NAIC NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS

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.

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

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.

Ref #	SSAP/ Appendix	Title	Summary
2021-20 **Exhibit A** **Excluded Components**	SSAP No. 86	Effective Derivatives - ASU 2017-12 *New SAP Concept* Effective January 1, 2023 (Early adoption permitted)	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 **IP No. 166 - Assets**	Preamble and SSAP No. 4	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. 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.

Ref #	SSAP/ Appendix	Title	Summary
2022-06	SSAP No. 104R	ASU 2021-07, Compensation - Stock Compensation *SAP Clarification* Effective Immediately (August 10, 2022)	Revisions incorporate the practical expedient from *ASU 2021-07, Compensation – Stock Compensation, Determining the Current Price of an Underlying Share for Equity-Classified Share-Based Awards* for the current price input, a required component for option-pricing models utilized in determining fair value for share-based payments.
2022-07	SSAP No. 47 SSAP No. 68	ASU 2021-08, Business Combinations *SAP Clarification* Effective Immediately (August 10, 2022)	Revisions reject *ASU 2021-08, Business Combinations, Accounting for Contract Assets and Contract Liabilities from Contracts with Customers* 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.

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

Issue: Effective Derivatives – ASU 2017-12

Check (applicable entity):

	P/C	Life	Health
Modification of existing SSAP	☒	☒	☒
New Issue or SSAP	☐	☐	☐
Interpretation	☐	☐	☐

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 then 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.

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*.

65. 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~~are 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

74.~~73~~ 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.

e. 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.*

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2022/7-Summer NM/Adoptions/21-20 - Effective Derivatives ASU 2017-12.docx

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

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.)

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)*

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)[1] 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)*

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 815-10-50-4EEEE. *(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 815-20-25-22A 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~~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 ~~815-20-25-84 through 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 ~~815-20-25-84 through 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)*

a. The notional amount of the interest rate swap matches the principal amount of the interest-bearing asset or liability being hedged.

b. 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.

c. 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.

c. The interval between repricings of the variable interest rate in the interest rate swap is frequent enough to justify an assumption that the variable payment or receipt is at a market rate (generally three to six months or less).

d. For fair value hedges of a proportion 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 (a) in paragraph 815-20-25-104)~~ matches the portion of the asset or liability being hedged.

e. For fair value hedges of portfolios (or proportions thereof) of similar interest-bearing assets or liabilities, both of the following criteria are met:

i. The notional amount of the interest rate swap designated as the hedging instrument matches the aggregate notional amount of the hedged item (whether it is all or a proportion of the total portfolio).

ii. The remaining criteria for the shortcut method are met with respect to the interest rate swap and the individual assets or liabilities in the portfolio.

f. The index on which the variable leg of the interest rate swap is based matches the benchmark interest rate designated as the interest rate risk being hedged for that hedging relationship.

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.

e. 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.

f. 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

(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)(iv)(01)(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 7~~815-20-25-81~~. (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

effective. ~~This shall include an assessment of the guidance in paragraph 815-20-25-100 when applicable.~~

b. There have been no adverse developments regarding the risk of counterparty default.

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 28-29~~815-20-35-2D 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)

a. Period-by-period approach. The period-by-period approach involves comparing the changes in the hedging instrument's fair values (or cash flows) that have occurred during the period being assessed to the changes in the hedged item's fair value (or hedged transaction's cash flows) attributable to the risk hedged that have occurred during the same period. If an entity elects to base its comparison of changes in fair value (or cash flows) on a period-by-period approach, the period cannot exceed three months. Fair value (or cash flow) patterns of the hedging instrument or the hedged item (or hedged transaction) in periods before the period being assessed are not relevant.

b. Cumulative approach. The cumulative approach involves comparing the cumulative changes (to date from inception of the hedge) in the hedging instrument's fair values (or cash flows) to the cumulative changes in the hedged item's fair value (or hedged transaction's cash flows) attributable to the risk hedged.

