommended that the 2021 limited-scope edits requested by industry be captured in this new agenda item, with agenda item 2017-33 retained as a broader scope project to review other derivative concepts, or subsequently disposed if no longer needed.

Information or issues (included in Description of Issue) not previously contemplated by the Working Group: None

Staff Recommendation:
It is recommended that the Working Group move this agenda item to the active listing, categorized as new SAP concepts, and direct NAIC staff to work with regulators and industry in assessing and developing revisions to facilitate effective hedge assessments consistently between SAP and U.S. GAAP. As this guidance will reflect a change from the original concepts reflected in SSAP No. 86, it is recommended that the revisions be detailed in an issue paper for historical reference. This issue paper is recommended to be completed concurrently or subsequently to the consideration of SSAP revisions. The anticipated revisions from this agenda item are considered to reflect new SAP concepts as the effective hedge relationships that will be assessed have not been allowed under existing statutory accounting guidance.

As detailed within this agenda item, the discussion, and potential revisions, are expected to encompass the following elements:

- Appropriate reporting lines for effective hedges when the hedged item is a liability.
- Recognition of hedged-item adjustments (to a closed portfolio) when the last-of-layer / portfolio method of hedging is used.
- Scope limitations of the last of layer / portfolio method to mirror U.S. GAAP.
- The potential bifurcation of derivatives, and how such items should be reported for statutory accounting, when only portions of derivatives are permitted to be designated as effective. (This pertains to potential mixed-measurement reporting values.)

As detailed above, the Working Group also welcomes comments from regulators and industry on whether a fundamental change in SAP for derivative measurement (to be more consistent with U.S. GAAP) should be considered. Although specific revisions are not yet detailed, it is recommended that this agenda item be exposed to solicit comments and feedback on the overall summary and potential revisions to be considered.

Status:
On December 11, 2021, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as substantive, and directed NAIC staff to work with regulators and industry in assessing and developing revisions to facilitate effective hedge assessments consistently between U.S. GAAP and statutory accounting.

On April 4, 2022, the Statutory Accounting Principles (E) Working Group exposed two documents for public comment. The first document (labeled 21-20 SSAP No. 86 – Exhibit A 3-2-22), proposes revisions in the form of a new Exhibit A (which will replace both Exhibit A and Exhibit B of SSAP No. 86 that adopts with modification U.S. GAAP guidance in determining hedge effectiveness. The second document (labeled 21-20 SSAP No. 86 – Excluded Components - 3-17-22), proposes measurement methods for excluded components in hedging.
instruments. The Working Group also directed staff to continue to work with industry representatives on other elements within ASU 2017-12: Derivatives and Hedging: Targeted Improvements to Accounting for Hedging Activities.

On August 10, 2022, the Statutory Accounting Principles (E) Working Group took the following actions:

1. Adopted as final, the exposed revisions:

   - NewThe first supplemental document’s (labeled 21-20 SSAP No. 86 – Exhibit A 38-210-22) revisions result in a new Exhibit A (which will replace both Exhibit A and Exhibit B) of SSAP No. 86 that adopts, with modification, U.S. GAAP guidance in determining hedge effectiveness.

   - Revisions to SSAP No. 86 to incorporate measurement methods for excluded components. The second supplemental document’s (labeled 21-20 SSAP No. 86 – Excluded Components - 3-178-10-22) revisions result in updated measurement methods for excluded components of hedging instruments.

2. Adopted as final revisions, illustrated below, which detail the January 1, 2023, effective date, with early adoption permitted, and relevant U.S. GAAP references.

3. Directed a blanks proposal to incorporate Schedule DB reporting fields and templates to capture the new disclosures for excluded components detailed in paragraph 41g of the exposed revisions.

4. Directed an Issue Paper to detail the derivative revisions from this agenda item and other statutory derivative revisions resulting from ASU 2017-12 and other recent U.S. GAAP issuances.

SSAP No. 86 Revisions

Relevant Literature

64. This statement adopts the framework established by FAS 133, FASB Statement No. 137, Accounting for Derivative Instruments and Hedging Activities—Deferral of the Effective Date of FASB Statement No. 133, An amendment of FASB Statement No. 133 (FAS 137) and FASB Statement No. 138, Accounting for Certain Derivative Instruments and Certain Hedging Activities, An amendment of FASB Statement No. 133 (FAS 138), for fair value and cash flow hedges, including its technical guidance to the extent such guidance is consistent with the statutory accounting approach to derivatives utilized in this statement. This statement adopts the provisions of FAS 133 and 138 related to foreign currency hedges. With the exception of guidance specific to foreign currency hedges and amendments specific to refining the hedging of interest rate risk (under FAS 138, the risk of changes in the benchmark interest rate would be a hedged risk), this statement rejects FAS No. 137 and 138 as well as the various related Emerging Issues Task Force interpretations. This statement adopts paragraphs 4 and 25 of FASB Statement No. 149: Amendment of Statement 133 on Derivative Instruments and Hedging Activities (FAS 149) regarding the definition of an underlying and guidance for assessing hedge effectiveness. (The adoption from FAS 149 on the assessment of hedge effectiveness is impacted by the adoption with modification of guidance from ASU 2017-12 as detailed in paragraph 65.b., with the guidance from ASU 2017-12 superseding the prior adoption to the extent applicable.) All other paragraphs in FAS 149 are rejected as not applicable for statutory accounting. This statement adopts FSP FAS 133-1 and FIN 45-5: Disclosures about Credit Derivatives and Certain Guarantees, An Amendment of FASB Statement No. 133 and FASB Interpretation No.45 and Clarification of the Effective Date of FASB Statement No. 161 (FSP FAS 133-1 and FIN 45-4) and requires disclosures by sellers of credit derivatives. This statement rejects FSP FIN 39-1, Amendments of FASB Interpretation No. 39, and ASU 2014-03, Derivatives and Hedging – Accounting for Certain Receive-Variable, Pay-Fixed Interest Rate Swaps – Simplified Hedge Accounting Approach.
This statement adopts, with modification, certain revisions to ASC 815-20 included in ASU 2017-12. Remaining provisions of ASU 2017-12 will be subsequently assessed for statutory accounting and shall not be considered adopted for statutory accounting until that assessment is complete.

a. Revisions effective January 1, 2019, with early adoption permitted. This adoption is limited to specific provisions, and related transition guidance, pertaining to the documentation and assessment of hedge effectiveness and only includes: 1) provisions allowing more time to perform the initial quantitative hedge effectiveness assessment; 2) provisions allowing subsequent assessments of hedge effectiveness to be performed qualitatively if certain conditions are met; and 3) revisions regarding use of the critical terms and short-cut methods for assessing hedge effectiveness.

b. Revisions effective January 1, 2023, with early adoption permitted, are limited to the criteria for initial and subsequent hedge effectiveness detailed in the FASB Accounting Standards Codification (ASC) paragraphs 815-20-25-72 through 815-20-35-20, as modified through the issuance of ASU 2017-12. This adoption reflects statutory modifications to specify that the accounting and reporting of hedging instruments, including excluded components of the instruments, shall follow statutory specific guidance detailed in the statement. The intent of this guidance is to clarify that the determination of whether a hedging instrument qualifies as an effective hedge shall converge with U.S. GAAP, but that the measurement method shall continue to follow statutory specific provisions. The adoption of the referenced ASC paragraphs only extends to revisions incorporated through ASU 2017-12; therefore, any subsequent U.S. GAAP edits would require statutory accounting consideration before considered adopted.

The remaining provisions of ASU 2017-12 will be subsequently assessed for statutory accounting and shall not be considered adopted for statutory accounting until that assessment is complete.

Effective Date and Transition

This statement is effective for derivative transaction entered into or modified on or after January 1, 2003. A modification is any revision or change in contractual terms of the derivative. SSAP No. 31 applies to derivative transaction prior to January 1, 2003. Alternatively, an insurer may choose to apply this statement to all derivatives to which the insurer is a party as of January 1, 2003. In either case, the insurer is to disclose the transition approach that is being used.

a. Revisions adopted to paragraph 64 to reject FSP FIN 39-1 is effective January 1, 2013, for companies that have previously reported a position in the balance sheet that was net of counterparty agreements. (Companies that have previously reported derivative instruments and/or related collateral gross shall not be impacted by these revisions.)

b. Revisions adopted in paragraph 16 clarify the reporting for amounts received/paid to adjust variation margin until the derivative contract has ended and are effective January 1, 2018, on a prospective basis, for reporting entities that have previously considered these amounts to reflect settlement or realized gains/losses. (Companies that have previously reported variation margin changes in line with the revisions shall not be impacted by these revisions.)

c. Revisions to incorporate limited provisions from ASU 2017-12 pertaining to the documentation of hedge effectiveness (detailed in paragraph 65) are effective January 1, 2019, with early adoption permitted for year-end 2018. However, if the reporting entity is a U.S. GAAP filer, the reporting entity may only elect early adoption if the entity has also elected early adoption of ASU 2017-12 for year-end 2018.

d. Revisions adopted April 2019 to explicitly include structured notes in scope of this statement are effective December 31, 2019. Revisions adopted July 2020 to define “derivative premium,” require gross reporting of derivatives without the impact of financing premiums and require separate recognition of premiums payable and premiums receivable, are effective January 1, 2021.
Revisions adopted August 2022 that adopt with modification the criteria for initial and subsequent hedge effectiveness detailed in the FASB ASC paragraphs 815-20-25-72 through 815-20-35-20, as modified through the issuance of ASU 2017-12 and that incorporate statutory accounting revisions for the accounting and reporting of excluded components are effective January 1, 2023, with early adoption permitted. These revisions shall be applied prospectively for all new and existing hedges. Entities shall detail the adoption of this guidance as a change in accounting principle pursuant to SSAP No. 3—Accounting Changes and Corrections of Errors.
Review of U.S. derivative guidance and the application to SAP is complex with many facets. This initial document considers consistency in the determination of hedge effectiveness between U.S. GAAP and SAP. The second element pertaining to the accounting and reporting of hedging instruments, including excluded components, will be considered separately, as that guidance has been historically different.

1) **Assessment of Hedge Effectiveness – Consistency with U.S. GAAP**

NAIC staff agree that the assessment of hedge effectiveness for derivatives should be consistent between U.S. GAAP and SAP. This would ensure that transactions identified to be highly effective hedges under U.S. GAAP would also be identified as highly effective hedges under statutory accounting. If a hedging instrument results with offsetting changes (or other permitted aspects) to a hedged item pursuant to the guidelines under U.S. GAAP to qualify as a highly effective hedge, the same assessment as a highly effective hedge should occur under SAP.

NAIC staff highlight that the current guidance in SSAP No. 86 in Exhibit A – Discussion of Hedge Effectiveness and Exhibit B – Assessment of Hedging Effectiveness have not been significantly updated since the original issuance of FAS 133, *Accounting for Derivative Instruments and Hedging Activities* and SSAP No. 86. Exhibit A continues to reference guidance issued by the Derivatives Implementation Group (DIG) in E7 and E8, which were not considered official FASB positions, although these DIG provisions (and other clarifications) been incorporated into the FASB Codification as authoritative. NAIC staff highlight that the list of components permitted to be excluded from the assessment of hedge effectiveness captured in the FASB Codification (815-20-25-82) differs from the statutory accounting guidance in SSAP No. 86, Exhibit B. The statutory accounting guidance in Exhibit B reflects original guidance from FAS 133, paragraph 63, but the statutory accounting guidance has not been updated to reflect provisions from the DIG E19 incorporated into the FASB Codification or the revisions from ASU 2017-12 that pertain to cross-currency basis spread.

To ensure consistency with U.S. GAAP in the assessment of hedge effectiveness, **NAIC staff recommend that the Working Group consider adoption, with modification, of U.S. GAAP guidance pertaining to the criteria for initial and subsequent hedge effectiveness detailed in the FASB Accounting Standards Codification (ASC) paragraphs 815-20-25-72 through 815-20-35-20, as modified through the issuance of ASU 2017-12.** Although the U.S. GAAP guidance for the assessment and determination of hedge effectiveness is proposed to be adopted, this action recommends statutory modifications to specify that the accounting and reporting of hedging instruments, including excluded components of the instruments, shall follow statutory specific guidance detailed in SSAP No. 86. The intent of this guidance is to clarify that the determination of whether a hedging instrument qualifies as an effective hedge shall converge with U.S. GAAP, but that the measurement method shall continue to follow statutory specific provisions. The proposed adoption only extends to revisions incorporated through ASU 2017-12, as such, any subsequent U.S. GAAP edits would continue to require statutory accounting consideration before they were considered adopted.

Exposure and request for comments - Excerpts of the U.S. GAAP guidance proposed to be adopted are recommended to replace the existing guidance in Exhibit A and Exhibit B of SSAP No. 86. However, these excerpts do not reflect the full U.S. GAAP guidance referenced. This reduction of quoted guidance is simply to manage the extent of detail captured in SSAP No. 86. With exposure of the proposed excerpts and adoption language, the Working Group requests comments on whether certain paragraphs should be removed as unnecessary in the Exhibit and whether other guidance from the referenced U.S. GAAP would be beneficial to be incorporated. (NAIC staff note that the U.S. GAAP themes previously captured within
Note: On August 10, 2022, the Statutory Accounting Principles (E) Working Group adopted a new Exhibit A as detailed within this document (This is new guidance and any tracked changes within show changes from U.S. GAAP. That tracking will not be shown in SSAP No. 86.)

SSAP No. 86—Derivatives
Assessment of Hedge Effectiveness

Exhibit A and B have been retained – with updated ASC language.) Unless noted with tracked changes, the cited paragraphs are proposed to be incorporated directly from U.S. GAAP. (The tracked changes most commonly update GAAP references or paraphrase topics captured in GAAP references.)

Proposed New Exhibit A Which Would Replace The Existing Exhibit A and Exhibit B

EXHIBIT A – DISCUSSION OF HEDGE EFFECTIVENESS

The guidance within this exhibit reflects the adoption, with modification, of FASB Accounting Standards Codification (ASC) 815-20-25-72 through 815-20-35-20, as revised through the issuance of ASU 2017-12: Derivatives and Hedging: Targeted Improvements to Accounting for Hedging Activities (ASU 2017-12) (issued on August 28, 2017). This adoption captures the U.S. GAAP guidance for the assessment and determination of hedge effectiveness, with modification to require the accounting and reporting of hedging instruments, including excluded components of hedging instruments to follow specific statutory accounting guidance in SSAP No. 86. The intent of this guidance is to clarify that the determination of whether a hedging instrument and derivative transaction qualifies as an effective hedge shall converge with U.S. GAAP, but that the measurement and reporting of effective hedge transactions shall follow statutory specific provisions. The adoption only extends to revisions incorporated to the FASB ASC through ASU 2017-12, therefore any subsequent U.S. GAAP edits to the ASC would require statutory accounting adoption before application. The guidance within this Exhibit reflects excerpts from the U.S. GAAP ASC, but do not reflect the full U.S. GAAP guidance referenced in the adopted language. The exclusion of cited guidance is to manage the extent of detail included within SSAP No. 86. Excerpts not duplicated within from the cited U.S. GAAP guidance are considered adopted unless subject to the specific accounting and reporting statutory exclusion. This Exhibit intends to supplement the guidance in SSAP No. 86 on hedge effectiveness. In any event in which this Exhibit could be interpreted as conflicting with the SSAP No. 86 guidance, the guidance in the body of SSAP No. 86 shall be followed.

(Staff Note: Tracked changes show proposed revisions to the U.S. GAAP guidance.)

Hedge Effectiveness Criteria Applicable to Both Fair Value Hedges and Cash Flow Hedges

1. This guidance addresses hedge effectiveness criteria applicable to both fair value hedges and cash flow hedges. (815-20-25-74)

2. To qualify for hedge accounting, the hedging relationship, both at inception of the hedge and on an ongoing basis, shall be expected to be highly effective in achieving either of the following: (815-20-25-75)
   
   a. Offsetting changes in fair value attributable to the hedged risk during the period that the hedge is designated (if a fair value hedge)
   
   b. Offsetting cash flows attributable to the hedged risk during the term of the hedge (if a cash flow hedge), unless the hedging instrument is used to modify the contractually specified interest receipts or payments associated with a recognized financial asset liability from one variable rate to another variable rate, except as indicated in paragraph 815-20-25-50

3. If the hedging instrument (such as an at-the-money option contract) provides only one-sided offset of the hedged risk, either of the following conditions shall be met: (815-20-25-76)
SSAP No. 86—Derivatives
Assessment of Hedge Effectiveness

Ref #2021-20

a. The increases (or decreases) in the fair value of the hedging instrument are expected to be highly effective in offsetting the decreases (or increases) in the fair value of the hedged item (if a fair value hedge).

b. The cash inflows (outflows) from the hedging instrument are expected to be highly effective in offsetting the corresponding change in the cash outflows or inflows of the hedged transaction (if a cash flow hedge).

4. There would be a mismatch between the change in fair value or cash flows of the hedging instrument and the change in fair value or cash flows of the hedged item or hedged transaction in any of the following circumstances, among others: (815-20-25-77)

   a. A difference between the basis of the hedging instrument and the hedged item or hedged transaction, to the extent that those bases do not move in tandem

   b. Differences in critical terms of the hedging instrument and hedged item or hedged transaction, such as differences in any of the following:

      i. Notional amounts

      ii. Maturities

      iii. Quantity

      iv. Location (not applicable for hedging relationships in which the variability in cash flows attributable to changes in a contractually specified component is designated as the hedged risk)

      v. Delivery Dates

5. An entity shall consider hedge effectiveness in two different ways—in prospective considerations and in retrospective evaluations: (815-20-25-79)

   a. Prospective considerations. The entity's expectation that the relationship will be highly effective over future periods in achieving offsetting changes in fair value or cash flows, which is forward looking, must be assessed on a quantitative basis at hedge inception unless one of the exceptions detailed in ASU 2017-12, paragraph 815-20-25-3(b)(2)(iv)(01) is met. Prospective assessments shall be subsequently performed whenever financial statements or earnings are reported and at least every three months. The entity shall elect at hedge inception in accordance with paragraph 815-20-25-3(b)(2)(iv)(03) whether to perform subsequent retrospective and prospective hedge effectiveness assessments on a quantitative or qualitative basis. See paragraphs 815-20-35-2A through 35-2F for additional guidance on qualitative assessments of hedge effectiveness. A quantitative assessment can be based on regression or other statistical analysis of past changes in fair values or cash flows as well as on other relevant information. The quantitative prospective assessment of hedge effectiveness shall consider all reasonably possible changes in fair value (if a fair value hedge) or in fair value or cash flows (if a cash flow hedge) of the

   1 Reference to this ASU 2017-12 guidance is consistent with the guidance in SSAP No. 86, paragraph 42, footnote 5.
derivative instrument and the hedged items for the period used to assess whether the requirement for expectation of highly effective offset is satisfied. The quantitative prospective assessment may not be limited only to the likely or expected changes in fair value (if a fair value hedge) or in fair value or cash flows (if a cash flow hedge) of the derivative instrument or the hedged items. Generally, the process of formulating an expectation regarding the effectiveness of a proposed hedging relationship involves a probability-weighted analysis of the possible changes in fair value (if a fair value hedge) or in fair value or cash flows (if a cash flow hedge) of the derivative instrument and the hedged items for the hedge period. Therefore, a probable future change in fair value will be more heavily weighted than a reasonably possible future change. That calculation technique is consistent with the definition of the term expected cash flow in FASB Concepts Statement No. 7, Using Cash Flow Information and Present Value in Accounting Measurements.

b. Retrospective evaluations. An assessment of effectiveness may be performed on a quantitative or qualitative basis on the basis of the entity’s election at hedge inception in accordance with paragraph 815-20-25-3(b)(2)(iv)(03). That assessment shall be performed whenever financial statements or earnings are reported, and at least every three months. See paragraphs 815-20-35-2 through 35-4 for further guidance. At inception of the hedge, an entity electing a dollar-offset approach to perform retrospective evaluations on a quantitative basis may choose either a period-by-period approach or a cumulative approach in designating how effectiveness of a fair value hedge or of a cash flow hedge will be assessed retrospectively under that approach, depending on the nature of the hedge initially documented in accordance with paragraph 815-20-25-3. For example, an entity may decide that the cumulative approach is generally preferred, yet may wish to use the period-by-period approach in certain circumstances. See paragraphs 815-20-35-5 through 35-6 for further guidance.

Skipping 815-20-25-79A

6. All assessments of effectiveness shall be consistent with the originally documented risk management strategy for that particular hedging relationship. An entity shall use the quantitative effectiveness assessment method defined at hedge inception consistently for the periods that the entity either elects or is required to assess hedge effectiveness on a quantitative basis. (815-20-25-80)

7. This Subtopic guidance does not specify a single method for assessing whether a hedge is expected to be highly effective. The method of assessing effectiveness shall be reasonable. The appropriateness of a given method of assessing hedge effectiveness depends on the nature of the risk being hedged and the type of hedging instrument used. Ordinarily, an entity shall assess effectiveness for similar hedges in a similar manner, including whether a component of the gain or loss on a derivative instrument is excluded in assessing effectiveness for similar hedges. Use of different methods for similar hedges shall be justified. The mechanics of isolating the change in time value of an option discussed beginning in paragraph 13 815-20-25-98 also shall be applied consistently. (815-20-25-81)

8. In defining how hedge effectiveness will be assessed, an entity shall specify whether it will include in that assessment all of the gain or loss on a hedging instrument. An entity may exclude all or a part of the hedging instrument’s time value from the assessment of hedge effectiveness, as follows: (815-20-25-82)
a. If the effectiveness of a hedge with an option is assessed based on changes in the option’s intrinsic value, the change in the time value of the option would be excluded from the assessment of hedge effectiveness.

b. If the effectiveness of a hedge with an option is assessed based on changes in the option’s minimum value, that is, its intrinsic value plus the effect of discounting, the change in the volatility value of the contract shall be excluded from the assessment of hedge effectiveness.

c. An entity may exclude any of the following components of the change in an option’s time value from the assessment of hedge effectiveness:

   i. The portion of the change in time value attributable to the passage of time (theta)
   
   ii. The portion of the change in time value attributable to changes due to volatility (vega)
   
   iii. The portion of the change in time value attributable to changes due to interest rates (rho).

d. If the effectiveness of a hedge with a forward contract or futures contract is assessed based on changes in fair value attributable to changes in spot prices, the change in the fair value of the contract related to the changes in the difference between the spot price and the forward or futures price shall be excluded from the assessment of hedge effectiveness.

e. An entity may exclude the portion of the change in fair value of a currency swap attributable to a cross-currency basis spread.

9. No other components of a gain or loss on the designated hedging instrument shall be excluded from the assessment of hedge effectiveness nor shall an entity exclude any aspect of a change in an option's value from the assessment of hedge effectiveness that is not one of the permissible components of the change in an option's time value. For example, an entity shall not exclude from the assessment of hedge effectiveness the portion of the change in time value attributable to changes in other market variables (that is, other than rho and vega). (815-20-25-83)

Note – The following ASC Paragraphs 815-20-25-83A and 83B would not be considered adopted under the proposed language as they address measurement and recognition. SAP measurement and recognition guidance will be captured in the body of the SSAP or Appendix C.

For fair value and cash flow hedges, the initial value of the component excluded from the assessment of effectiveness shall be recognized in earnings using a systematic and rational method over the life of the hedging instrument. Any difference between the change in fair value of the excluded component and amounts recognized in earnings under that systematic and rational method shall be recognized in other comprehensive income. Example 31 beginning in paragraph 815-20-55-235 illustrates this approach for a cash flow hedge in which the hedging instrument is an option and the entire time value is excluded from the assessment of effectiveness. (815-20-25-83A)
Note: On August 10, 2022, the Statutory Accounting Principles (E) Working Group adopted a new Exhibit A as detailed within this document (This is new guidance and any tracked changes within show changes from U.S. GAAP. That tracking will not be shown in SSAP No. 86.)

SSAP No. 86—Derivatives
Assessment of Hedge Effectiveness

For fair value and cash flow hedges, an entity alternatively may elect to record changes in the fair value of the excluded component currently in earnings. This election shall be applied consistently to similar hedges in accordance with paragraph 815-20-25-81 and shall be disclosed in accordance with paragraph 815-10-50-4E. (815-20-25-83B)

10. If the critical terms of the hedging instrument and of the hedged item or hedged forecasted transaction are the same, the entity could conclude that changes in fair value or cash flows attributable to the risk being hedged are expected to completely offset at inception and on an ongoing basis. For example, an entity may assume that a hedge of a forecasted purchase of a commodity with a forward contract will be perfectly effective if all of the following criteria are met:

a. The forward contract is for purchase of the same quantity of the same commodity at the same time and location as the hedged forecasted purchase. Location differences do not need to be considered if an entity designates the variability in cash flows attributable to changes in a contractually specified component as the hedged risk and the requirements in paragraphs 815-20-25-22 through 25-22B of the FASB Codification are met. (815-20-25-84)

b. The fair value of the forward contract at inception is zero.

c. Either of the following criteria is met:

i. The change in the discount or premium on the forward contract is excluded from the assessment of effectiveness pursuant to paragraphs 7-9 through 815-20-25-81 through 25-83.

ii. The change in expected cash flows on the forecasted transaction is based on the forward price for the commodity.

11. In a cash flow hedge of a group of forecasted transactions in accordance with paragraph 28.a. of the SSAP guidance 815-20-25-15(a)(2), an entity may assume that the timing in which the hedged transactions are expected to occur and the maturity date of the hedging instrument match in accordance with paragraph 10.a. 815-20-25-84(a) if those forecasted transactions occur and the derivative matures within the same 31-day period or fiscal month. (815-20-25-84A)

12. If all of the criteria in paragraphs 10-11 through 815-20-25-84A are met, an entity shall still perform and document an assessment of hedge effectiveness at the inception of the hedging relationship and, as discussed beginning in paragraph 815-20-35-9, on an ongoing basis throughout the hedge period. No quantitative effectiveness assessment is required at hedge inception if the criteria in paragraphs 10-11 through 815-20-25-84A are met (see paragraph 815-20-25-3(b)(2)(iv)(01)). (815-20-25-85)

Skipped paragraphs 815-20-25-86 to 815-20-25-97

Computing Changes in an Option's Time Value

13. In computing the changes in an option's time value that would be excluded from the assessment of hedge effectiveness, an entity shall use a technique that appropriately isolates those aspects of the change
in time value. Generally, to allocate the total change in an option's time value to its different aspects—the passage of time and the market variables—the change in time value attributable to the first aspect to be isolated is determined by holding all other aspects constant as of the beginning of the period. Each remaining aspect of the change in time value is then determined in turn in a specified order based on the ending values of the previously isolated aspects. (815-20-25-98)

14. Based on that general methodology, if only one aspect of the change in time value is excluded from the assessment of hedge effectiveness (for example, theta), that aspect shall be the first aspect for which the change in time value is computed and would be determined by holding all other parameters constant for the period used for assessing hedge effectiveness. However, if more than one aspect of the change in time value is excluded from the assessment of hedge effectiveness (for example, theta and vega), an entity shall determine the amount of that change in time value by isolating each of those two aspects in turn in a prespecified order (one first, the other second). The second aspect to be isolated would be based on the ending value of the first isolated aspect and the beginning values of the remaining aspects. The portion of the change in time value that is included in the assessment of effectiveness shall be determined by deducting from the total change in time value the portion of the change in time value attributable to excluded components. (815-20-25-99)

Skipped paragraphs 815-20-25-100 and 815-20-25-101

Assuming Perfect Hedge Effectiveness in a Hedge with an Interest Rate Swap

15. The conditions for the shortcut method do not determine which hedging relationships qualify for hedge accounting; rather, those conditions determine which hedging relationships qualify for a shortcut version of hedge accounting that assumes perfect hedge effectiveness. If all of the applicable conditions in the list in paragraph 17.815-20-25-104 are met, an entity may assume perfect effectiveness in a hedging relationship of interest rate risk involving a recognized interest-bearing asset or liability (or a firm commitment arising on the trade [pricing] date to purchase or issue an interest-bearing asset or liability) and an interest rate swap (or a compound hedging instrument composed of an interest rate swap and a mirror-image call or put option as discussed in paragraph 17.e.815-20-25-104[e]) provided that, in the case of a firm commitment, the trade date of the asset or liability differs from its settlement date due to generally established conventions in the marketplace in which the transaction is executed. The shortcut method's application shall be limited to hedging relationships that meet each and every applicable condition. That is, all the conditions applicable to fair value hedges shall be met to apply the shortcut method to a fair value hedge, and all the conditions applicable to cash flow hedges shall be met to apply the shortcut method to a cash flow hedge. A hedging relationship cannot qualify for application of the shortcut method based on an assumption of perfect effectiveness justified by applying other criteria. The verb match is used in the specified conditions in the list to mean be exactly the same or correspond exactly. (815-20-25-102)

16. Implicit in the conditions for the shortcut method is the requirement that a basis exist for concluding on an ongoing basis that the hedging relationship is expected to be highly effective in achieving offsetting changes in fair values or cash flows. In applying the shortcut method, an entity shall consider the likelihood of the counterparty’s compliance with the contractual terms of the hedging derivative that require the counterparty to make payments to the entity. (815-20-25-103)

17. All of the following conditions apply to both fair value hedges and cash flow hedges: (815-20-25-104)
The notional amount of the interest rate swap matches the principal amount of the interest-bearing asset or liability being hedged.

If the hedging instrument is solely an interest rate swap, the fair value of that interest rate swap at the inception of the hedging relationship must be zero, with one exception. The fair value of the swap may be other than zero at the inception of the hedging relationship only if the swap was entered into at the relationship’s inception, the transaction price of the swap was zero in the entity’s principal market (or most advantageous market), and the difference between transaction price and fair value is attributable solely to differing prices within the bid-ask spread between the entry transaction and a hypothetical exit transaction. The guidance in the preceding sentence is applicable only to transactions considered at market (that is, transaction price is zero exclusive of commissions and other transaction costs, as discussed in paragraph 820-10-35-9B). If the hedging instrument is solely an interest rate swap that at the inception of the hedging relationship has a positive or negative fair value, but does not meet the one exception specified in this paragraph, the shortcut method shall not be used even if all the other conditions are met.

If the hedging instrument is a compound derivative composed of an interest rate swap and mirror-image call or put option as discussed in (e), the premium for the mirror-image call or put option shall be paid or received in the same manner as the premium on the call or put option embedded in the hedged item based on the following:

i. If the implicit premium for the call or put option embedded in the hedged item is being paid principally over the life of the hedged item (through an adjustment of the interest rate), the fair value of the hedging instrument at the inception of the hedging relationship shall be zero (except as discussed previously in (b) regarding differing prices due to the existence of a bid-ask spread).

ii. If the implicit premium for the call or put option embedded in the hedged item was principally paid at inception-acquisition (through an original issue discount or premium), the fair value of the hedging instrument at the inception of the hedging relationship shall be equal to the fair value of the mirror-image call or put option.

d. The formula for computing net settlements under the interest rate swap is the same for each net settlement. That is, both of the following conditions are met:

i. The fixed rate is the same throughout the term.

ii. The variable rate is based on the same index and includes the same constant adjustment or no adjustment. The existence of a stub period and stub rate is not a violation of the criterion in (d) that would preclude application of the shortcut method if the stub rate is the variable rate that corresponds to the length of the stub period.

e. The interest-bearing asset or liability is not prepayable, that is, able to be settled by either party before its scheduled maturity, or the assumed maturity date if the hedged item is measured as a partial-term hedge of interest rate risk in which the assumed maturity of the
hedged items occur on the date in which the last hedged cash flow is due and payable, in
accordance with paragraph 815-25-35-13B, with the following qualifications:

i. This criterion does not apply to an interest-bearing asset or liability that is
prepayable solely due to an embedded call option (put option) if the hedging
instrument is a compound derivative composed of an interest rate swap and a
mirror-image call option (put option).

ii. The call option embedded in the interest rate swap is considered a mirror image of
the call option embedded in the hedged item if all of the following conditions are
met:

   (a.) The terms of the two call options match exactly, including all of the
       following:

       (1.) Maturities

       (2.) Strike price (that is, the actual amount for which the debt
           instrument could be called) and there is no termination payment
           equal to the deferred debt issuance costs that remain unamortized
           on the date the debt is called

       (3.) Related notional amounts

       (4.) Timing and frequency of payments

       (5.) Dates on which the instruments may be called.

   (b.) The entity is the writer of one call option and the holder (purchaser) of
       the other call option.

f. Any other terms in the interest-bearing financial instruments or interest rate swaps meet
both of the following conditions:

i. The terms are typical of those instruments.

ii. The terms do not invalidate the assumption of perfect effectiveness.

18. All of the following incremental conditions apply to fair value hedges only: (815-20-25-105)

a. The expiration date of the interest rate swap matches the maturity date of the interest-
bearing asset or liability or the assumed maturity date if the hedged item is measured as a
partial-term hedge of interest rate risk in which the assumed maturity of the hedged items
occur on the date in which the last hedged cash flow is due and payable in accordance with
paragraph 815-25-35-13B.

b. There is no floor or cap on the variable interest rate of the interest rate swap.
Note: On August 10, 2022, the Statutory Accounting Principles (E) Working Group adopted a new Exhibit A as detailed within this document (This is new guidance and any tracked changes within show changes from U.S. GAAP. That tracking will not be shown in SSAP No. 86.)

SSAP No. 86—Derivatives
Assessment of Hedge Effectiveness

19. All of the following incremental conditions apply to cash flow hedges only: (815-20-25-106)

a. All interest receipts or payments on the variable-rate asset or liability during the term of the interest rate swap are designated as hedged.

b. No interest payments beyond the term of the interest rate swap are designated as hedged.

c. Either of the following conditions is met:

i. There is no floor or cap on the variable interest rate of the interest rate swap.

ii. The variable-rate asset or liability has a floor or cap and the interest rate swap has a floor or cap on the variable interest rate that is comparable to the floor or cap on the variable-rate asset or liability. For purposes of this paragraph, comparable does not necessarily mean equal. For example, if an interest rate swap's variable rate is based on LIBOR and an asset's variable rate is LIBOR plus 2 percent, a 10 percent cap on the interest rate swap would be comparable to a 12 percent cap on the asset.

d. The repricing dates of the variable-rate asset or liability and the hedging instrument must occur on the same dates and be calculated the same way (that is, both shall be either prospective or retrospective). If the repricing dates of the hedged item occur on the same dates as the repricing dates of the hedging instrument but the repricing calculation for the hedged item is prospective whereas the repricing calculation for the hedging instrument is retrospective, those repricing dates do not match.
SSAP No. 86—Derivatives  
Assessment of Hedge Effectiveness

Ref #2021-20

c. For cash flow hedges of the interest payments on only a portion of the principal amount of the interest-bearing asset or liability, the notional amount of the interest rate swap designated as the hedging instrument (see paragraph 815-20-25-104(a)) matches the principal amount of the portion of the asset or liability on which the hedged interest payments are based.

d. For a cash flow hedge in which the hedged forecasted transaction is a group of individual transactions (as permitted by paragraph 28.a. of the SSAP guidance paragraph 815-20-25-15(a)), if both of the following criteria are met:
   i. The notional amount of the interest rate swap designated as the hedging instrument (see paragraph (a)) matches the notional amount of the aggregate group of hedged transactions.
   ii. The remaining criteria for the shortcut method are met with respect to the interest rate swap and the individual transactions that make up the group. For example, the interest rate repricing dates for the variable-rate assets or liabilities whose interest payments are included in the group of forecasted transactions shall match (that is, be exactly the same as) the reset dates for the interest rate swap.

g. The index on which the variable leg of the interest rate swap is based matches the contractually specified interest rate designated as the interest rate being hedged for that hedging relationship.

20. The shortcut method may be applied to a hedging relationship that involves the use of an interest rate swap-in-arrears provided all of the applicable conditions are met. (815-20-25-107)

21. Any discount or premium in the hedged debt's carrying amount (including any related deferred issuance costs) is irrelevant to and has no direct impact on the determination of whether an interest rate swap contains a mirror-image call option under paragraph 17e.i.(e). Typically, the call price is greater than the par or face amount of the debt instrument. The carrying amount of the debt is economically unrelated to the amount the issuer would be required to pay to exercise the call embedded in the debt. (815-20-25-108)

22. The fixed interest rate on a hedged item need not exactly match the fixed interest rate on an interest rate swap designated as a fair value hedge. Nor does the variable interest rate on an interest-bearing asset or liability need to be the same as the variable interest rate on an interest rate swap designated as a cash flow hedge. An interest rate swap’s fair value comes from its net settlements. The fixed and variable interest rates on an interest rate swap can be changed without affecting the net settlement if both are changed by the same amount. That is, an interest rate swap with a payment based on LIBOR and a receipt based on a fixed rate of 5 percent has the same net settlements and fair value as an interest rate swap with a payment based on LIBOR plus 1 percent and a receipt based on a fixed rate of 6 percent. (815-20-25-109)

23. Comparable credit risk at inception is not a condition for assuming perfect effectiveness even though actually achieving perfect offset would require that the same discount rate be used to determine the fair value of the swap and of the hedged item or hedged transaction. To justify using the same discount rate, the credit risk related to both parties to the swap as well as to the debtor on the hedged interest-bearing asset
Note: On August 10, 2022, the Statutory Accounting Principles (E) Working Group adopted a new Exhibit A as detailed within this document (This is new guidance and any tracked changes within show changes from U.S. GAAP. That tracking will not be shown in SSAP No. 86.)

SSAP No. 86—Derivatives
Assessment of Hedge Effectiveness

(in a fair value hedge) or the variable-rate asset on which the interest payments are hedged (in a cash flow hedge) would have to be the same. However, because that complication is caused by the interaction of interest rate risk and credit risk, which are not easily separable, comparable creditworthiness is not considered a necessary condition for assuming perfect effectiveness in a hedge of interest rate risk. (815-20-25-111)

Skipped paragraphs 815-20-25-112 through 815-20-25-143

Hedge Effectiveness – After Designation

24. If a fair value hedge or cash flow hedge initially qualifies for hedge accounting, the entity would continue to assess whether the hedge meets the effectiveness test on either a quantitative basis (using either a dollar-offset test or a statistical method such as regression analysis) or a qualitative basis. See paragraphs 815-20-35-2A through 35-2F for additional guidance on qualitative assessments of effectiveness. If the hedge fails the effectiveness test at any time (that is, if the entity does not expect the hedge to be highly effective at achieving offsetting changes in fair values or cash flows), the hedge ceases to qualify for hedge accounting. At least quarterly, the hedging entity shall determine whether the hedging relationship has been highly effective in having achieved offsetting changes in fair value or cash flows through the date of the periodic assessment.) (815-20-35-2)

Effectiveness Assessment on a Qualitative Basis

25. An entity may qualitatively assess hedge effectiveness if both of the following criteria are met: (815-20-35-2A)

a. An entity performs an initial quantitative test of hedge effectiveness on a prospective basis (that is, it is not assuming that the hedging relationship is perfectly effective at hedge inception as described in paragraph 815-20-25-3(b)(2)(i)(A) through (H)), and the results of that quantitative test demonstrate highly effective offset.

b. At hedge inception, an entity can reasonably support an expectation of high effectiveness on a qualitative basis in subsequent periods.

26. An entity may elect to qualitatively assess hedge effectiveness in accordance with paragraph 25 815-20-35-2A on a hedge-by-hedge basis. If an entity makes this qualitative assessment election, only the quantitative method specified in an entity’s initial hedge documentation must comply with paragraph 7815-20-25-81. (815-20-35-2B)

27. When an entity performs qualitative assessments of hedge effectiveness, it shall verify and document whenever financial statements or earnings are reported and at least every three months that the facts and circumstances related to the hedging relationship have not changed such that it can assert qualitatively that the hedging relationship was and continues to be highly effective. While not all-inclusive, the following is a list of indicators that may, individually or in the aggregate, allow an entity to continue to assert qualitatively that the hedging relationship is highly effective: (815-20-35-2C)

a. An assessment of the factors that enabled the entity to reasonably support an expectation of high effectiveness on a qualitative basis has not changed such that the entity can continue to assert qualitatively that the hedging relationship was and continues to be highly
28. If an entity elects to assess hedge effectiveness on a qualitative basis and then facts and circumstances change such that the entity no longer can assert qualitatively that the hedging relationship was and continues to be highly effective in achieving offsetting changes in fair values or cash flows, the entity shall assess effectiveness of that hedging relationship on a quantitative basis in subsequent periods. In addition, an entity may perform a quantitative assessment of hedge effectiveness in any reporting period to validate whether qualitative assessments of hedge effectiveness remain appropriate. In both cases, the entity shall apply the quantitative method that it identified in its initial hedge documentation in accordance with paragraph (b)(2)(iv)(03). (815-20-35-2D)

29. When an entity determines that facts and circumstances have changed and it no longer can assert qualitatively that the hedging relationship was and continues to be highly effective, the entity shall begin performing subsequent quantitative assessments of hedge effectiveness as of the period that the facts and circumstances changed. If there is no identifiable event that led to the change in the facts and circumstances of the hedging relationship, the entity may begin performing quantitative assessments of effectiveness in the current period. (815-20-35-2E)

30. After performing a quantitative assessment of hedge effectiveness for one or more reporting periods as discussed in paragraphs 28-29815-20-35-2D through 35-2E, an entity may revert to qualitative assessments of hedge effectiveness if it can reasonably support an expectation of high effectiveness on a qualitative basis for subsequent periods. See paragraphs 815-20-55-79G through 55-79N for implementation guidance on factors to consider when determining whether qualitative assessments of effectiveness can be performed after hedge inception. (815-20-35-2F)

Quantitative Hedge Effectiveness Assessments After Hedge Designation

31. Quantitative assessments can be based on regression or other statistical analysis of past changes in fair values or cash flows as well as on other relevant information. (815-20-35-2G)

32. If an entity elects at the inception of a hedging relationship to use the same regression analysis approach for both prospective considerations and retrospective evaluations of assessing effectiveness, then during the term of that hedging relationship both of the following conditions shall be met: (815-20-35-3)

   a. Those regression analysis calculations shall generally incorporate the same number of data points.

   b. That entity must periodically update its regression analysis (or other statistical analysis).

33. Electing to use a regression or other statistical analysis approach instead of a dollar-offset approach to perform retrospective evaluations of assessing hedge effectiveness may affect whether an entity can apply hedge accounting for the current assessment period. (815-20-35-4)

34. In periodically (that is, at least quarterly) assessing retrospectively the effectiveness of a fair value hedge (or a cash flow hedge) in having achieved offsetting changes in fair values (or cash flows) under a
dollar-offset approach, an entity shall use either a period-by-period approach or a cumulative approach on individual fair value hedges (or cash flow hedges): (815-20-35-5)

35. If an entity elects at inception of a hedging relationship to base its comparison of changes in fair value (or cash flows) on a cumulative approach, then that entity must abide by the results of that methodology as long as that hedging relationship remains designated. Electing to utilize a period-by-period approach instead of a cumulative approach (or vice versa) to perform retrospective evaluations of assessing hedge effectiveness under the dollar-offset method may affect whether an entity can apply hedge accounting for the current assessment period. (815-20-35-6)

Assessing Effectiveness Based on Whether the Critical Terms of the Hedging Instrument and the Hedged Items Match

36. If, at inception, the critical terms of the hedging instrument and the hedged forecasted transaction are the same (see paragraphs 10-11815-20-25-84 through 25-84A), the entity can conclude that changes in cash flows attributable to the risk being hedged are expected to be completely offset by the hedging derivative. Therefore, subsequent assessments can be performed by verifying and documenting whether the critical terms of the hedging instrument and the forecasted transaction have changed during the period in review. (815-20-35-9)

37. Because the assessment of hedge effectiveness in a cash flow hedge involves assessing the likelihood of the counterparty’s compliance with the contractual terms of the derivative instrument designated as the hedging instrument, the entity must also assess whether there have been adverse developments regarding the risk of counterparty default, particularly if the entity planned to obtain its cash flows by liquidating the derivative instrument at its fair value. (815-20-35-10)

38. If there are no such changes in the critical terms or adverse developments regarding counterparty default, the entity may conclude that the hedging relationship is perfectly effective. In that case, the change in fair value of the derivative instrument can be viewed as a proxy for the present value of the change in cash flows attributable to the risk being hedged. (815-20-35-11)
39. However, the entity must assess whether the hedging relationship is expected to continue to be highly effective using a quantitative assessment method (either a dollar-offset test or a statistical method such as regression analysis) if any of the following conditions exist: (815-20-35-12)

   a. The critical terms of the hedging instrument or the hedged forecasted transaction have changed.

   b. There have been adverse developments regarding the risk of counterparty default.

*Possibility of Default by the Counterparty to Hedging Derivative*

40. For an entity to conclude on an ongoing basis that the hedging relationship is expected to be highly effective in achieving offsetting changes in cash flows, the entity shall not ignore whether it will collect the payments it would be owed under the contractual provisions of the derivative instrument. In complying with the requirements of paragraph 2.b.815-20-25-75(b), the entity shall assess the possibility of whether the counterparty to the derivative instrument will default by failing to make any contractually required payments to the entity as scheduled in the derivative instrument. In making that assessment, the entity shall also consider the effect of any related collateralization or financial guarantees. The entity shall be aware of the counterparty’s creditworthiness (and changes therein) in determining the fair value of the derivative instrument. Although a change in the counterparty’s creditworthiness would not necessarily indicate that the counterparty would default on its obligations, such a change shall warrant further evaluation. (815-20-35-14)

41. If the likelihood that the counterparty will not default ceases to be probable, an entity would be unable to conclude that the hedging relationship in a cash flow hedge is expected to be highly effective in achieving cash flows. (815-20-35-15)

42. In contrast, a change in the creditworthiness of the derivative instrument's counterparty in a fair value hedge would have an immediate effect because that change in creditworthiness would affect the change in the derivative instrument's fair value, which would immediately affect both of the following: (815-20-35-16)

   a. The assessment of whether the relationship qualifies for hedge accounting

   b. The amount of mismatch between the change in the fair value of the hedging instrument and the hedged item attributable to the hedged risk recognized in earnings under fair value hedge accounting.

43. Paragraph 16815-20-25-103 states that, in applying the shortcut method, an entity shall consider the likelihood of the counterparty’s compliance with the contractual terms of the hedging derivative that require the counterparty to make payments to the entity. That paragraph explains that implicit in the criteria for the shortcut method is the requirement that a basis exist for concluding on an ongoing basis that the hedging relationship is expected to be highly effective in achieving offsetting changes in fair values or cash flows. (815-20-35-18)

*Change in Hedge Effectiveness Method When Hedge Effectiveness if Assessed on a Quantitative Basis*
If the entity identifies an improved method of assessing hedge effectiveness in accordance with the guidance in paragraph 6815-20-25-80 and wants to apply that method prospectively, it shall do both of the following: (815-20-35-19)

a. Discontinue the existing hedging relationship

b. Designate the relationship anew using the improved method.

The new method of assessing hedge effectiveness shall be applied prospectively and shall also be applied to similar hedges unless the use of a different method for similar hedges is justified. A change in the method of assessing hedge effectiveness by an entity shall not be considered a change in accounting principle as defined in Topic 250SSAP No. 3—Accounting Changes and Corrections of Errors. (815-20-35-20)

U.S. GAAP ASC Excerpts Proposed to be Excluded from Exhibit A

This information is included to illustrate the guidance within the adopted ASC references that are not proposed to be captured in Exhibit A. The guidance within these paragraphs would be considered part of the statutory adoption unless they include specific accounting and reporting guidance. Comments are requested on whether any of the following paragraphs should be explicitly captured in Exhibit A.

Skipping 815-20-25-79A

815-20-25-79A See paragraphs 815-20-25-139 through 25-142 about the timing of hedge effectiveness assessments required by paragraph 815-20-25-79 for a private company that is not a financial institution or a not-for-profit entity (except for a not-for-profit entity that has issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market).

Skipped paragraphs 815-20-25-86 through 815-20-25-97

815-20-25-86 The remainder of this guidance on hedge effectiveness criteria applicable to both fair value hedges and cash flow hedges is organized as follows:

a. Hedge effectiveness when the hedging instrument is an option or combination of options

b. Hedge effectiveness when hedged exposure is more limited than hedging instrument

c. Hedge effectiveness during designated hedge period

d. Assuming perfect effectiveness in a hedge with an interest rate swap (the shortcut method).

Hedge Effectiveness When the Hedging Instrument Is an Option or Combination of Options

815-20-25-87 The hedge effectiveness criteria applicable to options and combinations of options are organized as follows:

a. Determining whether a combination of options is net written
Determining Whether a Combination of Options Is Net Written

815-20-25-88  This guidance addresses how an entity shall determine whether a combination of options is considered a net written option subject to the requirements of paragraph 815-20-25-94. A combination of options (for example, an interest rate collar) entered into contemporaneously shall be considered a written option if either at inception or over the life of the contracts a net premium is received in cash or as a favorable rate or other term. Furthermore, a derivative instrument that results from combining a written option and any other non-option derivative instrument shall be considered a written option. The determination of whether a combination of options is considered a net written option depends in part on whether strike prices and notional amounts of the options remain constant.

Strike Prices and Notional Amounts Remain Constant

815-20-25-89  For a combination of options in which the strike price and the notional amount in both the written option component and the purchased option component remain constant over the life of the respective component, that combination of options would be considered a net purchased option or a zero cost collar (that is, the combination shall not be considered a net written option subject to the requirements of paragraph 815-20-25-94) provided all of the following conditions are met:

a. No net premium is received.

b. The components of the combination of options are based on the same underlying.

c. The components of the combination of options have the same maturity date.

d. The notional amount of the written option component is not greater than the notional amount of the purchased option component.

815-20-25-90  If the combination of options does not meet all of those conditions, it shall be subject to the test in paragraph 815-20-25-94. For example, a combination of options having different underlying indexes, such as a collar containing a written floor based on three-month U.S. Treasury rates and a purchased cap based on three-month London Interbank Offered Rate (LIBOR), shall not be considered a net purchased option or a zero cost collar even though those rates may be highly correlated.

Strike Prices and Notional Amounts Do Not Remain Constant

815-20-25-91  If either the written option component or the purchased option component for a combination of options has either strike prices or notional amounts that do not remain constant over the life of the respective component, the assessment to determine whether that combination of options can be considered not to be a written option under paragraph 815-20-25-88 shall be evaluated with respect to each date that either the strike prices or the notional amounts change within the contractual term from inception to maturity.

815-20-25-92  Even though that assessment is made on the date that a combination of options is designated as a hedging instrument (to determine the applicability of paragraph 815-20-25-94), it shall consider the
receipt of a net premium (in cash or as a favorable rate or other term) from that combination of options at each point in time that either the strike prices or the notional amounts change, such as either of the following circumstances:

a. If strike prices fluctuate over the life of a combination of options and no net premium is received at inception, a net premium will typically be received as a favorable term in one or more reporting periods within the contractual term from inception to maturity.

b. If notional amounts fluctuate over the life of a combination of options and no net premium is received at inception, a net premium or a favorable term will typically be received in one or more periods within the contractual term from inception to maturity.

815-20-25-93 In addition, a combination of options in which either the written option component or the purchased option component has either strike prices or notional amounts that do not remain constant over the life of the respective component shall satisfy all of the conditions in paragraph 815-20-25-89 to be considered not to be a written option (that is, to be considered to be a net purchased option or zero cost collar) under paragraph 815-20-25-88. For example, if the notional amount of the written option component is greater than the notional amount of the purchased option component at any date that the notional amount changes within the contractual term from inception to maturity, the combination of options shall be considered to be a written option under paragraph 815-20-25-88 and, thus, subject to the criteria in the following paragraph.

Hedge Effectiveness of Written Options

815-20-25-94 If a written option is designated as hedging a recognized asset or liability or an unrecognized firm commitment (if a fair value hedge) or the variability in cash flows for a recognized asset or liability or an unrecognized firm commitment (if a cash flow hedge), the combination of the hedged item and the written option provides either of the following:

a. At least as much potential for gains as a result of a favorable change in the fair value of the combined instruments (that is, the written option and the hedged item, such as an embedded purchased option) as exposure to losses from an unfavorable change in their combined fair value (if a fair value hedge)

b. At least as much potential for favorable cash flows as exposure to unfavorable cash flows (if a cash flow hedge).

815-20-25-95 The written-option test in the preceding paragraph shall be applied only at inception of the hedging relationship and is met if all possible percentage favorable changes in the underlying (from zero percent to 100 percent) would provide either of the following:

a. At least as much gain as the loss that would be incurred from an unfavorable change in the underlying of the same percentage (if a fair value hedge)

b. At least as much favorable cash flows as the unfavorable cash flows that would be incurred from an unfavorable change in the underlying of the same percentage (if a cash flow hedge).
Note: On August 10, 2022, the Statutory Accounting Principles (E) Working Group adopted a new Exhibit A as detailed within this document (This is new guidance and any tracked changes within show changes from U.S. GAAP. That tracking will not be shown in SSAP No. 86.)

SSAP No. 86—Derivatives
Assessment of Hedge Effectiveness

Ref #2021-20

815-20-25-96 The time value of a written option (or net written option) may be excluded from the written-option test if, in defining how hedge effectiveness will be assessed, the entity specifies that it will base that assessment on only changes in the option’s intrinsic value. In that circumstance, the change in the time value of the options would be excluded from the assessment of hedge effectiveness in accordance with paragraph 815-20-25-82(a).

815-20-25-97 When applying the written-option test to determine whether there is symmetry of the gain and loss potential of the combined hedged position for all possible percentage changes in the underlying, an entity is permitted to measure the change in the intrinsic value of the written option (or net written option) combined with the change in fair value of the hedged item.

Skipped paragraphs 815-20-25-100 and 815-20-25-101

Hedge Effectiveness When Hedged Exposure Is More Limited Than Hedging Instrument

815-20-25-100 An entity may designate as the hedging instrument in a fair value hedge or cash flow hedge a derivative instrument that does not have a limited exposure comparable to the limited exposure of the hedged item to the risk being hedged. However, to make that designation, in accordance with paragraph 815-20-25-75, the entity shall establish that the hedging relationship is expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk during the period that the hedge is designated. See paragraph 815-20-25-79(a) for additional guidance on prospective considerations of hedge effectiveness in this circumstance.

Hedge Effectiveness during Designated Hedge Period

815-20-25-101 It is inappropriate under this Subtopic for an entity to designate a derivative instrument as the hedging instrument if the entity expects that the derivative instrument will not be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk during the period that the hedge is designated, unless the entity has documented undertaking a dynamic hedging strategy in which it has committed itself to an ongoing repositioning strategy for its hedging relationship.

Skipped paragraphs 815-20-25-112 through 815-20-25-143

>>> Application of Prepayable Criterion

815-20-25-112 An interest-bearing asset or liability shall be considered prepayable under the provisions of paragraph 815-20-25-104(e) if one party to the contract has the right to cause the payment of principal before the scheduled payment dates unless either of the following conditions is met:

a. The debtor has the right to cause settlement of the entire contract before its stated maturity at an amount that is always greater than the then fair value of the contract absent that right.

b. The creditor has the right to cause settlement of the entire contract before its stated maturity at an amount that is always less than the then fair value of the contract absent that right.

815-20-25-113 However, none of the following shall be considered a prepayment provision:

a. Any term, clause, or other provision in a debt instrument that gives the debtor or creditor the right to cause prepayment of the debt contingent upon the occurrence of a specific event related
to the debtor’s credit deterioration or other change in the debtor’s credit risk, such as any of the following:

1. The debtor’s failure to make timely payment, thus making it delinquent
2. The debtor's failure to meet specific covenant ratios
3. The debtor's disposition of specific significant assets (such as a factory)
4. A declaration of cross-default
5. A restructuring by the debtor.

b. Any term, clause, or other provision in a debt instrument that gives the debtor or creditor the right to cause prepayment of the debt contingent upon the occurrence of a specific event that meets all of the following conditions:

1. It is not probable at the time of debt issuance.
2. It is unrelated to changes in benchmark interest rates, contractually specified interest rates, or any other market variable.
3. It is related either to the debtor’s or creditor’s death or to regulatory actions, legislative actions, or other similar events that are beyond the control of the debtor or creditor.

c. Contingent acceleration clauses that permit the debtor to accelerate the maturity of an outstanding note only upon the occurrence of a specified event that meets all of the following conditions:

1. It is not probable at the time of debt issuance.
2. It is unrelated to changes in benchmark interest rates, contractually specified interest rates, or any other market variable.
3. It is related to regulatory actions, legislative actions, or other similar events that are beyond the control of the debtor or creditor.

815-20-25-114 Furthermore, a right to cause a contract to be prepaid at its then fair value would not cause the interest-bearing asset or liability to be considered prepayable because that right would have a fair value of zero at all times and essentially would provide only liquidity to the holder.

815-20-25-115 Application of this guidance to specific debt instruments is illustrated in paragraph 815-20-25-102.

815-20-25-116 Application of the Shortcut Method to a Portfolio of Hedged Items

Portfolio hedging cannot be used to circumvent the application of the shortcut method criteria beginning in paragraph 815-20-25-102 to a fair value hedge of an individual interest-bearing asset.
or liability. A portfolio of interest-bearing assets or interest-bearing liabilities cannot qualify for the shortcut method if it contains an interest-bearing asset or liability that individually cannot qualify for the shortcut method.

815-20-25-117 The fair value hedge requirements of paragraph 815-20-25-12(b)(1) ensure that the individual items in a portfolio share the same risk exposure and have fair value changes attributable to the hedged risk that are expected to respond in a generally proportionate manner to the overall fair value changes of the entire portfolio. That requirement restricts the types of portfolios that can qualify for portfolio hedging; however, it also permits the existence of a mismatch between the change in the fair value of the individual hedged items and the change in the fair value of the hedged portfolio attributable to the hedged risk in portfolios that do qualify. As a result, the assumption of perfect effectiveness required for the shortcut method generally is inappropriate for portfolio hedges of similar assets or liabilities that are not also nearly identical (except for their notional amounts). Application of the shortcut method to portfolios that meet the requirements of paragraph 815-20-25-12(b)(1) is appropriate only if the assets or liabilities in the portfolio meet the same stringent criteria in paragraphs 815-20-25-104(e), 815-20-25-104(g), and 815-20-25-105(a) as required for hedges of individual assets and liabilities.

Application of Whether the Shortcut Method Was Not or No Longer Is Appropriate

815-20-25-117A In the period in which an entity determines that use of the shortcut method was not or no longer is appropriate, the entity may use a quantitative method to assess hedge effectiveness and measure hedge results without redesignating the hedging relationship if both of the following criteria are met:

- a. The entity documented at hedge inception in accordance with paragraph 815-20-25-3(b)(2)(iv)(04) which quantitative method it would use to assess hedge effectiveness and measure hedge results if the shortcut method was not or no longer is appropriate during the life of the hedging relationship.

- b. The hedging relationship was highly effective on a prospective and retrospective basis in achieving offsetting changes in fair value or cash flows attributable to the hedged risk for the periods in which the shortcut method criteria were not met.

815-20-25-117B If the criterion in paragraph 815-20-25-117A(a) is not met, the hedging relationship shall be considered invalid in the period in which the criteria for the shortcut method were not met and in all subsequent periods. If the criterion in paragraph 815-20-25-117A(a) is met, the hedging relationship shall be considered invalid in all periods in which the criterion in paragraph 815-20-25-117A(b) is not met.

815-20-25-117C If an entity cannot identify the date on which the shortcut criteria ceased to be met, the entity shall perform the quantitative assessment of effectiveness documented at hedge inception for all periods since hedge inception.

815-20-25-117D The terms of the hedged item and hedging instrument used to assess effectiveness, in accordance with paragraph 815-20-25-117A(b), shall be those existing as of the date that the shortcut criteria ceased to be met. For cash flow hedges, if the hypothetical derivative method is used as a proxy for the hedged item, the value of the hypothetical derivative shall be set to zero as of hedge inception.
Hedge Effectiveness Criterion Applicable to Fair Value Hedges Only—Effectiveness Horizon

815-20-25-118 In documenting its risk management strategy for a fair value hedge, an entity may specify an intent to consider the possible changes (that is, not limited to the likely or expected changes) in value of the hedging derivative instrument and the hedged item only over a shorter period than the derivative instrument's remaining life in formulating its expectation that the hedging relationship will be highly effective in achieving offsetting changes in fair value for the risk being hedged. The entity does not need to contemplate the offsetting effect for the entire term of the hedging instrument.

Consideration of Prepayment Risk Using the Last-of-Layer Method

815-20-25-118A In a fair value hedge of interest rate risk designated under the last-of-layer method in accordance with paragraph 815-20-25-12A, an entity may exclude prepayment risk when measuring the change in fair value of the hedged item attributable to interest rate risk.