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 10-11~~815-20-25-84 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 offsetting 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 16~~815-20-25-103~~ 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

44. If the entity identifies an improved method of assessing hedge effectiveness in accordance with the guidance in paragraph 6~~815-20-25-80~~ 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.

45. 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 250~~*SSAP 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

b. Hedge effectiveness of written options

c. Hedge effectiveness of options in general.

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).

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 815-20-55-75.

Application of the Shortcut Method to a Portfolio of Hedged Items

815-20-25-116 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 dedesignating 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 dedesignate 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

815-20-25-133 Paragraphs 815-10-35-1A through 35-1C, 815-10-50-3, 815-20-25-3A, 815-20-25-119, 815-20-25-134 through 25-138, 815-20-55-79A through 55-79B, 825-10-50-3, and 825-10-50-8 provide guidance for an entity electing the simplified hedge accounting approach. See paragraph 815-10-65-6 for transition guidance on applying 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:

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.

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:

    - Most foreign bond exposures come through private investments that are generally more difficult to sell, providing a disincentive to selling the bond exposure.

    - 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.

    - 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.)

    - 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

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.

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.

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 ~~B~~A, 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 spot 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

gain/loss, the fair value reflected in BACV, and for the excluded forward points (e.g., forward spot rates), the aggregate amount owed at maturity, along with current year and remaining amortization. (Note – These items will be captured in a blanks proposal/template.)

Proposed Edits to Exhibit C – Foreign Currency Swaps and Forwards

Note: Only Specific Excerpts Included

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;

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);

(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, ~~T~~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) ~~will~~ 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.

~~notional amount or designated notional amount times the difference between the forward rate available for the remaining maturity of the contract (i.e., the forward rate as of the balance sheet date) and the forward rate at the time it ceased to be an effective hedge.~~

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):

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.;

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.

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

Issue: Conceptual Framework – Updates

Check (applicable entity):

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

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 a 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 FN1 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 FN1 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. 5R—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 **FN1** 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~~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

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. 8~~6~~, 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. 8~~6~~, Chapter 4, Elements of Financial Statements,* paragraphs E16-E18~~25-33~~.

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 FN1 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 FN1 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

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.

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[1] 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[2], 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.

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[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. 37 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

- FASB Statement of Financial Accounting Concepts No. 8, Conceptual Framework for Financial Reporting – Chapter 4, Elements of Financial Statements

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[3] future economic benefits obtained or controlled by a particular entity as a result of past transactions or events~~. An asset has ~~three~~ two essential characteristics: (a) it is a present right~~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~~[4][5]~~, 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*.

~~[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] *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[6]. 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 ~~adopts~~ *FASB Statement of Financial Accounting Concepts No. 8~~6~~, Chapter 4, Elements of Financial Statements,* paragraphs E16-E18~~25-33~~.

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*

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2022/7-Summer NM/Adoptions/22-01A - IP No. 166 - Definition of Assets.docx

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

Issue: SSAP No. 48 – Alternative Valuation of Minority Ownership Interests

Check (applicable entity):

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

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 financials 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 financials 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:

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**.

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.

<u>Option 1</u>: 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~~

~~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.~~

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.

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

Issue: ASU 2021-10, Government Assistance

Check (applicable entity):

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

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 <u>only apply</u> to transactions that are accounted for by analogizing either a grant or contribution model. As such, these enhanced disclosures <u>do not</u> 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 <u>not accounted for</u> in accordance with other accounting standards – i.e., revenue in the normal course of business or debt), <u>NAIC staff believe the occurrence of such items requiring disclosure per ASU 2021-10 will likely be relatively infrequent</u>.

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):

	P/C	Life	Health
Modification of Existing SSAP	☒	☒	☒
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*.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2022/7-Summer NM/Adoptions/22-05 - ASU 2021-09 Lease Discount Rates.docx

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

Issue: ASU 2021-07, Compensation – Stock Compensation

Check (applicable entity):

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

Description of Issue: 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:

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.