Hedge Effectiveness Criteria Applicable to Cash Flow Hedges Only

815-20-25-119 The hedge effectiveness criteria applicable to cash flow hedges only are organized as follows:

a. Consideration of the time value of money

b. Consideration of counterparty credit risk

c. Additional considerations for options in cash flow hedges

d. Assuming perfect hedge effectiveness in a cash flow hedge of a variable-rate borrowing with a receive-variable, pay-fixed interest rate swap recorded under the simplified hedge accounting approach.

Consideration of the Time Value of Money

815-20-25-120 In assessing the effectiveness of a cash flow hedge, an entity generally shall consider the time value of money, especially if the hedging instrument involves periodic cash settlements.

815-20-25-121 An example of a situation in which an entity likely would reflect the time value of money is a tailing strategy with futures contracts. When using a tailing strategy, an entity adjusts the size or contract amount of futures contracts used in a hedge so that earnings (or expense) from reinvestment (or funding) of daily settlement gains (or losses) on the futures do not distort the results of the hedge. To assess offset of expected cash flows when a tailing strategy has been used, an entity could reflect the time value of money, perhaps by comparing the present value of the hedged forecasted cash flow with the results of the hedging instrument.

Consideration of Counterparty Credit Risk

815-20-25-122 For a cash flow hedge, an entity shall consider the likelihood of the counterparty’s compliance with the contractual terms of the hedging derivative instrument that require the counterparty to make payments to the entity. Paragraph 815-20-35-14 states that, for an entity to conclude on an ongoing
basis that a cash flow hedging relationship is expected to be highly effective in achieving offsetting changes in cash flows, the entity shall not ignore whether it will collect the payments it would be owed under the contractual provisions of the derivative instrument. See paragraphs 815-20-35-14 through 35-18 for further guidance.

Additional Considerations for Options in Cash Flow Hedges

815-20-25-123 When an entity has documented that the effectiveness of a cash flow hedge will be assessed based on changes in the hedging option’s intrinsic value pursuant to paragraph 815-20-25-82(a), that assessment (and the related cash flow hedge accounting) shall be performed for all changes in intrinsic value—that is, for all periods of time when the option has an intrinsic value, such as when the underlying is above the strike price of the call option.

815-20-25-124 When a purchased option is designated as a hedging instrument in a cash flow hedge, an entity shall not define only limited parameters for the risk exposure designated as being hedged that would include the time value component of that option. An entity cannot arbitrarily exclude some portion of an option’s intrinsic value from the hedge effectiveness assessment simply through an articulation of the risk exposure definition. It is inappropriate to assert that only limited risk exposures are being hedged (for example, exposures related only to currency-exchange-rate changes above $1.65 per pound sterling as illustrated in Example 26 [see paragraph 815-20-55-205]).

815-20-25-125 If an option is designated as the hedging instrument in a cash flow hedge, an entity may assess hedge effectiveness based on a measure of the difference, as of the end of the period used for assessing hedge effectiveness, between the strike price and forward price of the underlying, undiscounted. Although assessment of cash flow hedge effectiveness with respect to an option designated as the hedging instrument in a cash flow hedge shall be performed by comparing the changes in present value of the expected future cash flows of the forecasted transaction to the change in fair value of the derivative instrument (aside from any excluded component under paragraph 815-20-25-82), that measure of changes in the expected future cash flows of the forecasted transaction based on forward rates, undiscounted, is not prohibited. With respect to an option designated as the hedging instrument in a cash flow hedge, assessing hedge effectiveness based on a similar measure with respect to the hedging instrument eliminates any difference that the effect of discounting may have on the hedging instrument and the hedged transaction. Pursuant to paragraph 815-20-25-3(b)(2)(iv), entities shall document the measure of intrinsic value that will be used in the assessment of hedge effectiveness. As discussed in paragraph 815-20-25-80, that measure must be used consistently for each period following designation of the hedging relationship.

Assessing Hedge Effectiveness Based on an Option's Terminal Value

815-20-25-126 The guidance in paragraph 815-20-25-129 addresses a cash flow hedge that meets all of the following conditions:

a. The hedging instrument is a purchased option or a combination of only options that comprise either a net purchased option or a zero-cost collar.

b. The exposure being hedged is the variability in expected future cash flows attributed to a particular rate or price beyond (or within) a specified level (or levels).
c. The assessment of effectiveness is documented as being based on total changes in the option’s cash flows (that is, the assessment will include the hedging instrument’s entire change in fair value, not just changes in intrinsic value).

815-20-25-127 This guidance has no effect on the accounting for fair value hedging relationships. In addition, in determining the accounting for seemingly similar cash flow hedging relationships, it would be inappropriate to analogize to this guidance.

815-20-25-128 For a hedging relationship that meets all of the conditions in paragraph 815-20-25-126, an entity may focus on the hedging instrument’s terminal value (that is, its expected future pay-off amount at its maturity date) in determining whether the hedging relationship is expected to be highly effective in achieving offsetting cash flows attributable to the hedged risk during the term of the hedge. An entity’s focus on the hedging instrument’s terminal value is not an impediment to the entity’s subsequently deciding to designate that cash flow hedge before the occurrence of the hedged transaction. If the hedging instrument is a purchased cap consisting of a series of purchased caplets that are each hedging an individual hedged transaction in a series of hedged transactions (such as caplets hedging a series of hedged interest payments at different monthly or quarterly dates), the entity may focus on the terminal value of each caplet (that is, the expected future pay-off amount at the maturity date of each caplet) in determining whether each of those hedging relationships is expected to be highly effective in achieving offsetting cash flows. The guidance in this paragraph applies to a purchased option regardless of whether at the inception of the cash flow hedging relationship it is at the money, in the money, or out of the money.

815-20-25-129 A hedging relationship that meets all of the conditions in paragraph 815-20-25-126 may be considered to be perfectly effective if all of the following conditions are met:

a. The critical terms of the hedging instrument (such as its notional amount, underlying, maturity date, and so forth) completely match the related terms of the hedged forecasted transaction (such as the notional amount, the variable that determines the variability in cash flows, the expected date of the hedged transaction, and so forth).

b. The strike price (or prices) of the hedging option (or combination of options) matches the specified level (or levels) beyond (or within) which the entity’s exposure is being hedged.

c. The hedging instrument’s inflows (outflows) at its maturity date completely offset the change in the hedged transaction’s cash flows for the risk being hedged.

d. The hedging instrument can be exercised only on a single date—its contractual maturity date.

The condition in (d) is consistent with the entity’s focus on the hedging instrument’s terminal value. If the holder of the option chooses to pay for the ability to exercise the option at dates before the maturity date (for example, by acquiring an American-style option), the hedging relationship would not be perfectly effective.

815-20-25-129A In a hedge of a group of forecasted transactions in accordance with paragraph 815-20-25-15(a)(2), an entity may assume that the timing in which the hedged transactions are expected to occur and the maturity date of the hedging instrument match in accordance with paragraph 815-20-25-129(a) if those forecasted transactions occur and the derivative matures within the same 31-day period or fiscal month.
Hedge Effectiveness of a Net-Purchased Combination of Options

815-20-25-130 The guidance in the following paragraph addresses a cash flow hedging relationship that meets both of the following conditions:

   a. A combination of options (deemed to be a net purchased option) is designated as the hedging instrument.

   b. The effectiveness of the hedge is assessed based only on changes in intrinsic value of the hedging instrument (the combination of options).

815-20-25-131 The assessment of effectiveness of a cash flow hedging relationship meeting the conditions in the preceding paragraph may be based only on changes in the underlying that cause a change in the intrinsic value of the hedging instrument (the combination of options). Thus, the assessment can exclude ranges of changes in the underlying for which there is no change in the hedging instrument’s intrinsic value.

Hedge Accounting Provisions Applicable to Certain Private Companies

Assuming Perfect Hedge Effectiveness in a Cash Flow Hedge of a Variable-Rate Borrowing with a Receive-Variable, Pay-Fixed Interest Rate Swap Recorded under the Simplified Hedge Accounting Approach


815-20-25-134 The conditions for the simplified hedge accounting approach determine which cash flow hedging relationships qualify for a simplified version of hedge accounting. If all of the conditions in paragraphs 815-20-25-135 and 815-20-25-137 are met, an entity may assume perfect effectiveness in a cash flow hedging relationship involving a variable-rate borrowing and a receive-variable, pay-fixed interest rate swap.

815-20-25-135 Provided all of the conditions in paragraph 815-20-25-137 are met, the simplified hedge accounting approach may be applied by a private company except for a financial institution as described in paragraph 942-320-50-1. An entity may elect the simplified hedge accounting approach for any receive-variable, pay-fixed interest rate swap, provided that all of the conditions for applying the simplified hedge accounting approach specified in paragraph 815-20-25-137 are met. Implementation guidance on the conditions set forth in paragraph 815-20-25-137 is provided in paragraphs 815-20-55-79A through 55-79B.

815-20-25-136 In applying the simplified hedge accounting approach, the documentation required by paragraph 815-20-25-3 to qualify for hedge accounting must be completed by the date on which the first annual financial statements are available to be issued after hedge inception rather than concurrently at hedge inception.

815-20-25-137 An eligible entity under paragraph 815-20-25-135 must meet all of the following conditions to apply the simplified hedge accounting approach to a cash flow hedge of a variable-rate borrowing with a receive-variable, pay-fixed interest rate swap:

© 2022 National Association of Insurance Commissioners
a. Both the variable rate on the swap and the borrowing are based on the same index and reset period (for example, both the swap and borrowing are based on one-month London Interbank Offered Rate [LIBOR] or both the swap and borrowing are based on three-month LIBOR).

b. The terms of the swap are typical (in other words, the swap is what is generally considered to be a “plain-vanilla” swap), and there is no floor or cap on the variable interest rate of the swap unless the borrowing has a comparable floor or cap.

c. The repricing and settlement dates for the swap and the borrowing match or differ by no more than a few days.

d. The swap’s fair value at inception (that is, at the time the derivative was executed to hedge the interest rate risk of the borrowing) is at or near zero.

e. The notional amount of the swap matches the principal amount of the borrowing being hedged. In complying with this condition, the amount of the borrowing being hedged may be less than the total principal amount of the borrowing.

f. All interest payments occurring on the borrowing during the term of the swap (or the effective term of the swap underlying the forward starting swap) are designated as hedged whether in total or in proportion to the principal amount of the borrowing being hedged.

815-20-25-138 A cash flow hedge established through the use of a forward starting receive-variable, pay-fixed interest rate swap may be permitted in applying the simplified hedge accounting approach only if the occurrence of forecasted interest payments to be swapped is probable. When forecasted interest payments are no longer probable of occurring, a cash flow hedging relationship will no longer qualify for the simplified hedge accounting approach and the General Subsections of this Topic shall apply at the date of change and on a prospective basis.

Timing of Hedge Documentation for Certain Private Companies If Simplified Hedge Accounting Approach Is Not Applied

Concurrent Hedge Documentation

815-20-25-139 Concurrent with hedge inception, a private company that is not a financial institution as described in paragraph 942-320-50-1 shall document the following:

a. The hedging relationship in accordance with paragraph 815-20-25-3(b)(1)

b. The hedging instrument in accordance with paragraph 815-20-25-3(b)(2)(i)

c. The hedged item in accordance with paragraph 815-20-25-3(b)(2)(ii), including (if applicable) firm commitments or the analysis supporting a last-of-layer designation in paragraph 815-20-25-3(c), or forecasted transactions in paragraph 815-20-25-3(d)

d. The nature of the risk being hedged in accordance with paragraph 815-20-25-3(b)(2)(iii).
815-20-25-140 A private company that is not a financial institution is not required to perform or document the following items concurrent with hedge inception but rather is required to perform or document them within the time periods discussed in paragraph 815-20-25-142:

a. The method of assessing hedge effectiveness at inception and on an ongoing basis in accordance with paragraph 815-20-25-3(b)(2)(iv) and (vi)

b. Initial hedge effectiveness assessments in accordance with paragraph 815-20-25-3(b)(2)(iv)(01) through (04).

815-20-25-141 Example 1A beginning in paragraph 815-20-55-80A illustrates hedge documentation when the critical terms of the hedging instrument and hedged forecasted transaction match. Although that Example illustrates the documentation of the method of assessing hedge effectiveness, private companies that are not financial institutions may complete hedge documentation requirements in accordance with paragraphs 815-20-25-139 through 25-140.

Hedge Effectiveness Assessments

815-20-25-142 For a private company that is not a financial institution, the performance and documentation of the items listed in paragraph 815-20-25-140, as well as required subsequent quarterly hedge effectiveness assessments, may be completed before the date on which the next interim (if applicable) or annual financial statements are available to be issued. Even though the completion of the initial and ongoing assessments of effectiveness may be deferred to the date on which financial statements are available to be issued the assessments shall be completed using information applicable as of hedge inception and each subsequent quarterly assessment date when completing this documentation on a deferred basis. Therefore, the assessment should be performed to determine whether the hedge was highly effective at achieving offsetting changes in fair values or cash flows at inception and in each subsequent quarterly assessment period up to the reporting date.

Hedge Accounting Provisions Applicable to Certain Not-for-Profit Entities

815-20-25-143 Not-for-profit entities (except for not-for-profit entities that have issued, or are a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market) may apply the guidance on the timing of hedge documentation and hedge effectiveness assessments in paragraphs 815-20-25-139 through 25-142. Specifically, those entities shall document the items listed in paragraph 815-20-25-139 concurrent with hedge inception, but they may perform and document the items listed in paragraph 815-20-25-140 and perform the required subsequent quarterly hedge effectiveness assessments in accordance with paragraph 815-20-25-142 within the time periods discussed in paragraph 815-20-25-142.
Note: On August 10, 2022, the Statutory Accounting Principles (E) Working Group adopted the proposed revisions shown as tracked changes to SSAP No. 86 within this document.

SSAP No. 86—Derivatives
Measurement of Excluded Components
Ref #2021-20

Review of U.S. derivative guidance and the application to SAP is complex with many facets. This document is the second of two initial documents and focuses on the accounting and reporting of hedging instruments, including excluded components.

2) Measurement of Excluded Components In Hedging Instruments

Existing guidance in SSAP No. 86, paragraph 40, Exhibit B – Assessment of Hedging Effectiveness, and Exhibit C – Specific Hedge Accounting Procedures for Derivatives address components permitted to be excluded when determining hedge effectiveness and/or the measurement of excluded components. Key elements to note with regards to the existing guidance:

- Components permitted for exclusion in Exhibit B were adopted from U.S. GAAP (FAS 133, paragraph 63) at the time of initial SSAP adoption. Although these have not been updated since original issuance, NAIC staff is proposing (in the Hedge Effectiveness review document) to continue the adoption of U.S. GAAP in determining hedge effectiveness. This will ensure that hedging instruments identified as effective hedges under U.S. GAAP will be considered effective hedges under statutory accounting principles.

- The guidance in paragraph 40 and Exhibit B appears to adopt U.S. GAAP with the treatment of accounting for excluded components at fair value, with changes in fair value recognized as unrealized gains or losses.

- The existing guidance adopted from U.S. GAAP (in paragraph 40 and Exhibit B) is contradictory to guidance in SSAP No. 86, paragraph 23 and Exhibit C. Pursuant to paragraph 23, entities should not bifurcate the effectiveness of derivatives and a derivative instrument is either classified as an effective hedge or an ineffective hedge. If classified as an effective hedge, then the measurement method of the hedged item is used for the hedging instrument (e.g., amortized cost). This guidance does not seemingly permit reporting entities to report part of a hedging instrument at amortized cost, with excluded components reported at fair value. (However, NAIC staff believes this may in fact occur in practice under the provisions of paragraph 40 and Exhibit B.)

- Furthermore, the guidance in Exhibit C for foreign currency swaps and forwards identifies that premiums / discounts shall be amortized into income over the life of the contract. This treatment is different than the fair value / change in unrealized recognition for excluded component detailed in paragraph 40 and Exhibit B. (This guidance has been part of Exhibit C since the original adoption of the SSAP and reflects a difference from U.S. GAAP.)

Interested parties have identified that the SAP treatment of excluded components related to foreign currency transactions are hindering the ability to engage in those transactions and have requested consideration to 1) clarify the inconsistent guidance in SSAP No. 86, and 2) consider SAP specific measurement methods for excluded components to prevent surplus volatility from derivative transactions.

As background information, the classification of derivatives as highly effective is ultimately an income-statement matching tool. Although all derivatives are reported at fair value under U.S. GAAP, if effective hedges, then changes in fair value are allocated to either net income or other comprehensive income (OCI) in a manner that matches and predominantly offsets the fluctuations from the hedged item. (For example, under U.S. GAAP, a fair value hedge requires both the hedging instrument and the hedged item to be reported at fair value, so fluctuations on one of offset by the other.) Under SAP, as the hedged items are
not commonly reported at fair value, the guidance in SSAP No. 86 permits the derivative to reflect a measurement method that is more akin to the hedged item. (So, if hedging a bond at amortized cost, the hedging instrument would also be reported at amortized cost. This prevents fair value fluctuations from the highly effective hedge from causing ‘noise’ in the financial statements throughout the hedge duration.)

Interested parties have communicated that requiring excluded components for foreign currency hedges to be recognized at fair value, with changes in fair value recognized as unrealized gains / losses, the financial statements show volatility that is not reflective of the underlying hedging transaction:

- For foreign currency forward contracts that have a premium / discount (e.g., forward point – difference between the forward contract rate and the spot rate at derivative execution), the amount required is set at origination. Although the change in spot rate over the hedge term could result with a fair value change of the forward point / premium, this change in fair value does not impact the required amount that was set at derivative execution. (Under Exhibit C, the existing guidance would require amortization of the premium, but this is conflicting with paragraph 40 and Exhibit B.) Regardless of if the derivative is terminated early or is identified as ineffective, there is no change to the amount required from the forward point determined at derivative execution. (As such, requiring recognition at fair value, and the change of fair value, does not result with a presentation of the amount owed by the reporting entity.)

- For a foreign currency swap with a cross-currency basis spread, the fair value changes are captured as part of the foreign currency periodic interest accruals. (A forward contract does not have periodic interest accruals, which is why the premium / forward point is proposed to be amortized under the prior example). Furthermore, regardless of if the derivative transaction continues to be effective, at the time of derivative maturity, the cross-currency basis spread is zero. The only time a reporting entity would be obligated to provide payment for a cross-currency basis spread is if the currency swap is terminated prior to maturity. Interested parties have noted that this is unlikely for the following reasons:

  o Most foreign bond exposures come through private investments that are generally more difficult to sell, providing a disincentive to selling the bond exposure.

  o The investment was originally acquired as the risk profile of the foreign bond was attractive to the reporting entity over the term of the investment. So, unless the bond issuer is having significant credit deterioration, it is unlikely an insurer will sell the bond.

  o In the event the foreign bond is terminated early, the derivative would also be terminated early. This will result in both items being removed from the balance sheet, and the offsetting economics would be recognized together in the same period. (So, in this situation, even if a cross-currency basis spread is obligated, it would be offset by the foreign currency impact of the bond.)

  o Industry representatives have identified that it would be even more unlikely for the derivative to be sold while retaining the foreign bond, however, if that was to occur, then the existing guidance for derivative termination would occur.

After considering the scenarios and industry comments for foreign currency excluded components, NAIC staff agrees that requiring these foreign currency excluded components to be reported at fair value, with changes in fair value recognized as unrealized gains / losses throughout the derivative term, results with
Note: On August 10, 2022, the Statutory Accounting Principles (E) Working Group adopted the proposed revisions shown as tracked changes to SSAP No. 86 within this document.

SSAP No. 86—Derivatives
Measurement of Excluded Components

financial statement impacts that are not reflective of the derivative transactions. Ultimately, the fair value recognition of these components creates surplus volatility / noise, that is not reflective of the intent, nor the final outcome of the derivative instrument. NAIC staff highlights that the key exception to this conclusion would be for scenarios in which a reporting entity was to elect to terminate a derivative in advance of the maturity date. Although existing guidance requires recognition at fair value with the impact in net income (realized gain/loss) at the time of such termination, NAIC staff believes it would be more appropriate to require recognition at fair value at the time that an entity has decided to terminate a hedging instrument prior to its maturity date. This would be consistent with other statutory accounting guidance that requires recognition at fair value (other than amortized cost) at the time such decisions are made. NAIC staff believe this would be appropriate in situations in which both the hedging instrument and hedged item would be terminated together and situations in which the hedging instrument is terminated while the hedged item continues to be held.

Although the prior discussion, and current industry comments, were focused on foreign currency excluded components, NAIC staff highlights that U.S. GAAP permits other elements to be excluded from the assessment of hedge effectiveness. These include the following:

a. If the effectiveness of a hedge with an option is assessed based on changes in the option’s intrinsic value, the change in the time value of the option would be excluded from the assessment of hedge effectiveness.

b. If the effectiveness of a hedge with an option is assessed based on changes in the option’s minimum value, that is, its intrinsic value plus the effect of discounting, the change in the volatility value of the contract shall be excluded from the assessment of hedge effectiveness.

c. An entity may exclude any of the following components of the change in an option’s time value from the assessment of hedge effectiveness:

   i. The portion of the change in time value attributable to the passage of time (theta)
   ii. The portion of the change in time value attributable to changes due to volatility (vega)
   iii. The portion of the change in time value attributable to changes due to interest rates (rho).

Even if specific guidance is established for the foreign currency forward point and the cross-currency basis spread, statutory accounting guidance would still need clarification on the accounting and reporting for the other excluded components. If these excluded components are reported at fair value, with changes in unrealized gain/loss, NAIC staff highlights that the guidance should be clear in SSAP No. 86 and in the Schedule DB reporting instructions. Based on preliminary information, it seems current reporting for effective hedges is likely inconsistent for hedging instruments that have excluded components. NAIC staff has the impression that the following two options may currently be occurring:

- BACV reflects amortized cost. This would be consistent with SSAP No. 86, paragraph 23, but would be contrary to paragraph 40 and Exhibit B. (This would mean that the excluded components are not being recognized in the statutory financial statements.)

- BACV reflects a combination of amortized cost and fair value for the excluded components. This would be consistent with SSAP No. 86, paragraph 40 and Exhibit B, but would present an odd representation in Schedule DB as a derivative reported as an effective hedge would have an unrealized gain/loss, and the amount shown as an unrealized gain or loss would only be a specific portion of the change in fair value and could not be calculated from the information reported.
Note: On August 10, 2022, the Statutory Accounting Principles (E) Working Group adopted the revisions noted herein.

SSAP No. 86—Derivatives
Measurement of Excluded Components

Unless subsequent information and discussion supports a different approach for the non-foreign currency excluded components detailed above, NAIC staff agrees that reporting these components at fair value, with fair value changes recognized through unrealized gains/losses is appropriate. In order to facilitate this recognition, NAIC staff recommends clarifications to SSAP No. 86 to specify the commingled reporting of BACV for effective hedges with excluded components, as well as revisions to Schedule DB to capture information on excluded components in new electronic-only columns. NAIC staff also recommends a new disclosure that captures information on all excluded components by classification type.

Proposed SSAP Revisions To Incorporate / Clarify Guidance for Excluded Components

Derivatives Used in Hedging Transactions

22. Derivative instruments used in hedging transactions that meet the criteria of a highly effective hedge shall be considered an effective hedge and are permitted to be valued and reported in a manner that is consistent with the hedged asset or liability (referred to as hedge accounting). For instance, assume an entity has a financial instrument on which it is currently receiving income at a variable rate but wishes to receive income at a fixed rate and thus enters into a swap agreement to exchange the cash flows. If the transaction qualifies as an effective hedge and a financial instrument on a statutory basis is valued and reported at amortized cost, then the swap would also be valued and reported at amortized cost. Derivative instruments used in hedging transactions that do not meet or no longer meet the criteria of an effective hedge, or that meet the required criteria but the entity has chosen not to apply hedge accounting, shall be accounted for at fair value and the changes in the fair value shall be recorded as unrealized gains or unrealized losses (referred to as fair value accounting).¹

23. Entities shall not bifurcate the effectiveness of derivatives. A derivative instrument is either classified as an effective hedge or an ineffective hedge. Entities must account for the derivative using fair value accounting if it is deemed to be ineffective or becomes ineffective. Derivative instruments classified as effective with excluded components in determining hedge effectiveness pursuant to Exhibit A, paragraph 8, shall account for the derivative and excluded components pursuant to the guidance in paragraph 40. Entities may redesignate a derivative in a hedging relationship even though the derivative was used in a previous hedging relationship that proved to be ineffective. A change in the counterparty to a derivative instrument that has been designated as the hedging instrument in an existing hedging relationship would not, in and of itself, be considered a termination of the derivative instrument. An entity shall prospectively discontinue hedge accounting for an existing hedge if any one of the following occurs:

   a. Any criterion in paragraphs 26-38 is no longer met;
   
   b. The derivative expires or is sold, terminated, or exercised (the effect is recorded as realized gains or losses or, for effective hedges of firm commitments or forecasted transactions, in a manner that is consistent with the hedged transaction – see paragraph 24);
   
   c. The entity removes the designation of the hedge; or
   
   d. The derivative is deemed to be impaired in accordance with paragraph 18. A permanent decline in a counterparty’s credit quality/rating is one example of impairment required by paragraph 18, for derivatives used in hedging transactions.

¹ Pursuant to paragraph 19, the gross reported value of a derivative and the determination of unrealized gains or losses shall exclude the impact of financing premiums. Premiums payable or receivable from the acquisition or writing of a derivative shall not be reflected in the gross reporting of derivatives or in determining the fair value change in a derivative.
Note: On August 10, 2022, the Statutory Accounting Principles (E) Working Group adopted the proposed revisions shown as tracked changes to SSAP No. 86 within this document.

SSAP No. 86—Derivatives
Measurement of Excluded Components

Hedge Effectiveness

39. The measurement of hedge effectiveness for a particular hedging relationship shall be consistent with the entity’s risk management strategy and the method of assessing hedge effectiveness that was documented at the inception of the hedging relationship, as discussed in paragraph 41.

40. The gain or loss on a derivative designated as a hedge and assessed to be effective is reported consistently with the hedged item. (Therefore, if the hedged item is reported at amortized cost, and the hedging instrument is consistent with that measurement method, fluctuations in fair value would not be recognized as unrealized gains or losses for either the hedging item or hedging instrument.) If an entity’s defined risk management strategy for a particular hedging relationship excludes a specific component of the gain or loss, or related cash flows, on the hedging derivative from the assessment of hedge effectiveness (as discussed in Exhibit BA, paragraph 8), specific accounting treatment shall be followed for the that excluded component: of the gain or loss shall be recognized as an unrealized gain or loss. For example, if the effectiveness of a hedge with an option contract is assessed based on changes in the option’s intrinsic value, the changes in the option’s time value would be recognized in unrealized gains or losses. Time value is equal to the fair value of the option less its intrinsic value.

   a. If the excluded component pertains to the difference between a foreign currency spot price and the forward or future price (e.g., a forward rate), then this premium/discount shall be amortized into income over the life of the contract or hedged program. (This guidance addresses the excluded component in Exhibit A, paragraph 8.d.)

   b. If the excluded component pertains to a foreign currency swap cross-currency basis spread, the impact of fair value changes shall be reflected as a component of the foreign currency swap’s periodic interest accrual. (This guidance addresses the excluded component in Exhibit A, paragraph 8.e.)

   c. For all other excluded components, the excluded component shall be measured and reported at fair value, with changes in fair value recognized as unrealized gains or losses. (This guidance shall be applied to excluded components detailed in Exhibit A, paragraphs 8.a.-8.c.)

41. Hedging instruments with excluded components shall be identified in the financial statement investment schedule (Schedule DB) and shall be disclosed pursuant to paragraph 41.g.

Proposed New Disclosure Paragraph (This is proposed as a new subparagraph 41.g. with reordering of subsequent paragraphs.)

   g. For hedging instruments with excluded components for determining hedge effectiveness:

      i. In the investment schedule, identify hedging instruments with excluded components, and report the current fair value of the excluded component, the fair value of the excluded component that is reflected in the reported BACV for the hedging instrument (this item would not be applicable for foreign-currency forwards and currency swaps where the forward points or cross-currency basis, respectively, are the excluded component), and the change in fair value reported as an unrealized gains/loss. (Note – These items will be proposed in electronic columns to Schedule DB.)

      ii. In the notes to the financial statements, provide information on the aggregate excluded components by category: Time Value, Intrinsic Value, Forward Points and Cross Currency Basis Spread. The aggregate amounts reported should include the following (as applicable): current fair value, recognized unrealized
Note: On August 10, 2022, the Statutory Accounting Principles (E) Working Group adopted the revisions noted herein.

SSAP No. 86—Derivatives
Measurement of Excluded Components

Proposed Edits to Exhibit C – Foreign Currency Swaps and Forwards

Specific hedge accounting procedures for derivative instruments are outlined below.

1. Call and Put Options, Warrants, Caps, and Floors:
   a. Accounting at Date of Acquisition (purchase) or Issuance (written): The premium paid or received for purchasing or writing a call option, put option, warrant, cap or floor shall either be (i) recorded as an asset (purchase) or liability (written) on the Derivative line on the Assets (or) Liabilities pages or (ii) combined with the hedged item(s) individually or in the aggregate;
   b. Statement Value:
      i. Open derivatives hedging items recorded at amortized cost:
         (a) Options, warrants, caps, and floors purchased or written shall be valued at amortized cost in a manner consistent with the hedged item. (Components of a hedging instrument excluded from the determination of hedge effectiveness shall be recognized at fair value, with changes in fair value recognized as unrealized gains/losses throughout the duration of the hedging instrument. These components are not captured within the guidance for effective hedges detailed within this section.);
         (b) The amortization period and methods used shall result in a constant effective yield over the life of the hedged item or program. (For floating rate hedged items, the estimated effective yield shall be based on the current rate so the changes in yields attributable to changes in interest rates will be recognized in the period of change). Specific treatment includes:
            (1) Holdings in derivatives purchased or written within a year of maturity or expiry need not be amortized;
            (2) For hedges of forecasted transactions or firm commitments, the derivative may be recorded at cost until the hedged transaction occurs or it is determined that the hedge was not effective (see (d) in this section 1.b.i.);
            (3) For other derivatives, the amortization period is usually from date of acquisition (issuance) of the derivative to maturity of the hedged item or program.
         (c) For hedges where the cost of the derivative is combined with the hedged item, the statement value is zero. The fair value of the derivative and hedged item shall be determined and reported separately, either individually or in the aggregate;
(d) For hedges of forecasted transactions or firm commitments, the derivative shall be recorded at cost until (1) the hedged transaction occurs or (2) it is determined that the hedge was not effective (when the derivative is valued in accordance with (e) in this section);

(e) If during the life of the derivative it or a designated portion of the derivative is no longer effective as a hedge, valuation at amortized cost ceases and the derivative or the designated portion of the derivative shall be valued at its current fair value with gains and losses recognized in unrealized gains or unrealized losses to the extent it ceased to be an effective hedge.

d. Gain/Loss on Termination of an option, warrant, cap or floor accounted for under hedge accounting (includes closing, exercise, maturity, and expiry):

i. Exercise of an Option: The remaining book value of the derivative shall become an adjustment to the cost or proceeds of the hedged item(s) received or disposed of individually or in aggregate;

ii. Sale, maturity, expiry, or other closing transaction of a derivative which is an effective hedge—Any gain or loss on the transaction, except for excluded components, will adjust the basis (or proceeds) of the hedged item(s) individually or in aggregate. Alternatively, if the item being hedged is subject to IMR, the gain or loss on the terminated hedging derivative may be realized and shall be subject to IMR upon termination. For hedging instruments with excluded components in determining hedge effectiveness, the unrealized gain/loss from the change in fair value of the excluded component shall be realized upon the closing transaction. This gain/loss shall not be used to adjust the basis or proceeds of the hedged item.

iii. Gain/loss on termination of derivatives will be recognized currently in net income (realized gain/loss) to the extent they ceased to be effective hedges.

iv. Upon the redesignation of a derivative from a currently effective hedging relationship:

(a) with an item(s) carried at amortized cost to another effective hedging relationship with an item(s) carried at amortized cost, the derivative shall continue to be recorded at amortized cost and no gain or loss on the derivative shall be recognized.

(b) with an item(s) carried at amortized cost or fair value to an effective relationship with an item(s) carried at fair value, the accounting for the derivative shall be consistent with (ii) above.

(c) with an item(s) carried at fair value to an effective relationship with an item(s) carried at amortized cost, the accounting for the derivative shall be consistent with (ii) above.

2. Swaps, Collars, and Forwards (see also discussion in Introduction above):

a. Accounting at Date of Opening Position:

i. Any premium paid or received at date of opening shall either be (a) recorded on the Derivative line on the Assets (or) Liabilities pages or (b) combined with the hedged item(s), individually or in the aggregate;
Note: On August 10, 2022, the Statutory Accounting Principles (E) Working Group adopted the revisions noted herein.

SSAP No. 86—Derivatives
Measurement of Excluded Components

b. Statement Value:

i. Open derivatives hedging items recorded at amortized cost:

(a) Swaps, collars, and forwards shall be valued at amortized cost in a manner consistent with hedged item. (Components of a hedging instrument excluded from the determination of hedge effectiveness not addressed in 2.b.iii. shall be recognized at fair value, with changes in fair value of the excluded component recognized as unrealized gains/losses throughout the duration of the hedging instrument. These components are not captured within the guidance for effective hedges detailed within this section.);

(b) The amortization period and methods used shall result in a constant effective yield over the life of the hedged item or program. (For floating rate hedged items the estimated effective yield shall be based on the current rate so the changes in yields attributable to changes in interest rates will be recognized in the period of change.) Specific treatment includes:

(1) Holdings in derivatives purchased or written within a year of maturity or expiry need not be amortized;

(2) For hedges of forecasted transactions or firm commitments, the derivative shall be recorded at cost until (a) the hedged transaction occurs or (b) it is determined that the hedge was not effective (see (5) in this section 2.b.i.);

(3) For other derivatives the amortization period is usually from date of acquisition (issuance) of the derivative to maturity of the hedged item or program;

(4) For hedges where the cost of the derivative is combined with the hedged item, the statement value is zero. The fair value of the derivative and hedged item shall be determined and reported separately, either individually or in the aggregate;

(5) If during the life of the derivative it or a designated portion of the derivative is no longer effective as a hedge, valuation at amortized cost ceases and the derivative or a designated portion of the derivative shall be valued at its current fair value with gains and losses recorded in unrealized gains or unrealized losses to the extent that it ceased to be an effective hedge. Upon redesignation into an effective hedging relationship, the derivative’s mark to fair value through unrealized gain or loss shall be reversed.

ii. Open derivatives hedging items recorded at fair value (where gains and losses on the hedged item are recognized as adjustments to unassigned funds (surplus)):

(a) Swaps, collars, or forwards shall be valued at current fair value with changes in fair value recognized currently consistent with the hedged item; this will result in unrealized gain/loss treatment with adjustment to unassigned funds (surplus);
Note: On August 10, 2022, the Statutory Accounting Principles (E) Working Group adopted the proposed revisions shown as tracked changes to SSAP No. 86 within this document.

**SSAP No. 86—Derivatives**

**Measurement of Excluded Components**

Ref #2021-20

(b) For hedges where the derivative is combined with the hedged item, the fair value of the derivative and hedge item shall be determined and reported separately, either individually or in the aggregate. The cost (book value) basis used to figure gain/loss on the derivative is zero.

iii. Open foreign currency swap and forward contracts hedging foreign currency exposure on items denominated in a foreign currency and translated into U.S. dollars where fair value accounting is not being used:

(a) The foreign exchange premium (discount) on the currency contract shall be amortized into income over the life of the contract or hedge program. The foreign exchange premium (discount) is defined as the foreign currency (notional) amount to be received (paid) times the net of the forward rate minus the spot rate at the time the contract was opened. For forward contracts, an excluded component representing a foreign exchange premium (discount) (forward points) on the currency contract shall be amortized into income over the life of the contract or hedge program. Amortization is not required if the contract was entered into within a year of maturity. For foreign currency swaps, an excluded component representing a cross-currency basis spread is recognized into income through the foreign currency swap's periodic interest accruals.

Amortization is not required if the contract was entered into within a year of maturity;

(b) A foreign currency translation adjustment shall be reflected as an unrealized gain/loss (unassigned funds (surplus) adjustment) using the same procedures as done to translate the hedged item;

(c) The unrealized gain/loss for the period equals the foreign currency (notional) amount to be received (paid) times the net of the current spot rate minus the prior period end spot rate;

(d) The statement value of the derivative equals the amortized cost plus:

1. For forward contracts, the amortized (premium) discount plus the cumulative unrealized gain/(loss) on the contract.

2. For foreign currency swaps, the cumulative unrealized gain/(loss) on the contract. The cross-currency basis spread is recorded through the Investment Income Due and Accrued or Other Liabilities, as a component of the foreign currency swap's periodic interest accrual.

The cumulative unrealized gain/loss equals the foreign currency (notional) amount to be received (paid) times the net of the current spot rate minus the spot rate at the time the contract was opened;

(e) Recognition of unrealized gains/losses and amortization of foreign exchange premium/discount on derivatives hedging forecasted transactions or firm commitments shall be deferred until the hedged transaction occurs. These deferred gains/losses will adjust the basis or proceeds of the hedged transaction when it occurs;

(f) For hedges where the cost of the foreign currency contract is combined with the hedged item, the statement value on Schedule DB is zero. The
fair value of the derivative and hedged item shall be determined and reported separately, either individually or in the aggregate;

(g) If during the life of the currency contract it or a designated portion of the currency contract is not effective as a hedge, the derivative shall be recorded at fair value and valuation at amortized cost shall cease. To the extent it ceased to be an effective hedge, a cumulative unrealized gain/loss (surplus adjustment) shall be recognized equal to the difference between the carrying value of the derivative on the balance sheet and the fair value of the derivative if either of the following occur:

1. During the life of the currency contract it or a designated portion of the currency contract is not effective as a hedge.

2. The entity decides to terminate the derivative in advance of scheduled maturity.

iv. Open derivatives hedging items recorded at fair value, where gains and losses on the hedged item are recognized currently in earnings: swaps, collars and forwards shall be valued at current fair value with changes in fair value recognized currently in earnings together with the gains and losses on the hedged item.

(a) If during the life of the derivative it or a designated portion of the derivative is no longer effective as a hedge, recognition of changes in fair value through earnings ceases. The derivative shall continue to be valued at its current fair value, but thereafter gains or losses shall be recognized in unrealized gains or unrealized losses to the extent it ceased to be an effective hedge.

c. Cash Flows and Income:

i. Where the cost of the derivative is not combined with the hedged item:

(a) Amortization of premium paid or received on derivatives is an adjustment to net investment income or another appropriate caption within operating income consistent with the reporting of the hedged item;

(b) Periodic cash flows and accruals of income/expense are to be reported in a manner consistent with the hedged item, usually as net investment income or another appropriate caption within operating income.

ii. Where the cost of the derivative is combined with the hedged item, the cash flows and income of the derivative on Schedule DB is zero. All related amortization and cash flow accounting shall be reported with the hedged item instead of with the derivative.

d. Gain/Loss on Termination of a swap, collar or forward accounted for under hedge accounting (includes closing, exercise, maturity, and expiry):
Note: On August 10, 2022, the Statutory Accounting Principles (E) Working Group adopted the proposed revisions shown as tracked changes to SSAP No. 86 within this document.

_i. Exercise—_The remaining book value of the derivative shall become an adjustment to the cost or proceeds of the hedged item(s) received or disposed of individually or in aggregate;

_ii. Sale, maturity, expiry, or other closing transaction of a derivative which is an effective hedge—_Any gain or loss on the transaction, except for excluded components, will adjust the basis (or proceeds) of the hedged item(s) individually or in aggregate. Alternatively, if the item being hedged is subject to IMR, the gain or loss on the terminated hedging derivative may be realized and shall be subject to IMR upon termination.\(^7\)

_iii. Gain/loss on termination of derivatives will be recognized currently in net income (realized gain/loss) to the extent they ceased to be effective hedges.

_iv. Upon the redesignation of a derivative from a currently effective hedging relationship-

(a) with an item(s) carried at amortized cost to another effective hedging relationship with an item(s) carried at amortized cost, the derivative shall continue to be recorded at amortized cost and no gain or loss on the derivative shall be recognized.

(b) with an item(s) carried at amortized cost or fair value to an effective relationship with an item(s) carried at fair value, the accounting for the derivative shall be consistent with (ii) above.

(c) with an item(s) carried at fair value to an effective relationship with an item(s) carried at amortized cost, the accounting for the derivative shall be consistent with (ii) above.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2022/7-Summer NM/Adoptions/21-20 SSAP No. 86 - Excluded Components - 8-10-22.docx
Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A

Issue: Conceptual Framework – Updates

Check (applicable entity):

<table>
<thead>
<tr>
<th>Modification of Existing SSAP</th>
<th>P/C</th>
<th>Life</th>
<th>Health</th>
</tr>
</thead>
<tbody>
<tr>
<td>New Issue or SSAP</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interpretation</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Description of Issue: In December 2021, the Financial Accounting Standards Board (FASB) issued two new chapters of its conceptual framework. The conceptual framework is a body of interrelated objectives and fundamentals that provides the FASB with a foundation for setting standards and concepts to consider when it resolves questions or develops/modifies accounting and reporting guidance.

It is important to note that the Statements of Financial Accounting Concepts are not authoritative and do not establish new or change existing U.S. GAAP. Per the FASB chair, these concepts are “a tool for the Board to use in setting standards that improve the understandability of information entities provide to existing and potential investors, lenders, donors, and other resource providers.”

This agenda item reviews and summarizes each of the two newly issued concept chapters and reviews their potential impact on statutory accounting. Again, while the conceptual framework statements are not authoritative, they are the guiding principles for standard setting and these new updates have superseded chapters currently referenced in the Accounting Practices and Procedures Manual (AP&P Manual). In addition, and most notably, in the case of one of these chapters, FASB changed certain key fundamental definitions, specifically the definition of an asset and liability, which have historically been mirrored by statutory accounting.

Update 1:
FASB Concepts Statement No. 8, Conceptual Framework for Financial Reporting—Chapter 4, Elements of Financial Statements introduced updated definitions of certain key elements used in financial reporting – the definition of an asset and liability. The chapter states that assets and liabilities have conceptual and definitional primacy because assets and liabilities (and changes in those elements) are foundational to all the other items reported in the financial statements. To correctly identify and represent an asset or liability is the beginning basis for all financial reporting and due to their importance, updates to both financial statement elements have been adopted. A summary of each, comparing the historical and current definitions, is provided below:

Changes regarding the definition of an ASSET:

- **Historical definition:** a probable future economic benefit obtained or controlled by a particular entity as a result of past transactions or events.

- **Historical Characteristics: Three essential characteristics:**
  1. it embodies a probable future benefit that involves a capacity, singly or in combination with other assets, to contribute directly or indirectly to future net cash inflows,
  2. a particular enterprise can obtain the benefit and control others' access to it, and
  3. the transaction or other event giving rise to the enterprise's right to or control of the benefit has already occurred.

  ➢ **New Definition:** a present right of an entity to an economic benefit.
Current Characteristics: Two essential characteristics:

1. it is a present right, and
2. the right is to an economic benefit.

The combination of these two characteristics allows an entity to obtain the economic benefit and control others’ access to the benefit. A present right of an entity to an economic benefit entitles the entity to the economic benefit and the ability to restrict others’ access to the benefit to which the entity is entitled. For clarity, an “economic benefit” represents services or other items of economic value and generally result in net cash inflows to the entity.

Commentary regarding definitional changes:
The current definition of an asset no longer includes the term probable or the phrases future economic benefit and past transactions or events. The FASB concluded that the term probable has historically been misunderstood as implying that a future benefit must be probable to a certain threshold before the definition of an asset was met. Thus, if the probability of a future benefit was low, an asset could not be recognized. FASB also struck the phrase future economic benefit as this phrase often was interpreted that the asset must represent a certain future economic benefit (such as eventual cash inflows), however with this update, FASB clarified that the asset represents the rights to the benefit, not the actual benefit itself – nor the probability of realization.

Finally, FASB struck the phrase as the result of past transactions or events. It was concluded that if the asset represents a present right, by default, the right must have occurred as the result of a past transaction or event and thus this phraseology was deemed redundant and unnecessary.

Changes regarding the definition of a LIABILITY:

○ Historical definition: are [certain or] probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events.

○ Historical Characteristics: Three essential characteristics:

1. it embodies a present duty or responsibility to one or more other entities that entails settlement by probable future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand,
2. the duty or responsibility obligates a particular enterprise, leaving it little or no discretion to avoid the future sacrifice, and
3. the transaction or other event obligating the enterprise has already happened.

➢ New Definition: a present obligation of an entity to transfer an economic benefit.

➢ Current Characteristics: Two essential characteristics:

1. it is a present obligation, and
2. the obligation requires an entity to transfer or otherwise provide economic benefit to others. (For the purposes of this characteristic, transfer is typically used to describe obligations to pay cash or convey assets, while the term provide is used to describe obligations to provide services or stand by to do so).

Commentary regarding definitional changes:
The current definition of a liability no longer includes the term probable or the phrase in the future as a result of past transactions or events. The FASB concluded that the term probable has historically been understood as implying that a future obligation must meet a probability to a certain threshold before the definition of a liability was met. Thus, if the probability of a future transfer of an asset (or the requirement to provide a service) was low, a liability would likely not be recognized. In removing the term probable (and replacing it with “present
obligation”), FASB concluded that in almost all situations, the presence of an obligation will be apparent. It stated that most present obligations are legally enforceable, including obligations arising from binding contracts, agreements, statutes, or other legal or contractual means. Chapter 4 also discusses the prevalence of certain business risks and how to assess if they result in the recognition of a liability. It concluded that while certain businesses pose risk of future events occurring that will cause them to transfer an economic benefit (an asset), the risk itself does not represent a present obligation because exposure to a potential negative consequence does not constitute a present obligation.

However, FASB also stated situations lacking clear legal or contractual evidence of a present obligation may pose particular challenges that may make it difficult to discern whether a present obligation exists. In these settings, the FASB stated that constructive obligations or other noncontractual obligations are created by circumstance rather than by explicit agreement. In the absence of an explicit agreement, sufficient information to distinguish a present obligation is likely only available at the specific standards level. Thus, the FASB concluded that the specific facts and circumstances at the standards level (or in the case of statutory accounting, at the SAP level) must be utilized to determine whether the entity has created a constructive obligation and must recognize a liability.

FASB also struck the phrase as the result of past transactions or events. It was concluded that if the liability represents a present right, by default, the right must have occurred as the result of a past transaction or event and thus this phraseology was deemed redundant and unnecessary.

Update 2:
FASB Concepts Statement No. 8, Conceptual Framework for Financial Reporting—Chapter 7, Presentation identifies factors that the FASB will consider when deciding how items should be displayed on the financial statements. Chapter 7 describes the information to be included in the financial statements and how appropriate presentation can contribute to the objective of financial reporting – to communicate financial information about an entity that is useful to existing and potential investors, lenders, and other creditors in making decisions about providing resources (goods and services) to the entity. These decisions typically involve buying or selling of goods/services or holding equity and debt instruments as well as providing or settling loans or other forms of credit. This chapter articulates that the financial statements meet a “general purpose” and should not be considered to meet all purposes for possible users – and thus a common set of conceptual standards is appropriate.

Chapter 7 also describes the importance of financial statement notes, or supplementary information so that financial statement users are provided with a more complete picture of an entity’s accounting policy or any particular unique circumstance or event. In terms of general reporting, the conceptual statement relays that a distinction between nonhomogeneous items should be depicted in the financial statements with different reporting line items and subtotals and that the information should be provided based on recognition and measurement standards. In essence, reporting should be sufficiently aggregated, but not aggregated to a level in which the information is too consolidated for general use and understanding. Once reported, then any significant accounting policy or circumstance would further be defined with accompanying notes.

The chapter broadly states that to meet the objectives of financial reporting, line items should be distinct based on the information being provided – as the information should distinguish between various types of transactions/events and should assist users in their estimates in the amounts and timing of future cash flows or the entity’s ability to provide other economic value. The financial statements should depict the results of different types of transactions, including changes in events or other circumstances that may vary the frequency or predictability of performance based on many items, including changes in economic conditions.

In summary, while Chapter 7 does supersede sections of Statement of Financial Accounting Concept 5, it did not result in fundamental changes to the principal concepts of financial reporting. The chapter articulates the need for complete financial reporting, describes the interconnectedness of a ‘complete set of financial statements’ and relays the importance of these documents as the information in the financial statements is the primary (and typically the sole) source for analyzing current and potential future performance of an organization and its ability to meet its long-term financial objectives. At a high level, the chapter discusses what information should broadly be categorized
as revenues, expenses, gains, and losses and to the extent equity is impacted by operations as well as changes in owners’ equity through investments or distributions.

In terms of the impact to statutory accounting, the updated concepts in this chapter are not expected to modify current guidance, other than to update references to superseded accounting concepts.

Existing Authoritative Literature:

| NAIC Staff Note – the Preamble contains reference to certain concept statements in footnotes 2 and 4 and have been bolded below for ease of identification. It is important to note that while these footnotes currently reference superseded conceptual statements, the conceptual statements noted do not represent adopted guidance - they are noted as reference for overarching guiding principles regarding financial reporting. |

Preamble

IV. Statutory Accounting Principles Statement of Concepts

25. This document states the fundamental concepts on which statutory financial accounting and reporting standards are based. These concepts provide a framework to guide the National Association of Insurance Commissioners (NAIC) in the continued development and maintenance of statutory accounting principles (“SAP” or “statutory basis”) and, as such, these concepts and principles constitute an accounting basis for the preparation and issuance of statutory financial statements by insurance companies in the absence of state statutes and/or regulations.

26. The NAIC and state insurance departments are primarily concerned with statutory accounting principles that differ from GAAP reflective of the varying objectives of regulation. Recodification of areas where SAP and GAAP are parallel is an inefficient use of limited resources.

27. SAP utilizes the framework established by GAAP. FN2 This document integrates that framework with objectives exclusive to statutory accounting. The NAIC's guidance on SAP is comprehensive for those principles that differ from GAAP based on the concepts of statutory accounting outlined herein. Those GAAP pronouncements that are not applicable to insurance companies will not be adopted by the NAIC. For those principles that do not differ from GAAP, the NAIC must specifically adopt those GAAP Pronouncements to be included in statutory accounting. GAAP Pronouncements do not become part of SAP until and unless adopted by the NAIC.

28. The body of statutory accounting principles is prescribed in the statutory hierarchy of accounting guidance. This hierarchy provides the framework for judging the presentation of statutory financial statements in conformance with statutory accounting principles.

29. Statutory requirements vary from state to state. While it is desirable to minimize these variations, to the extent that they exist it is the objective of NAIC statutory accounting principles to provide the standard against which the exceptions will be measured and disclosed if material.

FN 2 - The GAAP framework applicable to insurance accounting is set forth in Statements of Financial Accounting Concepts One, Two, Five, and Six. These documents, promulgated by the Financial Accounting Standards Board, set forth the objectives and concepts which are used in developing accounting and reporting standards.

V. Statutory Hierarchy

42. The following Hierarchy is not intended to preempt state legislative and regulatory authority.

Level 1

SSAPs, including U.S. GAAP reference material to the extent adopted by the NAIC from the FASB Accounting Standards Codification (FASB Codification or GAAP guidance)
Level 2

Consensus positions of the Emerging Accounting Issues (E) Working Group as adopted by the NAIC (INTs adopted before 2016)

Interpretations of existing SSAPs as adopted by the Statutory Accounting Principles (E) Working Group (INTs adopted in 2016 or beyond)

Level 3

NAIC Annual Statement Instructions

Purposes and Procedures Manual of the NAIC Investment Analysis Office

Level 4

Statutory Accounting Principles Preamble and Statement of Concepts FN4

Level 5

Sources of nonauthoritative GAAP accounting guidance and literature, including: (a) practices that are widely recognized and prevalent either generally or in the industry, (b) FASB Concept Statements, (c) AICPA guidance not included in FASB Codification, (d) International Financial Reporting Standards, (e) Pronouncements of professional associations or regulatory agencies, (f) Technical Information Service Inquiries and Replies included in the AICPA Technical Practice Aids, and (g) Accounting textbooks, handbooks and articles

43. If the accounting treatment of a transaction or event is not specified by the SSAPs, preparers, regulators and auditors of statutory financial statements should consider whether the accounting treatment is specified by another source of established statutory accounting principles. If an established statutory accounting principle from one or more sources in Level 2 or 3 is relevant to the circumstances, the preparer, regulator or auditor should apply such principle. If there is a conflict between statutory accounting principles from one or more sources in Level 2 or 3, the preparer, regulator or auditor should follow the treatment specified by the source in the higher level—that is, follow Level 2 treatment over Level 3. Revisions to guidance in accordance with additions or revisions to the NAIC statutory hierarchy should be accounted for as a change in accounting principle in accordance with SSAP No. 3—Accounting Changes and Corrections of Errors.

44. Because of developments such as new legislation or the evolution of a new type of business transaction, there sometimes are no established statutory accounting principles for reporting a specific transaction or event. In those instances, it might be possible to report the event or transaction on the basis of its substance by selecting a statutory accounting principle that appears appropriate when applied in a manner similar to the application of an established statutory principle to an analogous transaction or event. In the absence of a SSAP or another source of established statutory accounting principles, the preparer, regulator or auditor of statutory financial statements may consider other accounting literature, depending on its relevance in the circumstances. Other accounting literature includes the Statutory Accounting Principles Statement of Concepts and GAAP reference material and accounting literature identified in Level 5. The appropriateness of other accounting literature depends on its relevance to the particular circumstances, the specificity of the guidance, and the general recognition of the issuer or author as an authority. For example, the Statutory Accounting Principles Statement of Concepts would be more authoritative than any other sources of accounting literature. Similarly, FASB Concepts Statements would normally be more influential than other sources of nonauthoritative GAAP pronouncements.

FN 4 - The Statutory Accounting Principles Statement of Concepts incorporates by reference FASB Concepts Statements One, Two, Five and Six to the extent they do not conflict with the concepts outlined in the statement. However, for purposes of applying this hierarchy the FASB Concepts Statements shall be included in Level 5 and only those concepts unique to statutory accounting as stated in the statement are included in Level 4.
SSAP No. 4—Assets and Nonadmitted Assets

**NAIC Staff Note** – this SAP contains the definition of the financial statement element of an **Asset**. Relevant items have been bolded below for ease of identification.

2. **For purposes of statutory accounting, an asset shall be defined as: probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events.** An asset has three essential characteristics: (a) it embodies a probable future benefit that involves a capacity, singly or in combination with other assets, to contribute directly or indirectly to future net cash inflows, (b) a particular entity can obtain the benefit and control others’ access to it, and (c) the transaction or other event giving rise to the entity’s right to or control of the benefit has already occurred. These assets shall then be evaluated to determine whether they are admitted. The criteria used is outlined in paragraph 3.

3. **As stated in the Statement of Concepts, "The ability to meet policyholder obligations is predicated on the existence of readily marketable assets available when both current and future obligations are due. Assets having economic value other than those which can be used to fulfill policyholder obligations, or those assets which are unavailable due to encumbrances or other third-party interests should not be recognized on the balance sheet," and are, therefore, considered nonadmitted. For purposes of statutory accounting principles, a nonadmitted asset shall be defined as an asset meeting the criteria in paragraph 2, which is accorded limited or no value in statutory reporting, and is one which is:

   a. Specifically identified within the *Accounting Practices and Procedures Manual* as a nonadmitted asset; or

   b. Not specifically identified as an admitted asset within the *Accounting Practices and Procedures Manual*.

If an asset meets one of these criteria, the asset shall be reported as a nonadmitted asset and charged against surplus unless otherwise specifically addressed within the *Accounting Practices and Procedures Manual*. The asset shall be depreciated or amortized against net income as the estimated economic benefit expires. In accordance with the reporting entity’s written capitalization policy, amounts less than a predefined threshold of furniture, fixtures, equipment, or supplies, shall be expensed when purchased.

4. **Transactions which do not give rise to assets as defined in paragraph 2 shall be charged to operations in the period the transactions occur.** Those transactions which result in amounts which may meet the definition of assets, but are specifically identified within the *Accounting Practices and Procedures Manual* as not giving rise to assets (e.g., policy acquisition costs), shall also be charged to operations in the period the transactions occur.

5. **The reporting entity shall maintain a capitalization policy containing the predefined thresholds for each asset class to be made available for the department(s) of insurance.**

**FN1** - *FASB Statement of Financial Accounting Concepts No. 6, Elements of Financial Statements*, states: Probable is used with its usual general meaning, rather than in a specific accounting or technical sense (such as that in *FASB Statement No. 5, Accounting for Contingencies*, paragraph 3), and refers to that which can reasonably be expected or believed on the basis of available evidence or logic but is neither certain nor proved.

**FN2** - If assets of an insurance entity are pledged or otherwise restricted by the action of a related party, the assets are not under the exclusive control of the insurance entity and are not available to satisfy policyholder obligations due to these encumbrances or other third-party interests. Thus, pursuant to paragraph 2(c), such assets shall not be recognized as an admitted asset on the balance sheet. Additional guidance for assets pledged as collateral is included in INT 01-31.
SSAP No. 5—Liabilities, Contingencies and Impairments of Assets

**NAIC Staff Note** – this SAP contains the definition of the financial statement element of a **Liability**. Relevant items have been bolded below for ease of identification.

2. A liability is defined as certain or probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or to provide services to other entities in the future as a result of a past transaction(s) or event(s).

3. A liability has three essential characteristics: (a) it embodies a present duty or responsibility to one or more other entities that entails settlement by probable future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand, (b) the duty or responsibility obligates a particular entity, leaving it little or no discretion to avoid the future sacrifice, and (c) the transaction or other event obligating the entity has already happened. This includes, but is not limited to, liabilities arising from policyholder obligations (e.g., policyholder benefits, reported claims and reserves for incurred but not reported claims). Liabilities shall be recorded on a reporting entity’s financial statements when incurred.

4. Estimates (e.g., loss reserves) are required in financial statements for many ongoing and recurring activities of a reporting entity. The mere fact that an estimate is involved does not of itself constitute a loss contingency. For example, estimates of losses utilizing appropriate actuarial methodologies meet the definition of liabilities as outlined above and are not loss contingencies.

**FN1 - FASB Statement of Financial Accounting Concepts No. 6, Elements of Financial Statements**, states: Probable is used with its usual general meaning, rather than in a specific accounting or technical sense (such as that in FASB Statement 5, Accounting for Contingencies, paragraph 3), and refers to that which can reasonably be expected or believed on the basis of available evidence or logic but is neither certain nor proved.

Activity to Date: (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): None

Information or issues (included in Description of Issue) not previously contemplated by the Working Group: None

Convergence with International Financial Reporting Standards (IFRS): While slightly different, the updated FASB asset & liability definitions do closer align with IFRS definitions. While IFRS retains the phrase “as a result of past events,” it also explicitly retains the term “control,” which is now implicit with the FASB updates. The elimination of the explicit term “control” was a deliberate action of the FASB as they noted that the notion of control has been historically misunderstood (control is to the right that gives rise to the economic benefit rather than to the economic benefits themselves). For reference **IFRS Chapter 4 – The Elements of Financial Statements**, defines an **asset** as a present economic resource controlled by the entity as a result of past events; with the economic resource representing a right that has the potential to produce economic benefits. Additionally, the chapter defines a **liability** as a present obligation of an entity to transfer an economic resource as a result of past events.

Staff Recommendation: NAIC staff recommends that the Working Group move this item to the active listing, categorized as a SAP clarification, and expose revisions to the Preamble, SSAP No. 4—**Assets and Nonadmitted Assets** and SSAP No. 5—**Liabilities, Contingencies and Impairment of Assets**, as illustrated below and in the issue papers, to incorporate updates from Chapter 4, Elements of Financial Statements and Chapter 7, Presentation of the FASB’s Conceptual Framework for Financial Reporting.

**Proposed edits to the Preamble:** proposed modifications reflect updates for superseded FASB Financial Accounting Concepts.
IV. Statutory Accounting Principles Statement of Concepts

25. This document states the fundamental concepts on which statutory financial accounting and reporting standards are based. These concepts provide a framework to guide the National Association of Insurance Commissioners (NAIC) in the continued development and maintenance of statutory accounting principles (“SAP” or “statutory basis”) and, as such, these concepts and principles constitute an accounting basis for the preparation and issuance of statutory financial statements by insurance companies in the absence of state statutes and/or regulations.

26. The NAIC and state insurance departments are primarily concerned with statutory accounting principles that differ from GAAP reflective of the varying objectives of regulation. Recodification of areas where SAP and GAAP are parallel is an inefficient use of limited resources.

27. SAP utilizes the framework established by GAAP. FN2 This document integrates that framework with objectives exclusive to statutory accounting. The NAIC’s guidance on SAP is comprehensive for those principles that differ from GAAP based on the concepts of statutory accounting outlined herein. Those GAAP pronouncements that are not applicable to insurance companies will not be adopted by the NAIC. For those principles that do not differ from GAAP, the NAIC must specifically adopt those GAAP Pronouncements to be included in statutory accounting. GAAP Pronouncements do not become part of SAP until and unless adopted by the NAIC.

28. The body of statutory accounting principles is prescribed in the statutory hierarchy of accounting guidance. This hierarchy provides the framework for judging the presentation of statutory financial statements in conformance with statutory accounting principles.

29. Statutory requirements vary from state to state. While it is desirable to minimize these variations, to the extent that they exist it is the objective of NAIC statutory accounting principles to provide the standard against which the exceptions will be measured and disclosed if material.

FN 2 - The GAAP framework applicable to insurance accounting is set forth in Statements of Financial Accounting Concepts One, Two, Five, and Six Eight. These documents, promulgated by the Financial Accounting Standards Board, set forth the objectives and concepts which are used in developing accounting and reporting standards.

V. Statutory Hierarchy

42. The following Hierarchy is not intended to preempt state legislative and regulatory authority.

Level 1

SSAPs, including U.S. GAAP reference material to the extent adopted by the NAIC from the FASB Accounting Standards Codification (FASB Codification or GAAP guidance)

Level 2

Consensus positions of the Emerging Accounting Issues (E) Working Group as adopted by the NAIC (INTs adopted before 2016)

Interpretations of existing SSAPs as adopted by the Statutory Accounting Principles (E) Working Group (INTs adopted in 2016 or beyond)

Level 3

NAIC Annual Statement Instructions

Purposes and Procedures Manual of the NAIC Investment Analysis Office
Level 4

Statutory Accounting Principles Preamble and Statement of Concepts FN4

Level 5

Sources of nonauthoritative GAAP accounting guidance and literature, including: (a) practices that are widely recognized and prevalent either generally or in the industry, (b) FASB Concept Statements, (c) AICPA guidance not included in FASB Codification, (d) International Financial Reporting Standards, (e) Pronouncements of professional associations or regulatory agencies, (f) Technical Information Service Inquiries and Replies included in the AICPA Technical Practice Aids, and (g) Accounting textbooks, handbooks and articles

FN 4 - The Statutory Accounting Principles Statement of Concepts incorporates by reference FASB Concepts Statements One, Two, Five and Six Eight to the extent they do not conflict with the concepts outlined in the statement. However, for purposes of applying this hierarchy the FASB Concepts Statements shall be included in Level 5 and only those concepts unique to statutory accounting as stated in the statement are included in Level 4.

Proposed edits SSAP No. 4—Assets and Nonadmitted Assets: proposed modifications reflect an updated definition of the term Asset – to match the newly issued definition in FASB Statement of Financial Accounting Concepts No. 8

2. For purposes of statutory accounting, an asset shall be defined as: a present right of an entity to an economic benefit, probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events. An asset has two three essential characteristics: (a) it is a present right that embodies a probable future benefit that involves a capacity, singly or in combination with other assets, to contribute directly or indirectly to future net cash inflows, and (b) the right is to an economic benefit, a particular entity can obtain the benefit and control others' access to it FN1 FN2, and (c) the transaction or other event giving rise to the entity's right to or control of the benefit has already occurred. These assets shall then be evaluated to determine whether they are admitted. The criteria used is outlined in paragraph 3.

3. As stated in the Statement of Concepts, "The ability to meet policyholder obligations is predicated on the existence of readily marketable assets available when both current and future obligations are due. Assets having economic value other than those which can be used to fulfill policyholder obligations, or those assets which are unavailable due to encumbrances or other third-party interests should not be recognized on the balance sheet," and are, therefore, considered nonadmitted. For purposes of statutory accounting principles, a nonadmitted asset shall be defined as an asset meeting the criteria in paragraph 2, which is accorded limited or no value in statutory reporting, and is one which is:

   a. Specifically identified within the Accounting Practices and Procedures Manual as a nonadmitted asset; or


If an asset meets one of these criteria, the asset shall be reported as a nonadmitted asset and charged against surplus unless otherwise specifically addressed within the Accounting Practices and Procedures Manual. The asset shall be depreciated or amortized against net income as the estimated economic benefit expires. In accordance with the reporting entity's written capitalization policy, amounts less than a predefined threshold of furniture, fixtures, equipment, or supplies, shall be expensed when purchased.

4. Transactions which do not give rise to assets as defined in paragraph 2 shall be charged to operations in the period the transactions occur. Those transactions which result in amounts which may meet the definition of assets, but are specifically identified within the Accounting Practices and Procedures Manual as not giving rise to assets (e.g., policy acquisition costs), shall also be charged to operations in the period the transactions occur.
5. The reporting entity shall maintain a capitalization policy containing the predefined thresholds for each asset class to be made available for the department(s) of insurance.

FN1 - FASB Statement of Financial Accounting Concepts No. 86, Elements of Financial Statements, states that the combination of these two characteristics allows an entity to obtain the economic benefit and control others’ access to the benefit. A present right of an entity to an economic benefit entitles the entity to the economic benefit and the ability to restrict others’ access to the benefit to which the entity is entitled.

Probable is used with its usual general meaning, rather than in a specific accounting or technical sense (such as that in FASB Statement No. 5, Accounting for Contingencies, paragraph 3), and refers to that which can reasonably be expected or believed on the basis of available evidence or logic but is neither certain nor proved.

FN2 - If assets of an insurance entity are pledged or otherwise restricted by the action of a related party, the assets are not under the exclusive control of the insurance entity and are not available to satisfy policyholder obligations due to these encumbrances or other third-party interests. Thus, pursuant to paragraph 2(c), such assets shall not be recognized as an admitted asset on the balance sheet. Additional guidance for assets pledged as collateral is included in INT 01-31.

Relevant Literature

9. This statement incorporates the definition of an asset from adopts FASB Statement of Financial Accounting Concepts No. 86, Chapter 4, Elements of Financial Statements, paragraphs E16-E1825-33.

References

Relevant Issue Papers

Issue Paper No. 4—Definition of Assets and Nonadmitted Assets

Issue Paper No. 119—Capitalization Policy, An Amendment to SSAP Nos. 4, 19, 29, 73, 79 and 82

Issue Paper No. 166—Updates to the Definition of an Asset

SSAP No. 5—Liabilities, Contingencies and Impairments of Assets: proposed modifications reflect an updated definition of the term Liability – to match the newly issued definition in FASB Statement of Financial Accounting Concepts No. 8

2. A liability is defined as a present obligation of an entity to transfer an economic benefit, certain or probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or to provide services to other entities in the future as a result of a past transaction(s) or event(s).

3. A liability has three two essential characteristics: (a) it is a present obligation embodies a present duty or responsibility to one or more other entities that entails settlement by probable future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand, and (b) the obligation requires an entity to transfer or otherwise provide economic benefit to others duty or responsibility obligates a particular entity, leaving it little or no discretion to avoid the future sacrifice, and (c) the transaction or other event obligating the entity has already happened. This includes, but is not limited to, liabilities arising from policyholder obligations (e.g., policyholder benefits, reported claims and reserves for incurred but not reported claims). Liabilities shall be recorded on a reporting entity’s financial statements when incurred.

4. Estimates (e.g., loss reserves) are required in financial statements for many ongoing and recurring activities of a reporting entity. The mere fact that an estimate is involved does not of itself constitute a loss contingency. For example, estimates of losses utilizing appropriate actuarial methodologies meet the definition of liabilities as outlined above and are not loss contingencies.
FN1—FASB Statement of Financial Accounting Concepts No. 6, Elements of Financial Statements, states: Probable is used with its usual general meaning, rather than in a specific accounting or technical sense (such as that in FASB Statement 5, Accounting for Contingencies, paragraph 3), and refers to that which can reasonably be expected or believed on the basis of available evidence or logic but is neither certain nor proved.

Relevant Literature

39. This statement adopts FASB Statement No. 5, Accounting for Contingencies (FAS 5), FASB Statement 114, Accounting by Creditors for Impairment of a Loan only as it amends in part FAS 5 and paragraphs 35 and 36 of FASB Statement of Financial Accounting Concepts No. 6—Elements of Financial Statements. FASB Interpretation No. 14, Reasonable Estimation of the Amount of a Loss, An Interpretation of FASB Statement No. 5 (FIN No. 14) is adopted with the modification to accrue the loss amount as the midpoint of the range rather than the minimum as discussed in paragraph 3 of FIN No. 14. This statement adopts with modification ASU 2013-04, Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation is Fixed at the Reporting Date with the same statutory modification adopted for FIN 14. This statement incorporates the definition of a liability from FASB Statement of Financial Accounting Concepts No. 8, Chapter 4, Elements of Financial Statements, paragraphs E37 and E38.

References

Relevant Issue Papers

Issue Paper No. 5—Definition of Liabilities, Loss Contingencies and Impairments of Assets

Issue Paper No. 20—Gain Contingencies

Issue Paper No. 135—Guarantor’s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others

Issue Paper No. 166—Updates to the Definition of an Asset

Recommendation:

NAIC staff recommends that the Working Group move this item to the active listing, categorized as a SAP clarification, and expose revisions to the Preamble, SSAP No. 4—Assets and Nonadmitted Assets and SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets, as illustrated in the agenda item and in the draft issue papers, to incorporate updates from Chapter 4, Elements of Financial Statements and Chapter 7, Presentation of the FASB’s Conceptual Framework for Financial Reporting.

Staff Review Completed by: Jim Pinegar—NAIC Staff, January – 2022

Status:

On April 4, 2022, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a SAP clarification, and exposed revisions to the Preamble, SSAP No. 4—Assets and Nonadmitted Assets and SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets to incorporate 1) updates from FASB Concepts Statement No. 8, Conceptual Framework for Financial Reporting—Chapter 7, Presentation which identifies factors to consider when deciding how items should be displayed on the financial statements, and 2) Concepts Statement No. 8, Conceptual Framework for Financial Reporting—Chapter 4, Elements of Financial Statements, which updates the definitions of an asset and a liability. The Working Group also exposed two draft issue papers for historical documentation of these SAP clarifications.
On August 10, 2022, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed revisions, as illustrated above, to the Preamble and SSAP No. 4—Assets and Nonadmitted Assets. The revisions incorporate updates from FASB Concepts Statement No. 8, *Conceptual Framework for Financial Reporting—Chapter 7, Presentation*, which identifies factors to consider when deciding how items should be displayed on the financial statements, and Concepts Statement No. 8, *Conceptual Framework for Financial Reporting—Chapter 4, Elements of Financial Statements*, which updates the definition of an asset. In addition, the Working Group adopted *Issue Paper No. 166—Updates to the Definition of an Asset*, which documents the revisions to SSAP No. 4.

Additionally, on August 10, 2022, the Working Group re-exposed the proposed revisions and draft issue paper related to the definition change of a liability in SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets. This exposure intends to provide additional time for industry to review the changes in accordance with statutory accounting statements. These revisions are also shown above under the SSAP No. 5R heading.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2022/7-Summer NM/Adoptions/22-01 Conceptual Framework.docx
Statutory Issue Paper No. 166

Updates to the Definition of an Asset

STATUS
Finalized – August 10, 2022

Original and Current Authoritative Guidance: SSAP No. 4

Type of Issue:
Common Area

SUMMARY OF ISSUE

1. This issue paper documents the SAP clarification revisions to SSAP No. 4—Assets and Nonadmitted Assets. The intent of the revisions is to align current statutory accounting guidance, specifically the definition of an “asset,” with the term utilized by the Financial Accounting Standards Board (FASB).

SUMMARY CONCLUSION

2. The statutory accounting principle clarifications to SSAP No. 4 (illustrated in Exhibit A), reflect that for the purposes of statutory accounting, an asset shall be defined as: a present right of an entity to an economic benefit. An asset has two essential characteristics: (1) it is a present right, and (2) the right is to an economic benefit. The combination of these two characteristics allows an entity to obtain the economic benefit and control others’ access to the benefit. A present right of an entity to an economic benefit entitles the entity to the economic benefit and the ability to restrict others’ access to the benefit to which the entity is entitled. For clarity, an “economic benefit” represents services or other items of economic value and generally result in net cash inflows to the entity. Pursuant to current guidance, assets are then evaluated, as outlined in paragraph 3 below, to determine whether they are admitted for statutory accounting purposes.

3. Assets having economic value other than those which can be used to fulfill policyholder obligations, or those assets which are unavailable due to encumbrances or other third-party interests should not be recognized on the balance sheet, and are, therefore, considered nonadmitted. For purposes of statutory accounting principles, a nonadmitted asset shall be defined as an asset meeting the criteria in paragraph 2, which is accorded limited or no value in statutory reporting, and is one which is:

   a. Specifically identified within the Accounting Practices and Procedures Manual as a nonadmitted asset; or


If an asset meets one of these criteria, the asset shall be reported as a nonadmitted asset and charged against surplus unless otherwise specifically addressed within the Accounting Practices and Procedures Manual. The asset shall be depreciated or amortized against net income as the estimated economic benefit expires. In accordance with the reporting entity's written capitalization policy, amounts less than a predefined threshold of furniture, fixtures, equipment, or supplies, shall be expensed when purchased.

4. Transactions which do not give rise to assets as defined in paragraph 2 shall be charged to operations in the period the transactions occur. Those transactions which result in amounts which may meet the definition of assets but are specifically identified within the Accounting Practices and Procedures Manual as not giving rise to assets (e.g., policy acquisition costs), shall also be charged to operations in the period the transactions occur.
5. The reporting entity shall maintain a capitalization policy containing the predefined thresholds for each asset class to be made available for the department(s) of insurance.

**DISCUSSION**

6. In December 2021, FASB issued *Concepts Statement No. 8, Conceptual Framework for Financial Reporting—Chapter 4, Elements of Financial Statements*, which introduced updated definitions of certain key elements used in financial reporting – most notably updating the fundamental definition of an asset. Through the FASB’s adoption of Concept Statement No. 8, the original Concept Statement No. 6 has been superseded. As statutory accounting currently reflects FASB’s historical definition, this issue paper is to review the prior concept definition (currently utilized by statutory accounting) and compare it to FASB’s updated concept definition and assess whether the revised concept definition shall be reflected in statutory accounting.

7. FASB concept statements do not reflect authoritative U.S. GAAP guidance. Rather concept statements are intended to set forth objectives and fundamental concepts that will be the basis for development of financial accounting and reporting guidance. The term “asset” is not captured or defined in the FASB Accounting Standards Codification (which is the source of authoritative U.S. GAAP.) Furthermore, although the concept statement is intended to be used as a guide in establishing authoritative U.S. GAAP, the FASB is not restricted to the concepts when developing guidance, and the FASB may issue U.S. GAAP which may be inconsistent with the objectives and fundamental concepts set forth in Concept Statements. A change in a FASB Concept Statement does not 1) require a change in existing U.S. GAAP, 2) amend, modify or interpret the Accounting Standards Codification, or 3) justify either changing existing generally accepted accounting and reporting practices or interpreting the Accounting Standards Codification based on personal interpretations of the objectives and concepts in the concepts statement.

8. Under the prior FASB concept statement, which was reflected in SSAP No. 4, an asset was defined as a probable future economic benefit obtained or controlled by a particular entity as a result of past transactions or events. In addition, the historical definition possessed three essential characteristics in that (1) it embodies a probable future benefit that involves a capacity, singly or in combination with other assets, to contribute directly or indirectly to future net cash inflows, (2) a particular enterprise can obtain the benefit and control others’ access to it, and (3) the transaction or other event giving rise to the enterprise’s right to or control of the benefit has already occurred.

9. Pursuant to the prior concept statement, and as incorporated in SSAP No. 4, *probable*, as referenced both in the definition and essential characters, was used in a usual general meaning, rather than in a specific accounting or technical sense and referred to which can reasonably be expected or believed on the basis of available evidence or logic but is neither certain nor proved.

10. With the new FASB conceptual framework chapter, an asset is now defined as a present right of an entity to an economic benefit. In addition, the current definition only has two essential characteristics in that the asset is (1) a present right, and (2) the right is to an economic benefit. The combination of these two characteristics allows an entity to obtain the economic benefit and control others’ access to the benefit. A present right of an entity to an economic benefit entitles the entity to the economic benefit and the ability to restrict others’ access to the benefit to which the entity is entitled. For clarity, an “economic benefit” represents services or other items of economic value to the asset holder and generally result in net cash inflows to the entity.

11. The updated asset definition from Concept Statement No. 8 no longer includes the term *probable* or the phrases *future economic benefit and as a result of past transactions or events*. The FASB concluded that the term *probable* has historically been misunderstood as implying that a future benefit must be probable to a certain threshold before the definition of an asset was met. Thus, if the probability of a future benefit was low, an asset could not be recognized. The FASB also struck the phrase *future economic benefit*...
as this phrase often was interpreted that the asset must represent a certain future economic benefit (such as eventual cash inflows), however with this action, the FASB clarified that the asset represents the rights to the benefit, not the actual benefit itself – nor the probability of realization. Finally, FASB struck the phrase as the result of past transactions or events. It was concluded that if the asset represents a present right, by default, the right must have occurred as the result of a past transaction or event and thus this phraseology was deemed redundant and unnecessary.

12. To meet the definition of an asset, the right must be a “present right,” that is the right must exist at the financial statement date, not a right that is expected to occur in the future. The existence of a present right at the financial statement date means that the right and therefore the reasons why that asset was obtained, must have arisen from a past transaction or event. A right entitles its holder to have or obtain something, or act in a certain manner. Rights can be obtained in various ways and are often obtained through legal ownership. Legal ownership gives the owner access to the economic benefits, including the ability to possess, use, and enjoy the right. However, legally enforceable rights to economic benefits can also be obtained without legal ownership of the underlying property. This occurs in cases where the underlying benefit itself, as is the example in the right of use or rights to specified cashflows in contract provisions, are possessed by an entity other than the legal title holder. One important aspect of the change in definition is the removal of the term “control.” The FASB clarified that while the term control has been removed, the notion of control has been maintained in the updated definition. In the prior definition, control was a required element and thus without control, an asset was not recognized. However, control often refers to the ability to direct, manage, or have power over something. The FASB stated that in many instances, constituents misunderstood the notion of control by 1) believing it represented a probable future economic benefit, or 2) failing to properly identify what was specifically controlled. An example provided was a trade receivable – the definition of control might be misapplied to mean the successful collection; however, the correct application should refer to the rights of collection – not the successful collection itself. Citing this as an example, the FASB concluded that while the notion of control was an important aspect, the explicit term did not sufficiently add to the definition – thus the term “control” was removed.

13. When reviewing the substance of the revisions, the FASB concluded that the updated definition resulted in a clearer and more precise definition and it did not fundamentally change the historical concept of an asset, nor should the revisions result in any material changes in instrument reclassification (e.g., items now being classified as an asset when previously they were not considered assets). For statutory accounting purposes, the updated definition should be viewed similarly, that is it does not change fundamental concepts, change current practices, or introduce a new, original or a modified accounting principle. The revisions to the definition of an asset clarify the definitional language and do not modify the original intent of SSAP No. 4 and thus the changes are deemed to be a statutory accounting principle clarification.

14. One concept articulated in SSAP No. 4, and one that is not proposed for revision, is the concept of nonadmitted assets. As revisions are not proposed to this concept, further discussion is not included in this issue paper.

Actions of the Statutory Accounting Principles (E) Working Group

15. During the Spring 2022 National Meeting, the Working Group exposed this issue paper for public comment.

16. During the Summer 2022 National Meeting, the Working Group adopted the exposed revisions to SSAP No. 4 and affirmed the SAP clarification classification of these revisions.
RELEVANT STATUTORY ACCOUNTING AND GAAP GUIDANCE

Statutory Accounting

17. Relevant excerpts of SSAP No. 4, paragraphs 2-5 regarding the definition of an asset and a nonadmitted asset (nonadmitted asset as it is referenced in definition of an asset paragraph) utilized by statutory accounting is:

2. For purposes of statutory accounting, an asset shall be defined as: probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events. An asset has three essential characteristics: (a) it embodies a probable future benefit that involves a capacity, singly or in combination with other assets, to contribute directly or indirectly to future net cash inflows, (b) a particular entity can obtain the benefit and control others’ access to it, and (c) the transaction or other event giving rise to the entity’s right to or control of the benefit has already occurred. These assets shall then be evaluated to determine whether they are admitted. The criteria used is outlined in paragraph 3.

3. As stated in the Statement of Concepts, "The ability to meet policyholder obligations is predicated on the existence of readily marketable assets available when both current and future obligations are due. Assets having economic value other than those which can be used to fulfill policyholder obligations, or those assets which are unavailable due to encumbrances or other third-party interests should not be recognized on the balance sheet," and are, therefore, considered nonadmitted. For purposes of statutory accounting principles, a nonadmitted asset shall be defined as an asset meeting the criteria in paragraph 2, which is accorded limited or no value in statutory reporting, and is one which is:

a. Specifically identified within the Accounting Practices and Procedures Manual as a nonadmitted asset; or


If an asset meets one of these criteria, the asset shall be reported as a nonadmitted asset and charged against surplus unless otherwise specifically addressed within the Accounting Practices and Procedures Manual. The asset shall be depreciated or amortized against net income as the estimated economic benefit expires. In accordance with the reporting entity’s written capitalization policy, amounts less than a predefined threshold of furniture, fixtures, equipment, or supplies, shall be expensed when purchased.

4. Transactions which do not give rise to assets as defined in paragraph 2 shall be charged to operations in the period the transactions occur. Those transactions which result in amounts which may meet the definition of assets, but are specifically identified within the Accounting Practices and Procedures Manual as not giving rise to assets (e.g., policy acquisition costs), shall also be charged to operations in the period the transactions occur.

---

1 FASB Statement of Financial Accounting Concepts No. 6, Elements of Financial Statements, states:

Probable is used with its usual general meaning, rather than in a specific accounting or technical sense (such as that in FASB Statement No. 5, Accounting for Contingencies, paragraph 3), and refers to that which can reasonably be expected or believed on the basis of available evidence or logic but is neither certain nor proved.

2 If assets of an insurance entity are pledged or otherwise restricted by the action of a related party, the assets are not under the exclusive control of the insurance entity and are not available to satisfy policyholder obligations due to these encumbrances or other third-party interests. Thus, pursuant to paragraph 2(c), such assets shall not be recognized as an admitted asset on the balance sheet. Additional guidance for assets pledged as collateral is included in INT 01-31.
5. The reporting entity shall maintain a capitalization policy containing the predefined thresholds for each asset class to be made available for the department(s) of insurance.

Generally Accepted Accounting Principles

18. Relevant paragraphs from *Concepts Statement No. 8, Conceptual Framework for Financial Reporting—Chapter 4, Elements of Financial Statements* have been included below:

**Assets**

E16. An asset is a present right of an entity to an economic benefit.

**Characteristics of Assets**

E17. An asset has the following two essential characteristics: a. It is a present right. b. The right is to an economic benefit.

The combination of those two characteristics allows an entity to obtain the economic benefit and control others’ access to the benefit. A present right of an entity to an economic benefit entitles the entity to the economic benefit and the ability to restrict others’ access to the benefit to which the entity is entitled.

E19. Essential to the definition of an asset is a right to an “economic benefit”—the capacity to provide services or benefits to the entities that use them. Generally, in a business entity, that economic benefit eventually results in potential net cash inflows to the entity. In a not-for-profit entity, that economic benefit is used to provide desired or needed goods or services to beneficiaries or other constituents, which may or may not directly result in net cash inflows to the entity. Some not-for-profit entities rely significantly on contributions or donations of cash to supplement selling prices or to replace cash or other assets used in providing goods and services. The relationship between the economic benefit of an entity’s assets and net cash inflows to that entity can be indirect in both business entities and not-for-profit entities.

E22. A right entitles its holder to have or obtain something or to act in a certain manner. Rights can be obtained in various ways. Often, rights are obtained by legal ownership, for example, owning a building. Legal ownership gives the owner access to economic benefits, including the ability to possess, use, and enjoy the right; to sell, donate, or exchange the right; or to exploit the right’s value by, for example, pledging it as a security for borrowing.

E23. Legally enforceable rights to economic benefits can be obtained without legal ownership of the underlying benefit itself as is the case, for example, when property is leased or intellectual property is licensed or when an entity has the rights to specified certain cash flows, as in the case of a contract providing rights only to interest flows from a specified debt instrument. Other legally enforceable rights that give rise to assets include the right to require other parties to make payments or render services and the right to use a patent or a trademark. Legally enforceable rights include, among other rights, contractual rights (for example, rights from options held).

E31. Another essential characteristic of an asset is that the right of an entity must be to an economic benefit. An asset of an entity might be represented by rights to a particular property (such as the right to possess, use, and enjoy a parcel of land) or by rights to some or all the economic benefits derived from the property.

19. One of the most notable changes to the definitional change was the explicit removal of the term *control*, however the notion of control was retained. *Chapter 4, Elements of Financial Statements* included commentary regarding the FASB’s rationale of the change.

BC4.17. The definition of an asset in Concepts Statement 6 associated assets with a particular entity by inclusion of the term control. Control often refers to the ability to direct, manage, or have
power over something to obtain or access benefits or to increase, maintain, or protect those benefits. Control goes beyond legal rights and includes the ability to obtain and control the benefit in other ways, including restricting, or otherwise prohibiting, the access of others to the economic benefit of the asset.

BC4.18. In applying the definition of an asset in Concepts Statement 6, however, many constituents misunderstood the notion of control. Some improperly viewed control of a probable future economic benefit in the same manner as described in business combinations or consolidation accounting. Additionally, in applying the term control, some failed to properly identify that which was controlled under the asset definition. For example, in the instance of trade receivables, the definition could be misunderstood to indicate that what is controlled is the successful collection of the receivable in the future. When applied appropriately, however, the definition in Concepts Statement 6 would conclude that the present right to collection is what is controlled. Similarly, if an entity has an option to acquire an asset, the present right of that entity is to the option itself, not the underlying asset that the option provides the right to acquire. Thus, control references the existing right that has the ability to generate economic benefits, or potential economic benefits, and to restrict others’ access to those benefits.

BC4.19. While the Board concluded that the notion of control was an important aspect of the asset definition, it was not clear to the Board whether the explicit term control added anything significant to the definition of an asset. Those considerations are addressed by including the term present right in the definition in this chapter. If an entity has a present right to an economic benefit, that would seem to be sufficient to establish the fact that the asset is an asset of that entity. Indeed, if an entity has exclusive rights, it presumably can deny or regulate access to that benefit by others, thereby implying control.

BC4.22. The Board redeliberated the issue and decided that the term control should not be used in the definition of an asset for the following reasons:

a. It eliminates redundancy. If an entity has a present right, that would seem to be sufficient to establish the fact that the asset is an asset of that entity. In fact, the Board used the phrase of the entity in the definition of an asset to clarify that point. Indeed, if an entity has exclusive rights, it presumably can deny or regulate access to that benefit by others.

b. It eliminates misunderstanding of the term. The term control has two issues in the existing definition of an asset. First, many have a different definition of the term control. Second, many associate the term control with whether one has control of the economic benefit. The Board notes that what is controlled is the existing right that gives rise to economic benefits, or potential economic benefits, rather than the economic benefits themselves. The Board’s reasoning for removing the term control is the same as removing other terms, such as future and probable, from the definition of an asset.

c. It avoids confusion with the IASB’s Conceptual Framework use and meaning of the term. The IASB defines an asset as “a present economic resource controlled by the entity as a result of past events.” In the basis for conclusions to the IASB’s Conceptual Framework’s discussion on control, footnote 19 references both IFRS 10, Consolidated Financial Statements, and IFRS 15, Revenue from Contracts with Customers. The Board is concerned about the references to IFRS 10 and IFRS 15 because those standards refer to control of an economic benefit, not control of the right. The Board notes that convergence with the IASB’s asset definition on this point is not critical because it could perpetuate the misunderstanding discussed above.

20. Other changes regarding the definition of an asset included removal of the term probable and the phrases future economic benefit and past transactions of events. Rationale for these changes were documented in Chapter 4, Elements of Financial Statements commentary as follows:
BC4.11. The definitions of both an asset and a liability in Concepts Statement 6 include the term probable and the phrases future economic benefit and past transactions or events. The term probable in the definitions in Concepts Statement 6 has been misunderstood as implying that a future economic benefit or a future sacrifice of economic benefit must be probable to a certain threshold before the definition of an asset or a liability is met. In other words, if the probability of future economic benefit is low, the asset definition is not met under that interpretation. A similar interpretation could be made for liabilities. The footnotes to the Concepts Statement 6 definition of assets and liabilities also were not helpful in clarifying the application of the term probable as used in the definitions of assets and liabilities. Accordingly, the Board decided to eliminate that term from the definitions of both assets and liabilities.

BC4.12. The term future in the definitions in Concepts Statement 6 focused on identifying a future flow of economic benefits to demonstrate that an asset exists or identifying a future transfer of economic benefits to demonstrate that a liability exists. The definitions in Concepts Statement 6 were often misunderstood as meaning that the asset (liability) is the ultimate future inflow (outflow). For example, in the instance of trade receivables, the definition in Concepts Statement 6 could be misunderstood to indicate that the asset is the successful collection of the receivable in the future. When applied appropriately, however, the definition would conclude that the asset is the present right to collection. Similar misunderstandings occurred in applying the liability definition. As a result, the Board concluded that a focus on the term present would appropriately shift the focus from identifying a future occurrence. Therefore, the Board decided to include the term present right to demonstrate that an asset exists and emphasize the term present obligation to demonstrate that a liability exists.

BC4.13. The definitions of assets and liabilities in Concepts Statement 6 both include the phrase past transactions or events. The Board concluded that if an entity has a present right or a present obligation, one can reasonably assume that it was obtained from some past transaction or event. Therefore, that phrase is considered redundant and has been eliminated from the definitions.

RELEVANT LITERATURE

Statutory Accounting
- Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy

Generally Accepted Accounting Principles

Effective Date

21. As issue papers are not authoritative and are not represented in the Statutory Hierarchy (see Section V of the Preamble), the consideration and adoption of this issue paper will not have any impact on the SAP clarifications adopted to SSAP No. 4 by the Working Group on August 10, 2022.
EXHIBIT A – SAP Clarification Revisions to SSAP No. 4—Assets and Nonadmitted Assets

Statement of Statutory Accounting Principles No. 4

Assets and Nonadmitted Assets

SCOPE OF STATEMENT

1. This statement establishes the definition of an “asset” for use in statutory accounting and establishes the criteria for consistent treatment of nonadmitted assets.

SUMMARY CONCLUSION

2. For purposes of statutory accounting, an asset shall be defined as: a present right of an entity to an economic benefit probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events. An asset has three essential characteristics: (a) it is a present right, (b) the right is to an economic benefit, and (c) the transaction or other event giving rise to the entity’s right to or control of the benefit has already occurred. These assets shall then be evaluated to determine whether they are admitted. The criteria used is outlined in paragraph 3.

3. As stated in the Statement of Concepts, "The ability to meet policyholder obligations is predicated on the existence of readily marketable assets available when both current and future obligations are due. Assets having economic value other than those which can be used to fulfill policyholder obligations, or those assets which are unavailable due to encumbrances or other third-party interests should not be recognized on the balance sheet," and are, therefore, considered nonadmitted. For purposes of statutory accounting principles, a nonadmitted asset shall be defined as an asset meeting the criteria in paragraph 2, which is accorded limited or no value in statutory reporting, and is one which is:

   a. Specifically identified within the Accounting Practices and Procedures Manual as a nonadmitted asset; or


---

Footnotes:

4. FASB Statement of Financial Accounting Concepts No. 6, Elements of Financial Statements, states:

    Probable is used with its usual general meaning, rather than in a specific accounting or technical sense (such as that in FASB Statement No. 5, Accounting for Contingencies, paragraph 3), and refers to that which can reasonably be expected or believed on the basis of available evidence or logic but is neither certain nor proved.

5. FASB Statement of Financial Accounting Concepts No. 8, Elements of Financial Statements, states that the combination of these two characteristics allows an entry to obtain the economic benefit and control others’ access to the benefit. A present right of an entity to an economic benefit entitles the entity to the economic benefits and the ability to restrict other’s access to the benefit to which the entity is entitled.

5 If assets of an insurance entity are pledged or otherwise restricted by the action of a related party, the assets are not under the exclusive control of the insurance entity and are not available to satisfy policyholder obligations due to these encumbrances or other third-party interests. Thus, pursuant to paragraph 2(c), such assets shall not be recognized as an admitted asset on the balance sheet. Additional guidance for assets pledged as collateral is included in INT 01-31.
If an asset meets one of these criteria, the asset shall be reported as a nonadmitted asset and charged against surplus unless otherwise specifically addressed within the Accounting Practices and Procedures Manual. The asset shall be depreciated or amortized against net income as the estimated economic benefit expires. In accordance with the reporting entity’s written capitalization policy, amounts less than a predefined threshold of furniture, fixtures, equipment, or supplies, shall be expensed when purchased.

4. Transactions which do not give rise to assets as defined in paragraph 2 shall be charged to operations in the period the transactions occur. Those transactions which result in amounts which may meet the definition of assets, but are specifically identified within the Accounting Practices and Procedures Manual as not giving rise to assets (e.g., policy acquisition costs), shall also be charged to operations in the period the transactions occur.

5. The reporting entity shall maintain a capitalization policy containing the predefined thresholds for each asset class to be made available for the department(s) of insurance.

Assets Pledged as Collateral or Otherwise Restricted

6. Assets that are pledged to others as collateral or otherwise restricted (not under the exclusive control of the insurer, subject to a put option contract, etc.) shall be identified in the investment schedules pursuant to the codes in the annual statement instructions, disclosed in accordance with SSAP No. 1—Accounting Policies, Risks & Uncertainties, and Other Disclosures, reported in the general interrogatories, and included in any other statutory schedules or disclosure requirements requesting information for assets pledged as collateral or otherwise restricted. Restricted assets should be reviewed to determine admitted or nonadmitted assets status in the statutory financial statements per the terms of their respective SSAPs. Asset restrictions may be a factor in determining the admissibility of an asset under a respective SSAP. However, determining that a restricted asset is an admitted asset does not eliminate the statutory requirements to document and identify the asset as one that is pledged as collateral or otherwise restricted.

7. Assets pledged as collateral are one example of assets that are not under the exclusive control of the insurer, and are therefore restricted, even if the assets are admitted under statutory accounting guidelines (e.g., the asset is substitutable and/or other related SSAP conditions are met). As such, the asset shall be coded as pledged in the investment schedules pursuant to the annual statement instructions, disclosed in accordance with SSAP No. 1, reported in the general interrogatories, and included in any other statutory schedules or disclosure requirements requesting information for assets pledged as collateral or otherwise restricted.

Disclosure

8. The financial statements shall disclose if the written capitalization policy and the resultant predefined thresholds changed from the prior period and the reason(s) for such change.

Relevant Literature

9. This statement incorporates the definition of an asset from FASB Statement of Financial Accounting Concepts No. 8, Chapter 4, Elements of Financial Statements, paragraphs E16-E18.

Effective Date and Transition

10. 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. Guidance reflected in paragraphs 3, 5 and 8,

---

6 An example of such a situation is detailed in footnote 2 pertaining to assets restricted by the action of a related party. This is only a single example and each restricted asset would need to be reviewed to ensure it qualifies as an admitted asset.
incorporated from SSAP No. 87, was originally effective for years beginning on and after January 1, 2004. The guidance in footnote 2 to paragraph 2 was originally contained within INT 01-03: Assets Pledged as Collateral or Restricted for the Benefit of a Related Party and was effective June 11, 2001.

REFERENCES

Relevant Issue Papers

- Issue Paper No. 4—Definition of Assets and Nonadmitted Assets
- Issue Paper No. 119—Capitalization Policy, An Amendment to SSAP Nos. 4, 19, 29, 73, 79 and 82
- Issue Paper No. 166—Updates to the Definition of an Asset
Issue: SSAP No. 48 – Alternative Valuation of Minority Ownership Interests

Check (applicable entity):

<table>
<thead>
<tr>
<th>Modification of Existing SSAP</th>
<th>P/C</th>
<th>Life</th>
<th>Health</th>
</tr>
</thead>
<tbody>
<tr>
<td>New Issue or SSAP</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interpretation</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Description of Issue: SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies establishes the statutory accounting principles for investments in joint ventures, partnerships, or limited liability companies (herein collectively referred to as SSAP No. 48 investments). This agenda item is presented to review the alternative valuation methods permitted in limited circumstances where the investee has a minor ownership interest (less than 10%) or lacks control as discussed in paragraphs 15 and 16 (see Authoritative Literature), and where audited U.S. GAAP basis financial statements are not available.

In general, SSAP No. 48 requires a financial statement audit for admission of investments with a more than minor ownership interest or where control is present. If an investee owns greater than 10% measured at the holding company level, or can exercise control, the SSAP No. 48 investment is to be reported using the equity method as defined in SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities, which effectively directs the valuation based on the nature of the operations (e.g., requiring statutory accounting for insurance operations or U.S. GAAP accounting for other various entities). Embedded in SSAP No. 97, the proxy for SSAP No. 48 investments in which the investor owns greater than 10% or can exercise control, is the requirement for a statutory or a U.S. GAAP financial statement audit. (The requirement for audited financial statements in these instances is not proposed to be the subject of discussion.)

If insurer has less than 10% ownership (minor ownership interest) or lacks control the preference is to use audited U.S. GAAP financial statements. However, when audited U.S. GAAP financial statements are not available, paragraph 9 provides the following three alternatives, which includes: 1) investee’s audited foreign GAAP with an audited U.S. GAAP reconciliation footnote, 2) audited IFRS financial statements, or 3) audited U.S. tax equity financial statements. The permissible exceptions for when audited U.S. GAAP basis financials are not available are detailed in paragraph 9 below:

9. If audited U.S. GAAP basis financial statements of the investee are not available, joint ventures, partnerships, and limited liability companies in which the entity has a minor ownership interest (i.e., less than 10%) or lacks control as stipulated in paragraphs 15 and 16 may be recorded based on either of the valuation methodologies allowed under paragraphs 9.a. or 9.b. If either one of the valuation methodologies allowed under paragraphs 9.a. or 9.b. is used to value the investment, documentation must be maintained regarding the reason that audited U.S. GAAP basis financial statements could not be provided.

a. Non U.S. joint ventures, partnerships, and limited liability companies in which the entity has a minor ownership interest of less than 10% and for which audited U.S. GAAP basis financial statements of the investee are not available, may be recorded based on:

i. the U.S. GAAP basis equity as set forth in the audited footnote reconciliation of the investee’s equity and income to U.S. GAAP within the investee’s audited foreign GAAP prepared financial statements or,

ii. the IFRS basis equity as set forth in the investee’s audited IFRS financial statements prepared in compliance, both annually and quarterly, with IFRS as issued by the International Accounting Standards Board (IASB).
b. If audited U.S. GAAP basis financial statements of the investee are not available, joint ventures, partnerships, and limited liability companies in which the entity has a minor ownership interest of less than 10%, measured at the holding company level, may be recorded based on the underlying audited U.S. tax basis equity. For investments recorded based on the underlying audited U.S. tax basis equity, the reporting entity shall review investments held by the joint venture, partnership or limited liability company in accordance with the impairment guidance in paragraphs 18 and 19. The reporting entity must first attempt to obtain audited U.S. GAAP basis financial statements and, if such financial statements are unavailable, must maintain documentation regarding the reason that audited U.S. GAAP basis financial statements could not be provided.

NAIC staff believe the intent of the U.S. GAAP audit exceptions provided in paragraph 9 was meant to accommodate limited situations where an insurer has a minor ownership interest and or lacks control and therefore, they are unable to require or entice the entity to acquire a U.S. GAAP audit. NAIC staff note this distinction, as SSAP No. 48, paragraph 9 currently permits that if an insurer owns less than 10% or lacks control, they are permitted the exceptions which still require audits if audited U.S. GAAP basis financial statements are unavailable. It is important to note that technically SSAP No. 48, paragraph 16 could permit a significant ownership percentage and as long as an insurer has rebutted control of the investment, they would be permitted to use the paragraph 9 exceptions, that is if the insurer could articulate why audited U.S. GAAP basis financial statements were not available.

This agenda item has been drafted to propose two alternative clarifications to SSAP No. 48. The first option presented is to propose deletion of the U.S. GAAP audit exception provided in SSAP No. 48, paragraph 9.b as this exception does not appear to be utilized by insurers. The second option presented is to retain the U.S. GAAP audit exception in paragraph 9.b but clarify that the U.S. tax basis audit is to reside at the investee level – that is the investee must have an audit in order for this valuation be permitted for admission of the investment. This clarification would eliminate any ambiguity regarding the level at which the audit is required.

Existing Authoritative Literature: While a significant portion of the potentially impacted paragraphs have been included above, all relevant SSAP No. 48 guidance is included below, with pertinent items bolded for emphasis.

SCOPE OF STATEMENT

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. 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. This statement does not address the accounting for investments in partnerships and limited liability companies that invest in Low-Income Housing Tax Credit Properties as discussed in SSAP No. 93—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.

SUMMARY CONCLUSION

2. Investments in joint ventures shall include investments in corporate joint ventures and unincorporated joint ventures (also referred to as undivided interests in ventures). A corporate joint venture is defined as a corporation owned and operated by a small group (the joint venturers) as a separate and specific business or project for the mutual benefit of the members of the group. A corporate joint venture usually provides an arrangement under which each joint venturer may participate, directly or indirectly, in the overall management of the joint venture. Joint venturers thus have an interest or relationship other than as passive investors. An unincorporated joint venture is similar in its purpose but is not incorporated.
3. **Investments in partnerships shall include investments in general partnership interests and limited partnership interests.** A general partnership is defined as an association in which each partner has unlimited liability. Each partner assumes joint and several liability for all partnership debts. A limited partnership shall be defined as a partnership having two classes of partners: (a) general partners who manage the partnership, subject to the partnership agreement, and have personal liability for the general obligations of the partnership and (b) limited partners who are passive investors and have no personal liability beyond their investment.

4. A limited liability company is defined as a business organization which is a hybrid of a corporation and partnership whereby the owners have limited liability like a corporation and profits may pass through to the owners for tax purposes like a partnership if certain criteria are met. The owner’s personal liability is limited to his own acts and the owners can fully participate in the management of the business with no adverse impact on their limited liability.

5. Investments in the ventures defined in paragraphs 2-4 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. Investments in joint ventures, partnerships, and limited liability companies shall be reported in Other Invested Assets in the financial statements.

6. **Investments in these ventures, except for joint ventures, partnerships and limited liability companies with a minor ownership interest, shall be reported using an equity method as defined in SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities, paragraphs 8.b.i. through 8.b.iv.** (The equity method calculation may result with a negative valuation of the investment; therefore, the SSAP No. 97 equity method calculation shall occur regardless of whether the investment is supported by an audit and the reporting entity will nonadmit the investment.) A reporting entity whose shares of losses in a SSAP No. 48 entity exceeds its investment in the SSAP No. 48 entity shall disclose the information required by SSAP No. 97, paragraph 35.a.

7. Investments reported using an equity method from SSAP No. 97, paragraph 8.b.ii. through 8.b.iv. may have fiscal year ends, not calendar year ends. To recognize a change to the reporting year-end of an equity method investee, including changes in, or the elimination of, previously existing differences (lag period) due to the reporting entity’s ability to obtain financial results from a reporting period that is more consistent with, or the same as, that of the reporting entity’s, the guidance included in FASB Emerging Issues Task Force No. 06-9: Reporting a Change in (or the elimination of) a Previously Existing Difference Between the Fiscal Year-End of a Parent Company and That of a Consolidated Entity or Between the Reporting Period of an Investor and That of an Equity Method Investee that defines such reporting period changes as a change in accounting principle in accordance with SSAP No. 3—Accounting Changes and Corrections of Errors shall be followed.

8. Joint ventures, partnerships and limited liability companies in which the entity has a minor ownership interest (i.e., less than 10%) or lacks control as stipulated in paragraphs 15 and 16, shall be recorded based on the underlying audited U.S. GAAP equity of the investee. The investment shall be nonadmitted if the audited financial statements include substantial doubt about the entity’s ability to continue as a going concern. Additionally, the investment shall be nonadmitted on the basis/contents of the audit opinion as detailed in paragraph 21 of SSAP No. 97.

9. If audited U.S. GAAP basis financial statements of the investee are not available, joint ventures, partnerships, and limited liability companies in which the entity has a minor ownership interest (i.e., less than 10%) or lacks control as stipulated in paragraphs 15 and 16 may be recorded based on either of the valuation methodologies allowed under paragraphs 9.a. or 9.b. If either one of the valuation methodologies allowed under paragraphs 9.a. or 9.b. is used to value the investment, documentation must be maintained regarding the reason that audited U.S. GAAP basis financial statements could not be provided.

a. Non U.S. joint ventures, partnerships, and limited liability companies in which the entity has a minor ownership interest of less than 10% and for which audited U.S. GAAP basis financial statements of the investee are not available, may be recorded based on:
the U.S. GAAP basis equity as set forth in the audited footnote reconciliation of the investee's equity and income to U.S. GAAP within the investee's audited foreign GAAP prepared financial statements or,

ii the IFRS basis equity as set forth in the investee’s audited IFRS financial statements prepared in compliance, both annually and quarterly, with IFRS as issued by the International Accounting Standards Board (IASB).

b. If audited U.S. GAAP basis financial statements of the investee are not available, joint ventures, partnerships, and limited liability companies in which the entity has a minor ownership interest of less than 10%, measured at the holding company level, may be recorded based on the underlying audited U.S. tax basis equity. For investments recorded based on the underlying audited U.S. tax basis equity, the reporting entity shall review investments held by the joint venture, partnership or limited liability company in accordance with the impairment guidance in paragraphs 18 and 19. The reporting entity must first attempt to obtain audited U.S. GAAP basis financial statements and, if such financial statements are unavailable, must maintain documentation regarding the reason that audited U.S. GAAP basis financial statements could not be provided.

10. The amount to be recorded shall be defined as the initial investment in an investee at cost (as defined in paragraph 3 of SSAP No. 68—Business Combinations and Goodwill) plus subsequent capital contributions to the investee. The carrying amount of the investment shall be adjusted for the amortization of the basis difference (difference between the cost and the underlying GAAP equity), as well as to recognize the reporting entity’s share of: (i) the audited U.S. GAAP basis earnings or losses of the investee after the date of acquisition, adjusted for any distributions received, or (ii) if audited U.S. GAAP basis financial statements of the investee are not available, the earnings or losses of the investee after the date of acquisition, adjusted for any distributions received, based on either one of the valuation methodologies allowed under paragraphs 9.a. or 9.b. A reporting entity’s share of adjustments, excluding changes in capital contributions to the investee, that are recorded directly to the investee’s stockholders’ equity shall also be recorded as adjustments to the carrying value of the investment with an offsetting amount recorded to unrealized capital gains and losses on investments.

11. Entities may recognize their investment in joint ventures, partnerships, and limited liability companies in which the entity has a minor ownership interest based on an unaudited basis for investment determination (i.e., foreign GAAP, IFRS, or tax basis as allowed under paragraph 9) if annual audited information is not complete as of the annual statement filing deadline. The recorded investment shall be adjusted for annual audit adjustments, if any, as soon as annual audited information is available. If financial statements of an investee are not sufficiently timely for the reporting entity to apply an equity method to the investee’s current results of operations, the reporting entity shall record its share of the earnings or losses of an investee from the most recent available financial statements. A lag in reporting shall be consistent from period to period.

15. Control is defined as the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of the investee, whether through the (a) ownership of voting securities, (b) by contract other than a commercial contract for goods or nonmanagement services, (c) by common management, or (d) otherwise. Control shall be presumed to exist if a reporting entity and its affiliates directly or indirectly, own, control, hold with the power to vote, or hold proxies representing 10% or more of the voting interests of the entity.

16. Control as defined in paragraph 15 shall be measured at the holding company level. For example, if one member of an affiliated group has a 5% interest in an entity and a second member of the group has an 8% interest in the same entity, the total interest is 13% and therefore each member of the affiliated group shall be presumed to have control. This presumption will stand until rebutted by an evaluation of all the facts and circumstances relating to the investment based on the criteria in FASB Interpretation No. 35, Criteria for Applying the Equity Method of Accounting for Investments in Common Stock, an Interpretation of APB Opinion No. 18. The corollary is required to demonstrate control when a reporting entity owns less than 10% of the voting interests of an
investee. The insurer shall maintain documents substantiating its determination for review by the domiciliary commissioner. Examples of situations where the presumption of control may be in doubt include the following:

a. Any limited partner investment in a Limited Partnership, unless the limited partner is affiliated with the general partner.

b. An entity where the insurer owns less than 50% of an entity and there is an unaffiliated individual or group of investors who own a controlling interest.

c. An entity where the insurer has given up participation rights as a shareholder to the investee.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups):
In May 2008, in agenda item 2007-34R: SSAP 48, the Working Group adopted revisions in SSAP No. 48 permitting the use of an audited U.S. tax basis equity valuation method in cases where the insurer is a minor interest or lacks control and audited U.S. GAAP financial statements of the investee were not available.

Information or issues (included in Description of Issue) not previously contemplated by the Working Group: None

Convergence with International Financial Reporting Standards (IFRS): N/A

Staff Recommendation: NAIC staff recommends that the Working Group move this item to the active listing, categorized as a SAP clarification, and expose two possible options for the U.S. GAAP audit exception in SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies. Option #1 proposes to delete the audited U.S. tax basis equity as a permissible valuation method as this method does not appear to be utilized by insurers. Option #2 proposes to retain the audited U.S. tax basis equity valuation method but clarifies that the audit must reside at the investee level.

Option 1: Delete the valuation method permitted in SSAP No. 48, paragraph 9b.

9. If audited U.S. GAAP basis financial statements of the investee are not available, joint ventures, partnerships, and limited liability companies in which the entity has a minor ownership interest (i.e., less than 10%) or lacks control as stipulated in paragraphs 15 and 16 may be recorded based on either of the valuation methodologies allowed under paragraphs 9.a. or 9.b. If either one of the valuation methodologies allowed under paragraphs 9.a. or 9.b. is used to value the investment, documentation must be maintained regarding the reason that audited U.S. GAAP basis financial statements could not be provided.

a. Non U.S. joint ventures, partnerships, and limited liability companies in which the entity has a minor ownership interest of less than 10% and for which audited U.S. GAAP basis financial statements of the investee are not available, may be recorded based on:

   i. the U.S. GAAP basis equity as set forth in the audited footnote reconciliation of the investee’s equity and income to U.S. GAAP within the investee’s audited foreign GAAP prepared financial statements or,

   ii. the IFRS basis equity as set forth in the investee’s audited IFRS financial statements prepared in compliance, both annually and quarterly, with IFRS as issued by the International Accounting Standards Board (IASB).

b. If audited U.S. GAAP basis financial statements of the investee are not available, joint ventures, partnerships, and limited liability companies in which the entity has a minor ownership interest of less than 10%, measured at the holding company level, may be recorded based on the underlying audited U.S. tax basis equity. For investments recorded based on the underlying audited U.S. tax basis equity, the reporting entity shall review
Option 2: Retain the alternative valuation method but clarify that the required U.S. tax basis equity audit is to reside at the investee level.

9. If audited U.S. GAAP basis financial statements of the investee are not available, joint ventures, partnerships, and limited liability companies in which the entity has a minor ownership interest (i.e., less than 10%) or lacks control as stipulated in paragraphs 15 and 16 may be recorded based on either of the valuation methodologies allowed under paragraphs 9.a. or 9.b. If either one of the valuation methodologies allowed under paragraphs 9.a. or 9.b. is used to value the investment, documentation must be maintained regarding the reason that audited U.S. GAAP basis financial statements could not be provided.

a. Non U.S. joint ventures, partnerships, and limited liability companies in which the entity has a minor ownership interest of less than 10% and for which audited U.S. GAAP basis financial statements of the investee are not available, may be recorded based on:

i. the U.S. GAAP basis equity as set forth in the audited footnote reconciliation of the investee’s equity and income to U.S. GAAP within the investee’s audited foreign GAAP prepared financial statements or,

ii. the IFRS basis equity as set forth in the investee’s audited IFRS financial statements prepared in compliance, both annually and quarterly, with IFRS as issued by the International Accounting Standards Board (IASB).

b. If audited U.S. GAAP basis financial statements of the investee are not available, joint ventures, partnerships, and limited liability companies in which the entity has a minor ownership interest of less than 10%, measured at the holding company level, may be recorded based on the underlying audited U.S. tax basis equity. The U.S. tax basis equity audit shall occur at the investee level. For investments recorded based on the underlying audited U.S. tax basis equity, the reporting entity shall review investments held by the joint venture, partnership or limited liability company in accordance with the impairment guidance in paragraphs 18 and 19. The reporting entity must first attempt to obtain audited U.S. GAAP basis financial statements and, if such financial statements are unavailable, must maintain documentation regarding the reason that audited U.S. GAAP basis financial statements could not be provided.

Staff Review Completed by: Jim Pinegar—NAIC Staff, February 2022

Status:
On April 4, 2022, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a SAP clarification, and exposed two possible options for the U.S. GAAP audit exception in SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies. The options are described below while the revisions are illustrated above in the recommended action.

Option #1 proposes to delete the audited U.S. tax basis equity as a permissible valuation method as this method does not appear to be utilized by insurers.

Option #2 proposes to retain the audited U.S. tax basis equity valuation method but clarifies that the audit must reside at the investee level.

On August 10, 2022, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed revisions detailed in option #2, as illustrated below, to SSAP No. 48—Joint Ventures, Partnerships and Limited
Liability Companies. These revisions clarify that the audit of an entity utilizing the U.S. tax basis equity valuation exception shall occur at the investee level.

**Adopted revisions to SSAP No. 48:**

9. If audited U.S. GAAP basis financial statements of the investee are not available, joint ventures, partnerships, and limited liability companies in which the entity has a minor ownership interest (i.e., less than 10%) or lacks control as stipulated in paragraphs 15 and 16 may be recorded based on either of the valuation methodologies allowed under paragraphs 9.a. or 9.b. If either one of the valuation methodologies allowed under paragraphs 9.a. or 9.b. is used to value the investment, documentation must be maintained regarding the reason that audited U.S. GAAP basis financial statements could not be provided.

   a. Non U.S. joint ventures, partnerships, and limited liability companies in which the entity has a minor ownership interest of less than 10% and for which audited U.S. GAAP basis financial statements of the investee are not available, may be recorded based on:

      i. the U.S. GAAP basis equity as set forth in the audited footnote reconciliation of the investee’s equity and income to U.S. GAAP within the investee’s audited foreign GAAP prepared financial statements or,

      ii. the IFRS basis equity as set forth in the investee’s audited IFRS financial statements prepared in compliance, both annually and quarterly, with IFRS as issued by the International Accounting Standards Board (IASB).

   b. If audited U.S. GAAP basis financial statements of the investee are not available, joint ventures, partnerships, and limited liability companies in which the entity has a minor ownership interest of less than 10%, measured at the holding company level, may be recorded based on the underlying audited U.S. tax basis equity. The U.S. tax basis equity audit shall occur at the investee level. For investments recorded based on the underlying audited U.S. tax basis equity, the reporting entity shall review investments held by the joint venture, partnership or limited liability company in accordance with the impairment guidance in paragraphs 18 and 19. The reporting entity must first attempt to obtain audited U.S. GAAP basis financial statements and, if such financial statements are unavailable, must maintain documentation regarding the reason that audited U.S. GAAP basis financial statements could not be provided.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2022/7-Summer NM/Adoptions/22-02 - SSAP No. 48 - Alt Valuation Minority Ownership.docx
Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A

Issue: ASU 2021-10, Government Assistance

Check (applicable entity):

<table>
<thead>
<tr>
<th>Modification of Existing SSAP</th>
<th>P/C</th>
<th>Life</th>
<th>Health</th>
</tr>
</thead>
<tbody>
<tr>
<td>New Issue or SSAP</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interpretation</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Description of Issue: In November 2021, the Financial Accounting Standards Board (FASB) issued *Accounting Standards Update (ASU) 2021-10, Government Assistance, Disclosures by Business Entities about Government Assistance* to increase financial statement transparency regarding certain types of government assistance by increasing the disclosure of such information in the notes to the financial statements.

The new disclosure aims to increase transparency by enhancing the identification of 1) the types of assistance received, 2) an entity’s accounting for said assistance, and 3) the effects of the assistance in an entity’s financial statements. The disclosures will contain information about the nature of the transactions, which includes a general description of the transaction and identification of the form (cash or other) in which the assistance was received. In terms of the effects on the financial statement, disclosure will include identification of the specific line items in both the balance sheet and income statement and a description of the extent to which they have been impacted by any government assistance. In addition, an entity will be required to disclose information about any significant terms of the transaction with a government entity, with items including durations of such agreements and any provisions for potential recapture.

ASU 2021-10 defines “government assistance,” in a comprehensive manner to capture most types of assistance and includes examples of tax credits, cash grants or grants of other assets. The scope of this ASU is narrow as it does not apply to not-for-profit entities or benefit plans. Further narrowing in scope, the new disclosure requirements in this ASU only apply to transactions that are accounted for by analogizing either a grant or contribution model. As such, these enhanced disclosures do not apply to government transactions that are accounted for in accordance with other codification topics, such as classifying the transactions as debt in ASC 470, income taxes in ASC 740, or as revenue from contracts with customers in ASC 606.

With the specificity of these additional disclosures only applying in certain circumstances (only applicable in cases where the government assistance is not accounted for in accordance with other accounting standards – i.e., revenue in the normal course of business or debt), NAIC staff believe the occurrence of such items requiring disclosure per ASU 2021-10 will likely be relatively infrequent.

NAIC staff also note that consistent with ASU 2021-10, had the assistance been accounted for in a differing manner (e.g., as debt per *SSAP No. 15—Debt and Holding Company Obligations*), that the required identification and disclosures for the applicable SSAP would apply. As a final note, it is anticipated that for most entities who qualified for and received Paycheck Protection Program (PPP) loans, as authorized by the CARES Act, that the additional disclosures in this ASU still would not apply. It is believed that most insurance reporting entities accounted for PPP transactions as liabilities per SSAP No. 15. [For reference, in accordance with SSAP No. 15, debt may only be derecognized if the reporting entity was legally released from the liability (SSAP No. 15, paragraph 11), at which time the extinguishment of debt was reported as a capital gain (SSAP No. 15, paragraph 25).]
Existing Authoritative Literature:

**NAIC Staff Note** – as mentioned above, NAIC staff believe that as these additional disclosures are not applicable for transactions that are in scope of other accounting standards, and only apply when the transaction is accounted for by analogy using the grant or contribution model, the prevalence of such items will be infrequent. As such, the most appropriate location for these items is reflected in SSAP No. 24.

**SSAP No. 24—Discontinued Operations and Unusual or Infrequent Items**

**Unusual or Infrequently Occurring Items**

9. A material event or transaction that an entity considers to be of an unusual nature or of a type that indicates infrequency of occurrence or both shall be reported consistently with the reporting entity’s reporting of continuing operations (i.e., no separate line item presentation in the balance sheet or statement of operations). Such items shall not be charged directly to surplus unless specifically addressed elsewhere within the *Accounting Practices and Procedures Manual*.

   a. “Unusual Nature” shall be defined as the underlying event or transaction that should possess a high degree of abnormality and be of a type clearly unrelated to, or only incidentally related to, the ordinary and typical activities of the entity, taking into account the environment in which the entity operates.

   b. “Infrequency of Occurrence” is defined as the underlying event or transaction that would not reasonably be expected to recur in the foreseeable future, taking into account the environment in which the entity operates.

**Disclosures [Unusual/Infrequent Items]**

16. The nature and financial effects of each unusual or infrequent event or transaction shall be disclosed in the notes to the financial statements. Gains or losses of a similar nature that are not individually material shall be aggregated. This disclosure shall include the line items which have been affected by the event or transaction considered to be unusual and/or infrequent.

**Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups):** None

**Information or issues (included in Description of Issue) not previously contemplated by the Working Group:** None

**Convergence with International Financial Reporting Standards (IFRS):** NA

**Staff Recommendation:** NAIC staff recommends that the Working Group move this item to the active listing, categorized as a SAP clarification, and expose revisions to *SSAP No. 24—Discontinued Operations and Unusual or Infrequent Items*, incorporating certain disclosures from ASU 2021-10. The proposed additions will supplement existing disclosures to require that if the unusual or infrequent item is as the result of government assistance, the transaction will require identification as well as a description of the terms and provisions of the assistance received.

NAIC staff recommend incorporating the new disclosures in ASU 2020-10, modified only to require the supplemental disclosures for all entity types (as SAP disclosures do not differentiate between entity type – i.e., not-for-profit vs. other). As a final note, existing disclosures for unusual/infrequent items (captured in financial statement note #21) already contains the requirement to identify the specific line items which have been affected by the events or transactions considered to be unusual and/or infrequent - thus that specific portion of ASU 2021-10 is not included in the proposed additions below.
Proposed Revisions to SSAP No. 24

Disclosures [Unusual/Infrequent Items]

16. The nature, including a general description of the transactions, and financial effects of each unusual or infrequent event or transaction shall be disclosed in the notes to the financial statements. Gains or losses of a similar nature that are not individually material shall be aggregated. This disclosure shall include the line items which have been affected by the event or transaction considered to be unusual and/or infrequent. If the unusual or infrequent item is as the result of government assistance (as defined in ASU 2021-10, Government Assistance, Disclosures by Business Entities about Government Assistance) disclosure shall additionally include the form in which the assistance has been received (for example, cash or other assets), and information regarding significant terms and conditions of the transaction, with items including, to the extent applicable, the duration or period of the agreement, and commitments made by the reporting entity, provisions for recapture, or other contingencies.

Relevant Literature

24. This statement adopts ASU 2021-10, Government Assistance: Disclosure by Business Entities about Government Assistance, with modification to require disclosure by all entity types.

Staff Review Completed by: Jim Pinegar - NAIC Staff, January 2022

Recommendation:
NAIC staff recommends that the Working Group move this item to the active listing, categorized as a SAP clarification, and expose revisions to SSAP No. 24—Discontinued Operations and Unusual or Infrequent Items, incorporating certain disclosures from ASU 2021-10. The proposed additions will supplement existing disclosures to require that if the unusual or infrequent item is as the result of government assistance, the transaction will require identification as well as a description of the terms and provisions of the assistance received.

Status:
On April 4, 2022, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a SAP clarification, and exposed revisions to SSAP No. 24—Discontinued Operations and Unusual or Infrequent Items, as illustrated above, which incorporate certain disclosures from ASU 2021-10 to supplement existing disclosures regarding unusual or infrequent items.

On August 10, 2022, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed revisions, as illustrated above, to SSAP No. 24—Discontinued Operations and Unusual or Infrequent Items. The revisions incorporate certain disclosures, adopted with modification from ASU 2021-10, to supplement existing disclosures regarding unusual or infrequent items.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2022/7-Summer NM/Adoptions/22-04 - ASU 2021-10 Govt Assistance.docx
**Statutory Accounting Principles (E) Working Group**

**Maintenance Agenda Submission Form**

**Form A**

**Issue:** ASU 2021-09, Leases (Topic 842), Discount Rate for Lessees That Are Not Public Business Entities

**Check (applicable entity):**

- [x] Modification of Existing SSAP
- [x] New Issue or SSAP
- [ ] Interpretation

**Description of Issue:** In November 2021, the Financial Accounting Standards Board (FASB) issued *Accounting Standard Update (ASU) 2021-09, Leases (Topic 842), Discount Rate for Lessees That Are Not Public Business Entities*. This ASU was issued as part of FASB’s post-implementation review to address issues that have been found during the implementation of the new lease guidance from *ASU 2016-02, Leases (Topic 842)*. Topic 842 generally requires the capitalization of leases, which is calculated by discounting the lease payments utilizing the implicit rate in the lease, or if not determinable, the lessee’s incremental borrowing rate. However, the standard also provides nonpublic entities with a practical expedient, permitting the use of a risk-free rate (e.g., U.S. Treasury Rate) for the capitalization calculation. As the risk-free rate is generally lower than anyone’s incremental borrowing rate, stakeholders expressed concerns that the calculation of present value (utilizing the practical expedient) often results in recognition of lease liabilities and right-of-use assets that are greater than those recognized by their public counterparts. To alleviate this concern, the guidance in ASU 2021-09 broadens the practical expedient so nonpublic lessees may make the risk-free rate election by class of underlying asset, rather than at the entity-wide level – thus the entity more able to apply the practical expedient when beneficial. An entity that makes the risk-free rate election is required to disclose which asset classes it has elected to apply a risk-free rate. The guidance provided in this ASU is specific to the financing lease treatment under U.S. GAAP, and since *SSAP No. 22R—Leases* requires nearly all leases to be treated as operating leases for statutory accounting, adoption of this guidance would be unnecessary.

**Existing Authoritative Literature:**
The ASUs related to Topic 842 have previously been rejected in *SSAP No. 22R—Leases*.

**Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups):** None

**Information or issues (included in Description of Issue) not previously contemplated by the Working Group:** None

**Convergence with International Financial Reporting Standards (IFRS):** ASC Topic 842 was the result of a joint project between FASB and the International Accounting Standards Board.

**Recommendation:** NAIC staff recommends the Working Group move this agenda item to the active listing, categorized as a SAP clarification and expose revisions to reject ASU 2021-05 in *SSAP No. 22R—Leases*. Under statutory accounting almost all leases are classified as operating leases, thus this U.S. GAAP guidance is not necessary. Proposed Revision to SSAP No. 22R (Relevant Literature section – paragraph 52):

j. **ASU 2021-09, Leases (Topic 842), Discount Rate for Lessees That Are Not Public Business Entities (Rejected in its entirety)**

**Staff Review Completed by:** Jake Stultz, NAIC Staff – January 2022
Status:
On April 4, 2022, the Statutory Accounting Principles (E) Working Group moved this item to the active listing, categorized as a SAP clarification, and exposed revisions, as illustrated above, to reject ASU 2021-09 in SSAP No. 22R—Leases.

On August 10, 2022, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed revisions, as illustrated above, to reject ASU 2021-09 in SSAP No. 22R—Leases.

Issue: ASU 2021-07, Compensation – Stock Compensation

Check (applicable entity):

<table>
<thead>
<tr>
<th>Modification of Existing SSAP</th>
<th>P/C</th>
<th>Life</th>
<th>Health</th>
</tr>
</thead>
<tbody>
<tr>
<td>New Issue or SSAP</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interpretation</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

In October 2021, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2021-07, Compensation – Stock Compensation (Topic 718), Determining the Current Price of an Underlying Share for Equity-Classified Share-Based Awards to offer nonpublic companies a practical expedient to one of the several inputs necessary for option-priced modeling. When equity share options or similar instruments are granted in a share-based payment transaction, the fair value (which is used to determine expense recognition at inception and during any subsequent award modification) is estimated using an option-pricing model valuation technique.

In terms of option-priced models, the Black-Scholes-Merton model is considered to be one of the most widely used as it has less complexity than other pricing models. However, despite its reduced complexity, it (and various other pricing models) requires numerous inputs which typically include exercise price, expected dividend rate, risk-free interest rate, expected term, expected share price volatility, and current share price. For public entities, the determination of these values is generally readily available, however for nonpublic entities, many of these inputs are not easily determinable.

Of these inputs, private company stakeholders have indicated that three of these inputs (exercise price, expected dividend rate, and risk-free interest rate) are easy to obtain. However, stakeholders indicated that the remaining three inputs (expected share price volatility, expected term, and current share price) can be costly and difficult to estimate. Topic 718 already provides nonpublic entities with practical expedients for expected share price volatility and expected term. However, prior to ASU 2021-07, a practical expedient was not available for estimating the current price input. The current price input is often considered the most costly and complex input to determine and audit for nonpublic entities, primarily because an active market for those entities’ shares does not exist and therefore a readily determinable market price is not available.

ASU 2021-07 provides a practical expedient for nonpublic entities to determine the current price by utilizing a “reasonable application of a reasonable valuation method.” The practical expedient describes several characteristics of a reasonable valuation method and will include 1) consideration of the value of all tangible and intangible assets, 2) the present value of future anticipated cash flows, 3) the market value of similar entities, 4) recent arm’s-length transactions involving the sale or transfer of stock/equity interests, and 5) other relevant factors that affect the valuation or have a material economic effect on the entity. The calculation of share price must be timely in it cannot be more than 12 months stale, and all available information after the date of calculation that may materially affect the valuation of the entity must be considered for any value updates.

One final note - this ASU provides a practical expedient (not an accounting alternative) to one of the inputs used for nonpublic companies in their option-pricing modeling. Also, as mentioned previously, this is the third such practical expedient permitted in Topic 718, of which the previous two (expected share price volatility and expected term) have previously been adopted and are currently permissible for use in SSAP No. 104R—Share-Based Payments (further detailed in the “Existing Authoritative Literature” section).
Existing Authoritative Literature: ASU 2021-07 offers a third practical expedient for the inputs utilized in option-pricing models. As previously mentioned, the prior two practical expedients are permissible in SSAP No. 104R and are included herein for reference:

Practical Expedient Regarding Volatility: Topic 718 (paragraph 718-10-30-20) recognizes nonpublic entities may not be able to reasonably estimate the fair value as it is not practicable to estimate share volatility, a component of the fair value calculation. Adoption of this first practical expedient to address this circumstance occurred through the Working Group’s adoption of FAS 123R, Share-Based Payment. The applicable paragraph in SSAP No. 104R has been included with relevant guidance bolded.

52. A reporting entity may not be able to reasonably estimate the fair value of its equity share options, nonemployee awards and similar instruments because it is not practicable for the reporting entity to estimate the expected volatility of its share price. In that situation, the entity shall account for its equity share options, nonemployee awards and similar instruments based on a value calculated using the historical volatility of an appropriate industry sector index instead of the expected volatility of the entity’s share price (the calculated value). A reporting entity’s use of calculated value shall be consistent between employee share-based payment transactions and nonemployee share-based payment transactions. Throughout the remainder of this statement, provisions that apply to accounting for share options, nonemployee awards and similar instruments at fair value also apply to calculated value.

Practical Expedient Regarding Expected Term: Topic 718 (paragraph 718-10-30-20A) recognizes nonpublic entities may not be able to reasonably account for the expected term of a share-based payment. Adoption of a second practical expedient to address this circumstance occurred through the Working Group’s adoption, with modification, of ASU 2016-09, Improvements to Employee Share-Based Payment Accounting. The applicable paragraphs from SSAP No. 104R have been included below:

53. For an award that meets the conditions in paragraph 54, a reporting entity may make an entity-wide accounting policy election to estimate the expected term using the following practical expedient:

a. If vesting is only dependent upon a service condition, a reporting entity shall estimate the expected term as the midpoint between the employee’s requisite service period or the nonemployee’s vesting period and the contractual term of the award.

b. If vesting is dependent upon satisfying a performance condition, an entity first would determine whether the performance condition is probable of being achieved.

i. If the reporting entity concludes that the performance condition is probable of being achieved, the entity shall estimate the expected term as the midpoint between the employee’s requisite service period or the nonemployee’s vesting period and the contractual term.

ii. If the reporting entity concludes that the performance condition is not probable of being achieved, the reporting entity shall estimate the expected term as either:

(a) The contractual term if the service period is implied (that is, the requisite service period or the nonemployee’s vesting period is not explicitly stated but inferred based on the achievement of the performance condition at some undetermined point in the future).

(b) The midpoint between the employee’s requisite service period or the nonemployee’s vesting period and the contractual term if the requisite service period is stated explicitly.
54. A reporting entity that elects to apply the practical expedient in paragraph 53 shall apply the practical expedient to a share option or similar award that has all of the following characteristics:

   a. The share option or similar award is granted at the money.
   b. The grantee has only a limited time to exercise the award (typically 30-90 days) if the grantee no longer provides goods or terminates service after vesting.
   c. The grantee can only exercise the award. The grantee cannot sell or hedge the award.
   d. The award does not include a market condition.

A reporting entity that elects to apply the practical expedient in paragraph 53 may always elect to use the contractual term as the expected term when estimating the fair value of a nonemployee award as described in paragraph 42. However, a reporting entity must apply the practical expedient in paragraph 53 for all nonemployee awards that have all the characteristics listed in this paragraph if that reporting entity does not elect to use the contractual term as the expected term and that reporting entity elects the accounting policy election to apply the practical expedient in paragraph 53.

ASU 2021-07 also supplements existing disclosure requiring that if this new practical expedient is utilized, its use shall be disclosed. NAIC staff have determined that additional disclosures in SSAP No. 104R are likely not necessary as existing SAP disclosures reference the disclosures in FASB Codification 718-10-50-2 as required – which is the location for FASB’s new disclosure regarding use of this practical expedient.

Disclosures

113. An entity with one or more share-based payment arrangements shall disclose information that enables users of the financial statements to understand all of the following:

   a. The nature and terms of such arrangements that existed during the period and the potential effects of those arrangements on shareholders;
   b. The effect of compensation costs arising from share-based payment arrangements on the income statement;
   c. The method of estimating the fair value of the goods or services received, or the fair value of the equity instruments granted (or offered to grant), during the period; and
   d. The cash flow effects resulting from share-based payment arrangements.

114. The disclosures in paragraph 113 are for annual audited statutory financial statements only. This statement adopts FASB Codification 718-10-50-2 for the minimum disclosure information needed to achieve the objective in paragraph 113 of this statement, noting that a reporting entity may need to disclose additional information to achieve the objectives.

As final reference, SSAP No. 104R has predominantly adopted, with modification from U.S. GAAP guidance regarding share-based payment guidance, as detailed below.

126. This statement adopts with modification the U.S. GAAP guidance for share-based payment transactions reflected in FASB Accounting Standards Codification (ASC) Topic 718, Compensation – Stock Compensation, as modified by the ASUs listed in paragraphs 126.a through 126.e, excluding the guidance in ASC Subtopic 718-40, Employee Stock Ownership Plans (ESOPs). Statutory accounting guidance for ESOPs is addressed in SSAP No. 12—Employee Stock Ownership Plans. This adoption with modification includes the related implementation guidance reflected within the FASB Codification Topic 718 not reflected within this standard. The U.S. GAAP guidance adopted with modification reflects the adoption with modification of the following ASUs:
a. **ASU 2018-07, Improvements to Nonemployee Share-Based Payment Accounting.** The revisions from ASU 2018-07 expand the scope of ASC 718 to include share-based payment transactions for acquiring goods and services from nonemployees. With ASU 2018-17, ASC 505-50, *Equity – Equity Payments to Nonemployees* was superseded.

b. **ASU 2017-09, Scope of Modification Accounting**

c. **ASU 2016-09, Improvements to Employee Share-Based Payment Accounting**

d. **ASU 2014-12, Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period**

e. **ASU 2010-13, Effect of Denominating the Exercise Price of a Share-Based Payment Award in the Current of the Market in Which the Underlying Equity Security Trades**

127. The statutory accounting guidance for share-based payments is intended to be consistent with U.S. GAAP. Adopted modifications to U.S. GAAP guidance are as follows:

a. GAAP references to “public and nonpublic” guidance have been eliminated. However, entities that report share-payment transactions under U.S. GAAP as “public” entities shall not report different amounts between U.S. GAAP and SAP. (For example, if a reporting entity reports “fair value” under U.S. GAAP, that entity shall not utilize a “calculated or intrinsic” amount under statutory accounting.

b. Prepaid assets are nonadmitted.

c. GAAP references are revised to reference applicable statutory accounting guidance.

d. GAAP reporting line items (either explicitly provided in the statement or adopted by reference – such as the GAAP implementation guidance) shall be replaced to reference applicable statutory annual statement line items. (For example, GAAP references to “other comprehensive income” shall be reflected within “Surplus - Unassigned Funds”).

e. GAAP guidance to calculate earnings per share is not applicable to statutory accounting and has not been included within the statement.

f. GAAP effective date and transition, and transition disclosures have not been incorporated. Reporting entities shall follow the effective date and transition elements provided within this statement.

g. Inclusion of guidance specific to statutory for consolidated/holding company plans.

128. The adoption with modification of FASB Codification Topic 718 detailed in paragraph 126 of this statement reflects adoption with modification of the following pre-codification GAAP standards:

a. **FAS 123R, Share-Based Payment (FAS 123R);**

b. **FAS 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity (FAS 150) – (Adopted only to the extent referenced in FAS 123R for classifying instruments as equity or liability for application in this statement. Adopted guidance is reflected in Exhibit A);**

c. **FASB Staff Position FAS 123(R) -1: Classification and Measurement of Freestanding Financial Instruments Originally issued in Exchange for Employee Services under FASB Statement No. 123(R) (FAS 123R-1);**

d. **FASB Staff Position (FSP) FAS 123(R)-2: Practical Accommodation to the Application of Grant Date as Defined in FASB Statement No. 123(R) (FSP FAS 123R-2);**
e. **FASB Staff Position (FSP) FAS123(R)-4: Classification of Options and Similar Instruments Issued as Employee Compensation That Allow for Cash Settlement upon the Occurrence of a Contingent Event (FSP FAS 123R-4);**

f. **FASB Staff Position (FSP) FAS 123(R)-5: Amendment of FASB Staff Position FAS 123R-1 (FSP FAS 123R-5);**

g. **FASB Staff Position (FSP) FAS 123(R)-6: Technical Corrections of FASB Statement No. 123(R) (FSP FAS 123R-6);**

h. **FASB Emerging Issues Task Force 97-14: Accounting for Deferred Compensation Arrangements Where Amounts Earned Are Held in a Rabbi Trust and Invested (EITF 97-14);**

i. **FASB Emerging Issues Task Force 00-16: Recognition and Measurement of Employer Payroll Taxes on Employee Stock-Based Compensation (EITF 00-16);**

j. **FASB Technical Bulletin 97-01, Accounting under Statement 123 for Certain Employee Stock Purchase Plans with a Look-Back Option (TB 97-01);**

129. The adoption with modification of FASB Codification Topic 718 in this statement reflects rejection of the following pre-codification GAAP standards:

a. **FASB Staff Position (FSP) FAS 123(R)-3: Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards (FSP FAS 123R-3);** and

b. **FASB Staff Position (FSP) EITF 03-6-1; Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities (FSP EITF 03-6-1).**

**Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups):** None

**Information or issues (included in Description of Issue) not previously contemplated by the Working Group:** None

**Convergence with International Financial Reporting Standards (IFRS):** N/A

NAIC staff recommends that the Working Group move this item to the active listing, categorized as a SAP clarification, and expose revisions to **SSAP No. 104R—Share-Based Payments** to incorporate the practical expedient for the current price input, a required component for the option-pricing models – models in which are utilized in the determination of fair value for share-based payments. Integration of this third practical expedient is consistent with previous decisions by the Working Group to adopt the prior two practical expedients regarding option-pricing modeling input permitted by FASB. The language proposed by NAIC staff directs that the practical expedient is only available when a reporting entity is not able to reasonable estimate the current fair value. While this language is technically broader than what was adopted by FASB (as ASU 2021-07 directly references non-public companies), the proposed language is consistent with prior Working Group adoptions and by default, should not be utilized by public entities – as they would be able to reasonable estimate fair value, which is likely the publicly traded share price.

**Proposed Revisions to SSAP No. 104R**

52. A reporting entity may not be able to reasonably estimate the fair value of its equity share options, nonemployee awards and similar instruments because it is not practicable for the reporting entity to estimate the expected volatility of its share price. In that situation, the entity shall account for its equity share options, nonemployee awards and similar instruments based on a value calculated using the historical volatility of an appropriate industry sector index instead of the expected volatility of the entity’s share price (the calculated value). A reporting entity’s use of calculated value shall be consistent between employee share-based payment transactions and nonemployee share-based payment transactions. Throughout the
remainder of this statement, provisions that apply to accounting for share options, nonemployee awards and similar instruments at fair value also apply to calculated value.

53. For an award that meets the conditions in paragraph 54, a reporting entity may make an entity-wide accounting policy election to estimate the expected term using the following practical expedient:

a. If vesting is only dependent upon a service condition, a reporting entity shall estimate the expected term as the midpoint between the employee’s requisite service period or the nonemployee’s vesting period and the contractual term of the award.

b. If vesting is dependent upon satisfying a performance condition, an entity first would determine whether the performance condition is probable of being achieved.

i. If the reporting entity concludes that the performance condition is probable of being achieved, the entity shall estimate the expected term as the midpoint between the employee’s requisite service period or the nonemployee’s vesting period and the contractual term.

ii. If the reporting entity concludes that the performance condition is not probable of being achieved, the reporting entity shall estimate the expected term as either:

(a) The contractual term if the service period is implied (that is, the requisite service period or the nonemployee’s vesting period is not explicitly stated but inferred based on the achievement of the performance condition at some undetermined point in the future).

(b) The midpoint between the employee’s requisite service period or the nonemployee’s vesting period and the contractual term if the requisite service period is stated explicitly.

54. A reporting entity that elects to apply the practical expedient in paragraph 53 shall apply the practical expedient to a share option or similar award that has all of the following characteristics:

a. The share option or similar award is granted at the money.

b. The grantee has only a limited time to exercise the award (typically 30-90 days) if the grantee no longer provides goods or terminates service after vesting.

c. The grantee can only exercise the award. The grantee cannot sell or hedge the award.

d. The award does not include a market condition.

A reporting entity that elects to apply the practical expedient in paragraph 53 may always elect to use the contractual term as the expected term when estimating the fair value of a nonemployee award as described in paragraph 42. However, a reporting entity must apply the practical expedient in paragraph 53 for all nonemployee awards that have all the characteristics listed in this paragraph if that reporting entity does not elect to use the contractual term as the expected term and that reporting entity elects the accounting policy election to apply the practical expedient in paragraph 53.

55. If a reporting entity is not able to reasonably estimate the current share price (fair value), as a practical expedient, a reporting entity may use a value determined by the reasonable application of a reasonable valuation method as the current price of its underlying share for purposes of determining the fair value of an award that is classified as equity at grant date or upon a modification. The determination of whether a valuation method is reasonable, or whether an application of a valuation method is reasonable, shall be made on the facts and circumstances as of the measurement date. Factors to be considered under a reasonable valuation method include, as applicable:
Ref #2022-06

a. The value of tangible and intangible assets

b. The present value of anticipated future cash flows

c. The market value of stock or equity interests in similar corporations and other entities engaged in trades or businesses substantially similar to those engaged by the entity for which the stock is to be valued, the value of which can be readily determined through nondiscretionary, objective means (such as through trading prices on an established securities market or an amount in an arm’s length transaction)

d. Recent arm’s length transactions involving the sale or transfer of stock or equity interest

e. Other relevant factors such as control premiums or discounts for lack of marketability and whether the valuation method is used for other purposes that have a material economic effect on the entity, its stockholders, or its creditors

f. The entity’s consistent use of a valuation method to determine the value of its stock or assets for other purposes, including for purposes unrelated to compensation of service providers.

Effective Date and Transition

130. This statement was effective January 1, 2013, with interim and annual financial reporting thereafter. Early adoption was permitted for December 31, 2012, financial statements with interim and annual reporting thereafter. At the time of initial adoption of this statement, reporting entities with existing share-based payment instruments that applied the guidance in SSAP No. 13—Stock Options and Stock Purchase Plans were to apply the requirements of SSAP No. 104 prospectively to new awards and to awards modified, repurchased or cancelled after the required effective date. Those reporting entities were to continue to account for any portion of awards outstanding at the date of initial application using the statutory accounting principles originally applied to those awards (e.g., SSAP No. 13).

131. Since the initial adoption of SSAP No. 104, subsequent revisions were effective as follows:

a. ASU 2021-07, Compensation – Stock Compensation, Determining the Current Price of an Underlying Share for Equity-Classified Share-Based Awards. This SAP clarification is effective August 10, 2022.

a.b. ASU 2018-07, Improvements to Nonemployee Share-Based Payment Accounting: Nonsubstantive revisions effective January 1, 2020, with early application permitted.

b.c. ASU 2017-09, Scope of Modification Accounting: Nonsubstantive revisions effective January 1, 2018, applicable to modifications that occur on or after the effective date, with early application permitted.

d.e. ASU 2016-09, Improvements to Employee Share-Based Payment Accounting: Nonsubstantive revisions effective December 31, 2017, with early adoption permitted. The adoption included the transition provisions from ASU 2016-19, although not duplicated within this statement.

d.e. ASU 2014-12, Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period: Nonsubstantive revisions effective January 1, 2016, with early adoption permitted.

e.f. ASU 2010-13, Effect of Denominating the Exercise Price of a Share-Based Payment Award in the Current of the Market in Which the Underlying Equity Security Trades: Captured in the original adoption of SSAP No. 104, effective January 1, 2013.

Staff Review Completed by: Jim Pinegar– NAIC Staff, February 2022
Status:
On April 4, 2022, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a SAP clarification, and exposed revisions to *SSAP No. 104R—Share-Based Payments* to incorporate a practical expedient for the current price input, a required component for option-pricing models which are utilized in the determination of fair value for share-based payments.

On August 10, 2022, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed revisions, as illustrated above, to *SSAP No. 104R—Share-Based Payments* to incorporate a practical expedient for the current price input, a required component for option-pricing models which are utilized in the determination of fair value for share-based payments.

https://naiconline.sharepoint.comteams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2022/7-Summer NM/Adoptions/22-06 - ASU 2021-07  Stock Compensation.docx
Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A

Issue: ASU 2021-08, Business Combinations

Check (applicable entity):

<table>
<thead>
<tr>
<th>Modification of Existing SSAP</th>
<th>P/C</th>
<th>Life</th>
<th>Health</th>
</tr>
</thead>
<tbody>
<tr>
<td>New Issue or SSAP</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interpretation</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Description of Issue: In October 2021, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2021-08, Business Combinations, Accounting for Contract Assets and Contract Liabilities from Contracts with Customers to require acquiring entities to apply Topic 606 (the topic that specifies the accounting for revenue and liabilities resulting from contracts with customers), when valuing and recognizing contract related assets and liabilities in a business combination.

Prior to the issuance of ASU 2021-08, acquirers would generally only recognize such items based on their fair values on the date of acquisition. When assessing liabilities at fair value, acquirers would generally only recognize an acquiree’s deferred revenue (i.e., a contract liability), to the extent the acquirer had a legal obligation to perform a service or remit a product. However, to only recognize a contract liability to the extent of a legal obligation is contrary to Topic 606 as it states that performance obligations may (and often) extend beyond legal obligations – with examples including implied promises and customer business practices within the contract with a customer, regardless of whether such promises were legally enforceable.

This ASU noted that the amendments will enhance comparability of the business results from before and after the acquisition (as presumably in most cases, the Topic 606 liability of the acquiree would transfer from the acquiree to the acquirer) and thus continuity of presentation would be retained. It is also important to note that the application of Topic 606 (rather than applying fair value standards) for acquired contract liabilities will generally result in a larger liability being recognized by the acquirer. This is because in cases where a provider receives cash in advance of performing a service or providing a product, in many instances some or all of the advanced funds have been spent prior to the date of acquisition, and thus the acquirer, using fair value measurement techniques, will not designate value to the spent funds. However again, the primary goal of these amendments is to improve comparability by providing consistent recognition and measurement guidance for revenue contracts - regardless of if those contracts were or were not acquired in a business combination.

The statutory accounting guidance for business combinations is found in SSAP No. 68—Business Combinations and Goodwill and requires business combinations be reported at cost, which in an arms-length transaction; is presumably fair value. SSAP No. 68 also requires that for entities (other than insurance reporting entities), the acquirer use the acquiree’s U.S. GAAP book value for the determination of statutory goodwill. The calculation of statutory goodwill, while beyond the scope of this agenda item, is important to briefly comment on as it adds an additional level of conservatism not recognized by U.S. GAAP – as it requires the recognition of goodwill for the amount of cost in excess of the acquiree’s book value (as opposed to fair value under U.S. GAAP).

So, in essence, for statutory accounting, other than the reporting of statutory goodwill, the acquiree’s book value of all associated assets (and liabilities) are reported on the acquirer’s books. As ASU 2021-08 requires the acquirer to utilize the acquiree’s book value, measured via Topic 606, for contract liabilities, the practice (unless the acquiree has not previously or has incorrectly applied Topic 606) conceptually consistent statutory accounting requirements, requires a measurement method previously rejected by statutory accounting.
Existing Authoritative Literature: As previously mentioned, the statutory guidance for business combinations is contained in SSAP No. 68 - relevant paragraphs, with applicable guidance is included below.

SSAP No. 68

Business Combinations

2. A business combination shall be accounted for as either a statutory purchase or a statutory merger. Business combinations that create a parent-subsidiary relationship shall be accounted for as a statutory purchase. Business combinations where equity of one entity is issued in exchange for the equity of another entity, which is then canceled, and prospectively only one entity exists, shall be accounted for as a statutory merger.

Statutory Purchases of SCA Investments

3. The statutory purchase method of accounting is defined as accounting for a business combination as the acquisition of one entity by another. It shall be used for all purchases of SCA entities including partnerships, joint ventures, and limited liability companies. The acquiring reporting entity shall record its investment at cost. Cost is defined as the sum of: (a) any cash payment, (b) the fair value of other assets distributed, (c) the fair value of any liabilities assumed, and (d) any direct costs of the acquisition. Contingent consideration issued in a purchase business combination that is embedded in a security or that is in the form of a separate financial instrument shall be recorded by the issuer at fair value at the acquisition date.

4. For those acquired SCA entities accounted for in accordance with paragraphs 8.b.i., 8.b.ii., 8.b.iii. or 8.b.iv. of SSAP No. 97, and joint venture, partnership or limited liability company entities accounted for in accordance with paragraph 8 of SSAP No. 48, goodwill is defined as the difference between the cost of acquiring the entity and the reporting entity’s share of the book value of the acquired entity. When the cost of the acquired entity is greater than the reporting entity’s share of the book value, positive goodwill exists. When the cost of the acquired entity is less than the reporting entity’s share of the book value, negative goodwill exists. Goodwill resulting from assumption reinsurance shall be recorded as a separate write-in for other-than-invested assets. All other goodwill shall be reported in the carrying value of the investment.

5. A business combination accounted for under the statutory purchase method and in which the acquired entity is valued in accordance with paragraphs 8.b.ii., 8.b.iii. or, 8.b.iv. of SSAP No. 97 shall determine the amount of positive goodwill or negative goodwill created by the combination using the reporting entity’s share of the GAAP net book value of the acquired entity, adjusted to a statutory basis of accounting in accordance with paragraph 9 of SSAP No. 97 in the case of acquired entities valued in accordance paragraphs 8.b.ii. or 8.b.iv. of SSAP No. 97. Business combinations accounted for under the statutory purchase method and in which the acquired entity is valued in accordance with, paragraph 8.b.i. of SSAP No. 97 shall determine the amount of positive or negative goodwill created by the business combination using the insurer’s share of the statutory book value of the acquired entity.

6. For those acquired SCA entities accounted for in accordance with paragraph 8.b.i. of SSAP No. 97 under the statutory purchase method, the historical bases of the acquired entity shall continue to be used in preparing its statutory financial statements. Therefore, pushdown accounting is not permitted.

As mentioned above, utilizing an acquiree’s book value is likely consistent with current practice, however, all previous Topic 606 guidance has been rejected for statutory accounting as insurance contracts are explicitly excluded from its scope. The rejections are noted within the body of statutory guidance in SSAP No. 47—Uninsured Plans.
SSAP No. 47

Relevant Literature

15. This statement rejects ASU 2014-09, Revenue from Contracts with Customers; ASU 2015-14, Revenue From Contracts With Customers; ASU 2016-08, Revenue From Contracts with Customers: Principal versus Agent Considerations (Reporting Revenue Gross versus Net); ASU 2016-10, Revenue from Contracts with Customers: Identifying Performance Obligations and Licensing; ASU 2016-12, Revenue from Contracts with Customers: Narrow-Scope Improvements and Practical Expedients; ASU 2016-20, Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers; ASU 2018-18, Collaborative Arrangements (Topic 808), Clarifying the Interaction between Topic 808 and Topic 606, and ASU 2021-02, Franchisors—Revenue from Contracts with Customers.

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): As previously mentioned, all ASUs related to ASC Topic 606 have been rejected by the Working Group.

Information or issues (included in Description of Issue) not previously contemplated by the Working Group: None

Convergence with International Financial Reporting Standards (IFRS): ASC Topic 606 and IFRS 15 are the result of the joint project between the FASB and IASB to improve financial reporting by creating common revenue recognition guidance.

Staff Recommendation: NAIC staff recommends that the Working Group move this item to the active listing, categorized as SAP clarifications to:

1) Expose revisions to SSAP No. 47—Uninsured Plans to reject ASU 2021-08 for statutory accounting. This recommendation is consistent with how the prior ASUs related to Topic 606 have been treated.

2) Expose revisions to SSAP No. 68—Business Combinations and Goodwill to reject the ASU 2021-08 for statutory accounting, while noting that rejection does not impact the determination of U.S. GAAP book value in an acquired entity. NAIC staff note that as all prior Topic 606 guidance has been rejected for statutory accounting, the explicit rejection of this ASU should not be construed to mean that the U.S. GAAP net book value (which is utilized for the determination of statutory goodwill) will need to be modified by the guidance required in this ASU. The intent is to not modify any U.S. GAAP requirements for the determination of U.S. GAAP net book value within this standard.

Proposed Revisions to SSAP No. 47

Relevant Literature

15. This statement rejects ASU 2014-09, Revenue from Contracts with Customers; ASU 2015-14, Revenue From Contracts With Customers; ASU 2016-08, Revenue From Contracts with Customers: Principal versus Agent Considerations (Reporting Revenue Gross versus Net); ASU 2016-10, Revenue from Contracts with Customers: Identifying Performance Obligations and Licensing; ASU 2016-12, Revenue from Contracts with Customers: Narrow-Scope Improvements and Practical Expedients; ASU 2016-20, Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers; ASU 2018-18, Collaborative Arrangements (Topic 808), Clarifying the Interaction between Topic 808 and Topic 606, and ASU 2021-02, Franchisors—Revenue from Contracts with Customers, and ASU 2021-08, Business Combinations, Accounting for Contract Asset and Contract Liabilities from Contracts with Customers.
Proposed Revisions to SSAP No. 68

Relevant Literature

22. This statement rejects ASU 2021-08, Business Combinations, Accounting for Contract Asset and Contract Liabilities from Contracts with Customers; however, the rejection of which shall not modify the U.S. GAAP accounting standards as required within this standard. ASU 2019-06, Intangibles—Goodwill and Other Business Combinations, and Non-for-Profit Entities, ASU 2017-04, Simplifying the Test for Goodwill Impairment, ASU 2016-03, Intangibles—Goodwill and Other, Business Combinations, Consolidation, Derivatives and Hedging; ASU 2014-02, Accounting for Goodwill (a consensus of the Private Company Council), ASU 2012-02, Testing Indefinite-Lived Intangible Assets for Impairment, ASU 2011-08, Testing Goodwill for Impairment and ASU 2010-28, When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts; Accounting Principles Board Opinion No. 16, Business Combinations; FASB Statement No. 38, Accounting for Preacquisition Contingencies of Purchased Enterprises, an amendment of APB Opinion No. 16; Accounting Principles Board Opinion No. 17, Intangible Assets; FASB Statement No. 79, Elimination of Certain Disclosures for Business Combinations by Nonpublic Enterprises; FASB Statement No. 141, Business Combinations; and FASB Statement No. 142, Goodwill and Other Intangible Assets The following related interpretative pronouncements are also rejected:

[NAIC Staff Note, the remainder of this paragraph has been omitted for brevity.]

Staff Review Completed by: Jim Pinegar - NAIC Staff, February 2022

Status:
On April 4, 2022, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a SAP clarification, and exposed revisions to SSAP No. 47—Uninsured Plans and SSAP No. 68—Business Combinations and Goodwill to reject ASU 2021-08 for statutory accounting. In addition, the proposed revisions to SSAP No. 68 include notations that the rejection of ASU 2021-08 does not impact the determination of U.S. GAAP book value in an acquired entity. The proposed revisions are illustrated above, under the recommended action.

On August 10, 2022, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed revisions, as illustrated above, to SSAP No. 47—Uninsured Plans and SSAP No. 68—Business Combinations and Goodwill to reject ASU 2021-08 for statutory accounting. In addition, the revisions to SSAP No. 68 include notations that the rejection of ASU 2021-08 does not impact the determination of U.S. GAAP book value of an acquired entity.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2022/7-Summer NM/Adoptions/22-07 - ASU 2021-08 Business Combinations.docx
This page intentionally left blank.
APPLICATION OF THE VALUATION MANUAL FOR TESTING THE ADEQUACY OF LIFE INSURER RESERVES

Background

The NAIC Valuation Manual (VM-30) contains actuarial opinion and supporting actuarial memorandum requirements, including requirements for asset adequacy analysis. Regulators have observed a lack of uniform practice in the implementation of asset adequacy analysis. The variety of practice in incorporating the risk of complex assets into testing does not provide regulators comfort as to reserve adequacy. Examples of complex assets are structured securities, including asset-backed securities and collateralized loan obligations, as well as assets originated by the company or affiliated or contracted entity. An initial increase of this activity has been noted in support of general account annuity blocks; however, recent activity was noted in other life insurer blocks.

This Guideline is intended to provide uniform guidance and clarification of requirements for the appropriate support of certain assumptions for asset adequacy analysis performed by life insurers. In particular, this Guideline:

1. Helps identify reserve adequacy and claims-paying ability in moderately adverse conditions, including conditions negatively impacting cash flows from complex assets;

2. Clarifies elements to consider in establishing margins on asset-related assumptions;

3. Ensures recognition that higher expected gross returns from assets are, to some extent, associated with higher risk, and that assumptions fit reasonably within the risk-return spectrum;

4. Requires sensitivity testing regarding complex assets supporting life insurer business;

5. Identifies expectations in practice regarding the valuation of complex assets within asset adequacy analysis;

6. Reflects that while complex assets tend to have higher uncertainty regarding timing and amount of cash flows than more traditional investments, because complex assets are difficult to classify, and the regulatory concern is regarding the projected net yields and cash flows from those assets, the focus of the analysis requirements will be on assets categorized as high-yielding; and

7. Requires additional documentation of investment fee income relationships with affiliated entities or entities close to the company.

Text

1. Effective Date

This Guideline shall be effective for asset adequacy analysis of the reserves reported in the December 31, 2022 Annual Statement and for the asset adequacy analysis of the reserves reported in all subsequent Annual Statements.

Guidance note: It is anticipated that the requirements contained in this Guideline will be incorporated into VM-30 at a future date, effective for a future valuation year. Requirements in the Guideline will cease to apply to annual statutory financial statements when the corresponding or replacement VM-30 requirements become effective.

2. Scope

This Guideline shall apply to all life insurers with:
A. Over $5 billion of general account actuarial reserves (from Exhibits 5, 6, 7, and 8 of the Annual Statement) and non-unitized separate account assets or

B. Over $100 million of general account actuarial reserves (from Exhibits 5, 6, 7, and 8 of the Annual Statement) and non-unitized separate account assets and over 5% of supporting assets (selected for asset adequacy analysis) in the category of Projected High Net Yield Assets, as defined in Section 3.F.

Actuarial reserve amounts are included in the amounts in A and B whether directly written or assumed through reinsurance and are determined before any reinsurance ceded credit.

The Guideline applies to assets supporting liabilities tested in the asset adequacy analysis except it does not apply to unitized separate account assets or policy/contract loans.

3. Definitions

A. Equity-like Instruments. Assets that include the following:

i. Any assets that, for purposes of risk-based capital C-1 reporting, are in the category of common stock, i.e., have a 30% or higher risk-based capital charge.

ii. Any assets that are captured on Schedule A or Schedule BA of the Annual Statement.

iii. Bond funds.

B. Fair Value. The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, consistent with methodology of fair value, as reported in the Annual Statement.

C. Net Market Spread. For each asset grouping, shall mean the spread over comparable Treasury bonds that equates the fair value as of the valuation date with modeled cash flows, less the default assumption used in asset adequacy analysis.

Market conventions and other approximations are acceptable for the purposes of this definition.

D. Investment Grade Net Spread Benchmark. The applicable spread found in Appendix I using the weighted average life (WAL) of the associated non-Equity-like Instrument.

E. Guideline Excess Spread. The net spread derived by subtracting the Investment Grade Net Spread Benchmark from the Net Market Spread for non-Equity-like Instruments. Investment expenses shall be excluded from this calculation.

F. Projected High Net Yield Assets. Currently held or reinvestment assets that are either:

i. An Equity-like Instrument assumed to have higher value at projection year 10 or later than under an assumption of annual total returns, before the deduction of investment expenses, of 4% for the first 10 projection years after the valuation date followed by 5% for projection year 11 and after. Aggregation shall be done at a level of granularity that is consistent with or more granular than how the assets are grouped, i.e., compressed, in the asset adequacy analysis model, or

ii. Assets other than Equity-like Instruments where the assumed Guideline Excess Spread is higher than zero. In addition:

(a) Aggregation of the comparison between the assumed Net Market Spread from each asset and the Investment Grade Net Spread Benchmark shall be done at a level of granularity that is consistent with or more granular than how the assets are grouped, i.e., compressed, in the asset adequacy analysis model.
(b) For applicable assets that do not have an explicit WAL or term to maturity, the Appointed Actuary shall disclose the method used to determine the appropriate WAL used for comparing to the Investment Grade Net Spread Benchmark.

c) For purposes of the comparison between the assumed Net Market Spread from each asset and the Investment Grade Net Spread Benchmark, investment expenses shall be excluded.

iii. The following asset types can be excluded from the scope of requirements in sections 4.A.ii through 5:

(a) Cash or cash equivalents,

(b) Treasuries and agency bonds, and

(c) Public non-convertible, fixed-rate corporate bonds with no or immaterial callability.

4. Asset Adequacy Considerations and Documentation Expectations

A. Net return and risk documentation.

i. For all assets, either currently held or in assumed reinvestments, provide:

(a) Identification of the assumed gross asset yield and the key components (for example, default and investment expenses) deducted to arrive at the assumed net asset yield.

(b) Explanation of any future reinvestment strategy assumptions that materially differ from current practices.

ii. For Projected High Net Yield Assets, either currently held or in assumed reinvestments, provide:

(a) A detailed explanation describing the relationship between the expected gross returns from these assets and the risk. It shall also include, for the aspect of any higher expected gross returns not assumed to be associated with higher risk, an explanation of how overperforming assets with expected returns lying outside the risk-return spectrum can be assumed to persist and be available for reinvestments throughout the projection period in moderately adverse conditions.

(b) Commentary on how assumptions on assets with risk factors leading to substantial volatility of returns, as identified through sensitivity testing or other means, contain an appropriate margin to reflect the uncertainty in the timing and amounts of asset cash flows.

(c) Identification of the extent to which Projected High Net Yield Assets are supporting major product categories, e.g., individual fixed annuities and pension risk transfers.

(d) Explanation of rationale for materially changing or not changing complex-asset-based assumptions from the prior year’s analysis.

B. Model rigor. Where significant risks associated with complex, Projected High Net Yield Assets are not adequately captured with traditional modeling techniques, more rigorous modeling of those risks should occur.

i. Where necessary to adequately reflect the risk:

(a) Multi-scenario testing of those risks specific to complex assets should be performed. For example, investments that may provide a higher expected return in part due to limited
information, niche skill sets, or other factors may require unique scenarios (for instance to adequately capture credit or liquidity risk) to fully encompass potential sources of loss.

(b) Asset cash flows should be appropriately projected to reflect anticipated liquidity under adverse conditions. If such model aspects are not developed, sufficient additional conservatism to reflect this risk shall be applied.

c) To the extent that the process for modeling or otherwise evaluating the risks is complex, and the potential for disconnect between reality and modeling increases, an additional margin to assumption(s) should be applied. Any such margin shall be applied in the direction of asset adequacy analysis results being less favorable.

d) The full distribution of risk associated with complex assets should be considered.

ii. An Appointed Actuary may use simplifications, approximations, and modeling efficiency techniques if the Appointed Actuary can demonstrate that the use of such techniques does not make asset adequacy analysis results more favorable. These techniques may be less appropriate if the amount of complex, high-yielding assets becomes a higher percentage of total assets.

Guidance note: Actuarial Standards of Practice (ASOPs), including ASOP No. 7 and No. 56 contain additional guidance on the use of models in the analysis of cash flows.

C. Fair Value determination. In asset adequacy analysis, when an asset is projected to be available for sale, a Fair Value of that asset is established, based on the projected market conditions. Fair Value should only be determined internally (by the insurance or investment management company) when the market-based value of the asset or similar asset cannot be obtained or expected to be obtained in a projected scenario.

i. When the Fair Value of a material portion of supporting assets is determined internally, the actuarial memorandum shall contain a step-by-step description of the approach used to calculate the Fair Value of such assets.

ii. Provide the total Fair Value of assets that have values determined internally.

iii. When the Fair Value of a material portion of assets is determined internally, a sensitivity test should be performed (and the impact on asset adequacy analysis results presented) assuming a haircut to internally derived Fair Values that the Appointed Actuary deems reasonable given the commensurate level of anticipated uncertainty.

D. Non-publicly traded assets. For non-publicly traded assets originated by the company, within the company’s group, or within an entity closely tied to a company’s group (inclusive of the company's investment manager), provide the following:

i. Documentation of practices to help ensure accurate valuation of those assets.

ii. The total Fair Value of such assets.

iii. To the extent the contractual agreement affects the investment income revenue streams included in the asset adequacy analysis, disclose in detail applicable contractual agreements and revenue sharing, e.g., performance fees, between the entity responsible for providing investment or other types of services and the insurer.
Also, assumed net cash flows from assets should be net of all explicit or implicit fees or expenses, such as origination fees, as well as reflective of other asset-related risks including credit risk, illiquidity risk, and other market risks.

E. **Investments expenses (fees).** Assumed investment expenses, whether paid to an external asset manager or to internal investment management staff, as well as additional expenses that are directly attributable to the specific investments, should be commensurate with the expected expenses in light of the complexity of the assets.

F. **Reinsurance modeling.** Related to reinsurance, relevant communications and disclosures, for instance commentary on collectability and counterparty risk, should be presented in the memorandum.

**Guidance note:** Section 4.F is consistent with the standard laid out in ASOP No. 11 – Reinsurance Involving Life Insurance, Annuities, or Health Benefit Plans in Financial Reports.

G. **Borrowing.** Please identify if any borrowing is modeled besides to address very short-term liquidity needs. Also, verify borrowing and reinvestment rates to ensure that projections are not materially benefiting from arbitrage advantages.

5. Sensitivity Tests and Attribution Analysis related to Assumptions on Projected High Net Yield Assets

A. Sensitivity testing

i. Perform and disclose, separately for (a) and (b), the asset adequacy analysis results from the following sensitivity tests:

   (a) For reinvestment assets other than Equity-like Instruments, assume the Net Market Spreads (before deduction of investment expenses) for Projected High Net Yield Assets do not exceed the Investment Grade Net Spread Benchmark and apply the test to a baseline of a level Treasury rate scenario.

   For the purposes of limiting the Net Market Spreads at the Investment Grade Net Spread Benchmark, Projected High Net Yield Assets may be aggregated together but shall not include any assets that are not Projected High Net Yield Assets.

   (b) For reinvestment assets that are Equity-like Instruments, assume annual total returns, before the deduction of investment expenses, of 4% for the first 10 projection years after the valuation date followed by 5% for projection year 11 and after.

   ii. Strict technical compliance for each asset may not be practical for reasons such as model limitations. Professional judgment should be applied to produce sensitivity testing results that are consistent with the spirit of the test. A variety of alternative methods may be acceptable. Appropriate explanation and justification should be provided for the method that was employed.

   iii. Sensitivity testing for the purpose of this Guideline does not reflect commentary on moderately adverse conditions, but the volatility and impact demonstrated from the testing should be contemplated in Section 4.A.ii.(b) considerations.

B. For Projected High Net Yield Assets for non-Equity-like Instruments either currently held or in assumed reinvestments, perform and disclose the following attribution analysis steps at the asset type level associated with the templates in Section 6:

   i. State the assumed Guideline Excess Spread.
ii. Estimate the proportion of the Guideline Excess Spread attributable to the following factors:

(a) Credit risk

(b) Illiquidity risk

(c) Deviations of current spreads from long-term spreads defined in Appendix 1

(d) Volatility and other risks (identify and describe these risks in detail)

iii. Provide commentary on the results of Section 5.B.ii. Also, where judgment is applied, provide supporting rationale of how the expected return in excess of the Investment Grade Net Spread Benchmark is estimated.

Guidance note: a best-efforts approach is expected for the year-end 2022 attribution analysis

6. Reporting, Review, and Templates

Guidance note: The NAIC Valuation Analysis (E) Working Group (VAWG) shall serve as a resource in the targeted review of asset adequacy analysis related to modeling of business supported with Projected High Net Yield Assets. VAWG shall provide periodic reports identifying outliers and concerns regarding the analysis to help inform regulators on the effectiveness of the Guideline in meeting the seven objectives stated in the Background section.

A. The documentation, sensitivity test results, and attribution analysis referenced above are to be incorporated as a separate, easily identifiable section of the actuarial memorandum required by VM-30 or as a standalone document, with a due date of April 1 following the applicable valuation date. The domiciliary commissioner may approve a later due date for companies seeking a hardship extension. The separate section or standalone document shall be available to other state insurance commissioners in which the company is licensed upon request to the company. The confidentiality and information provisions in state adoptions of NAIC Model 820 regarding the actuarial memorandum are applicable to the separate section or standalone document required by this Guideline.

B. Sample templates (to be adopted by the Life Actuarial Task Force):

i. Asset types – will be categorized when the templates are completed.

ii. Template for the asset summary.

iii. Template for components of net asset yield for various asset classes, with separate tables to be provided for initial assets and reinvestment assets.

iv. Template for sensitivity test aspects for Projected High Net Yield Assets that are fixed-income.

v. Template for sensitivity test results for Projected High Net Yield Assets.

vi. Template for attribution analysis, with separate tables to be provided for initial assets and reinvestment assets for Projected High Net Yield Assets.
### Appendix I – Investment Grade Net Spread Benchmark

<table>
<thead>
<tr>
<th>WAL (Weighted Avg Life)</th>
<th>Investment Grade Net Spread Benchmark (in bps)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1-10</td>
<td>170</td>
</tr>
<tr>
<td>11-20</td>
<td>175</td>
</tr>
<tr>
<td>21-30</td>
<td>185</td>
</tr>
</tbody>
</table>
Revisions to the
As of March 2022, Accounting Practices and Procedures Manual

On **October 24, 2022**, the Statutory Accounting Principles (E) Working Group adopted the following revisions to the *As of March 2022 Accounting Practices and Procedures Manual*. Documents associated with these revisions are linked to the reference items in bold text.

<table>
<thead>
<tr>
<th>Ref #</th>
<th>SSAP/ Appendix</th>
<th>Title</th>
<th>Summary</th>
</tr>
</thead>
<tbody>
<tr>
<td>INT 22-02</td>
<td>SSAP No. 9 SSAP No. 101</td>
<td>Third Quarter 2022 Reporting of the Inflation Reduction Act – Corporate Alternative Minimum Tax Effective September 30, 2022</td>
<td>This INT provides accounting and disclosure guidance for the third quarter 2022 financial statements related to the CAMT. Because a reporting entity is unlikely to be able to make a reasonable estimate, the INT provides exceptions to reporting for Sept. 30. It also includes disclosure information. INT 22-02 will be automatically nullified on Dec. 1, 2022.</td>
</tr>
</tbody>
</table>

https://naiconline.sharepoint.com/teams/frsstatutoryaccounting/national meetings/a. national meeting materials/2022/7-summer nm/adoptions/adoptions 8.10.2022 toc.docx
INT 22-02: Third Quarter 2022 Reporting of the Inflation Reduction Act - Corporate Alternative Minimum Tax

INT 22-02 Dates Discussed

October 6, 2022; October 24, 2022

INT 22-02 References

Current:
SSAP No. 9—Subsequent Events
SSAP No. 101—Income Taxes

INT 22-02 Issue

Key Provisions of the Inflation Reduction Act

1. The Inflation Reduction Act (Act) was enacted on August 16, 2022, and included a new corporate alternative minimum tax (CAMT). The Act and the CAMT go into effect for tax years beginning after 2022. Reporting entities shall refer to the Act and the resulting regulations and other tax guidance to determine application, but a non-authoritative high-level summary based on information at the time of initial INT discussion regarding the CAMT is as follows:

   a. The CAMT is 15% of the corporation’s “adjusted financial statement income” for the tax year, reduced by corporate alternative minimum foreign tax credit.

   b. The CAMT will only apply to corporations (determined on an affiliated group basis) with average adjusted financial statement income in excess of $1 billion for the three prior tax years. This threshold is reduced to $100 million in the case of certain foreign-parented corporations. When a corporation becomes subject to the CAMT, it remains an applicable to the CAMT, even if its average adjusted financial statement income is less than $1 billion, unless an exception applies.

   c. A corporation's adjusted financial statement income is the amount of net income or loss the corporation reports on its applicable financial statement. The income is adjusted for various purposes including certain adjustments in the case of consolidated returns or for foreign income.

   d. The Act includes references to the tax codes which provides a hierarchy for determining the “applicable financial statement.” At a high level, the first choice is U.S. generally accepted accounting principles (GAAP) financial statements; the second choice is international financial reporting standards (IFRS) financial statements. If GAAP and IFRS financial statements are not available, the financial statements filed by the taxpayer with any other regulatory or government body is acceptable. If the taxpayer is part of an affiliated group of corporations filing a consolidated return, the adjustable financial statement income for the group considers the group's applicable financial statement.

   e. To determine its U.S. federal income tax liability, a corporation will need to compute taxes under both systems—the regular tax system and the CAMT system. The CAMT is payable to the extent the tentative CAMT exceeds the regular corporate income tax. Any CAMT
paid is available indefinitely as a credit carryover that could reduce future regular tax in future years if the regular tax liability is in excess of CAMT tax liability.

f. The Act directs the Treasury to issue regulations and other guidance relate to implementing the CAMT, so several issues are pending detailed clarifications including clarifying the definition of an applicable corporation, and providing guidance on the starting point for, and adjustments to, adjusted financial statement income, as well as the handling of separate company tax returns when required under current tax law that are unique to the insurance industry.

**Interpretation Issues**

2. This interpretation is focused on addressing third quarter 2022 transition accounting and reporting aspects of the new CAMT. While most insurers will not be subject to the CAMT, for those that know that they are subject, and those that could be subject to the CAMT, there are a variety of reporting uncertainties, particularly regarding reporting for third quarter 2022.

3. The CAMT is effective for the tax years on or after 2023.

4. Both statutory accounting principles and U.S. GAAP require the effects of tax changes on deferred taxes, including the valuation allowance (future realizability of existing DTAs) in the period in which the legislation is enacted (third quarter 2022). *SSAP No. 101—Income Taxes*, paragraph 7.e. requires the statutory valuation allowance adjustment as a direct reduction in the gross DTA if, based on the weight of available evidence, it is more likely than not that some or all of the gross DTAs will not be realized. Gross DTA less the statutory valuation allowance results in adjusted gross DTAs. The statutory valuation allowance adjustment is not reported as a separate line in the statutory financial statements (it is an off-balance sheet item that reduces the gross DTAs). The statutory valuation allowance is disclosed.

5. The statutory accounting calculation for admissible DTAs is determined using adjusted gross DTAs (gross DTAs reduced by the valuation allowance). For statutory accounting, admittance of adjusted gross DTAs in *SSAP No. 101* depends on a three-component calculation, for which the second step limits admittance of adjusted gross DTAs to those that are expected to be realized in a timeframe that does not exceed three years. The actual number of years permitted depends on specifics for each reporting entity (type and other information about the reporting entity), but the maximum timeframe is three years. The last step admits DTAs which can be offset by DTLs.

6. Guidance in *SSAP No. 9—Subsequent Events* requires consideration of Type I and Type II subsequent events through the date of the statutory financial statements and the date of issuance of the audited financial statements, or the date in which audited financial statements are available to be issued. For subsequent events identified after the statutory financial statements are filed (example, March 1), but before the audited financial statements are issued (example, June 1), reporting entities are generally required by their domestic state to amend their filed statutory financial statements to ensure that the statutory financial statements and the audited financial statements are consistent. Under this guidance, as additional information is made available on the impact of the Act, or information becomes available to update estimates and assessments, under existing statutory accounting guidance in *SSAP No. 9*, reporting entities would need to identify updated estimates as a Type I subsequent event in the audited financial statements.

---

1 A Type I subsequent event relates to an event or transaction that provides additional evidence with respect to conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements. Under *SSAP No. 9*, entities shall recognize in the financial statements the effects of all material Type I subsequent events. A Type II subsequent event pertains to events or transactions that provide evidence to conditions that did not exist at the balance sheet date but arose after that date. Type II events are disclosed in the financial statements.
Issue 1 – Consideration of the Act for Third Quarter 2022 Financial Statements

7. During the period of enactment (third quarter 2022) reporting entities filing statutory financial statements would normally have to consider the applicability of the CAMT and if applicable, determine the impact on the statutory valuation allowance as well as assess DTAs for admissibility (e.g., realization timeframe). These elements will be collectively referred to as “calculations impacted by the Act” or “calculations impacted by the CAMT.”

8. This interpretation will address the issue for what reporting entities are required to report or disclose regarding the calculations impacted by the CAMT for September 30, 2022, financial statements.

Issue 2 – Consideration of Subsequent Events for Third Quarter 2022 Financial Statements

9. SSAP No. 9 requires consideration of subsequent events through the date of the statutory financial statements and the date of issuance of the audited financial statements, or the date in which audited financial statements are available to be issued.

10. For reporting entities that materially revise or establish calculations impacted by the CAMT subsequent to September 30, 2022 (including the statutory valuation allowance, the timing of determination of net admitted DTAs, and the determination of the applicability of the CAMT), this interpretation will address the extent a Type I or Type II subsequent event assessment is required for third quarter 2022 financial reporting.

INT 22-02 Discussion

11. The Statutory Accounting Principles (E) Working Group consensuses to the noted issues are included below.

Response: Issue 1 – Consideration of the Act for Third Quarter 2022 Financial Statements

12. Reporting entities that are aware they will be subject to the CAMT would normally reflect the effects of the Act on the calculations impacted by the CAMT if reasonably estimable for third quarter 2022. Because of the timing of the adoption of the Act and the considerable number of unknown variables for September 30, 2022, reporting, the Working Group has determined that a reasonable estimate is not determinable for third quarter 2022 interim financial statements for the calculations impacted by the CAMT.

13. Because reasonable estimates of calculations impacted by the CAMT are not determinable, reporting entities shall not recognize impacts related to CAMT for third quarter 2022 financial statements, but shall make the following disclosures regarding the CAMT and the Act:

   a. The Act was enacted during the reporting period on August 16, 2022.

   b. A statement regarding whether the reporting entity (or the controlled group of corporations of which the reporting entity is a member) has determined if it expects to be liable for CAMT in 2023. For example:

      i. The reporting entity (or the controlled group of corporations of which the reporting entity is a member) has determined that it does not expect to be liable for CAMT in 2023.

      ii. The reporting entity (or the controlled group of corporations of which the reporting entity is a member) has not determined as of the reporting date if it will be liable
for CAMT in 2023. The third quarter 2022 financial statements do not include an estimated impact of the CAMT because a reasonable estimate cannot be made.

iii. The reporting entity (or the controlled group of corporations of which the reporting entity is a member) has determined that it expects to be liable for CAMT in 2023. The third quarter 2022 financial statements do not include an estimated impact of the CAMT, because a reasonable estimate cannot be made.

Response: Issue 2 – Consideration of Subsequent Events for Third Quarter 2022 Financial Statements

14. For third quarter 2022 reporting, CAMT updated estimates or other calculations affected by the Act determined subsequent to third quarter statutory financial statement or filing date shall not be recognized as Type I subsequent events. Meaning, amended financial statements are not required to reflect updated estimates subsequent to the third quarter filing date and prior to the filing the third quarter financial statements. With the disclosure required under Issue 1, additional subsequent event disclosure (such as what would be required for Type II event) is not required.

15. Reporting entities shall be working in good faith to complete the accounting for the changes adopted under the Act.

INT 22-02 Status

16. The consensuses in this interpretation were adopted to provide reporting guidance regarding the calculations impacted by the CAMT and provide limited-scope, limited-time exceptions to the valuation allowance and DTA calculations in response to legislation under SSAP No. 101 as well as Type I subsequent event requirements in SSAP No. 9 for September 30, 2022, statutory reporting. As detailed, the exceptions to SSAP No. 101 and SSAP No. 9 are effective for third quarter 2022. Due to the short-term nature of the SSAP No. 9 exception, this interpretation will be automatically nullified on December 1, 2022, and will be included as a nullified INT in Appendix H – Superseded SSAPs and Nullified Interpretations in the As of March 2023 Accounting Practices and Procedures Manual.

17. Further discussion is planned.