~~c.~~d. *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.com/teams/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):

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

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 contacts 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.**(INT 00-28) 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

Actuarial Guideline LIII

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

WAL (Weighted Avg Life)	Investment Grade Net Spread Benchmark (in bps)
1-10	170
11-20	175
21-30	185

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.

Ref #	SSAP/ Appendix	Title	Summary
INT 22-02	SSAP No. 9 SSAP No. 101	Third Quarter 2022 Reporting of the Inflation Reduction Act – Corporate Alternative Minimum Tax Effective September 30, 2022	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.

https://naiconline.sharepoint.com/teams/frsstatutoryaccounting/national meetings/a. national meeting materials/2022/7-summer nm/adoptions/adoptions 8.10.2022 toc.docx

Interpretation of the
Statutory Accounting Principles (E) Working Group

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[1] 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.

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

On **December 13, 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.

Ref #	SSAP/ Appendix	Title	Summary
INT 22-02	SSAP No. 9 SSAP No. 101	Interpretation (INT) 22-02: Third Quarter 2022 through First Quarter 2023 Reporting of the Inflation Reduction Act – Corporate Alternative Minimum Tax *Interpretation* Effective Immediately (December 13, 2022)	Revisions extend INT 22-02 for Dec. 31, 2022, and first quarter 2023 statutory financial statements. This INT provides an exception that does not require entities to assess valuation allowance and deferred tax asset impacts, tax estimates from the Inflation Reduction Act CAMT for third-quarter 2022 through first-quarter 2023. It also provides subsequent event exceptions and disclosures.
2021-25	SSAP No. 19 SSAP No. 73	Leasehold Improvements After Lease Termination *SAP Clarification* Effective Immediately (December 13, 2022)	Revisions clarify that leasehold improvements shall be immediately expensed upon lease termination unless limited exceptions are met.
2022-09	SSAP No. 86	ASU 2022-01 – Fair Value Hedging – Portfolio Layer Method *New SAP Concept* Effective January 1, 2023 (Early adoption permitted)	Revisions adopt with modification derivative guidance from *ASU 2017-12, Derivatives and Hedging* and *ASU 2022-01, Fair Value Hedging – Portfolio Layer* to incorporate the portfolio layer method and partial-term hedges for statutory accounting.
2022-10	SSAP No. 36	ASU 2022-02 – Troubled Debt Restructurings and Vintage Disclosures *SAP Clarification* Effective Immediately (December 13, 2022)	Revisions reject *ASU 2022-02, Troubled Debt Restructurings and Vintage Disclosures* and identifies that retained guidance reflects superseded U.S. generally accepted accounted principles (GAAP).

Ref #	SSAP/ Appendix	Title	Summary
2022-13	SSAP No. 25 SSAP No. 97	Related Parties – Footnote Updates *SAP Clarification* Effective Immediately (December 13, 2022)	Revisions identify foreign open-end investment funds as a fund in which ownership percentage is not deemed to reflect control unless the entity actually controls with the power to direct the underlying company.

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Interpretation of the
Statutory Accounting Principles (E) Working Group

INT 22-02: Third Quarter 2022 through First Quarter 2023 Reporting of the Inflation Reduction Act - Corporate Alternative Minimum Tax

INT 22-02 Dates Discussed

October 6, 2022; October 24, 2022, November 16, 2022; December 13, 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 "applicable 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 corporation for purposes of 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, an applicable 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[1] 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 on October 24, 2022, 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.

17. On December 13, 2022, the Working Group adopted a consensus to extend this interpretation for December 31, 2022, and first quarter 2023 statutory financial statements. For application as of year-end 2022 and first quarter 2023:

a. Consistent with paragraphs 12 and 13, the Working Group has concluded that a reasonable estimate is not determinable for December 31, 2022, and March 31, 2023, therefore impacts related to the CAMT in the year-end 2022 and March 31, 2023, financial statements are not required.

b. The reporting entity shall include disclosures in paragraph 13 in the year-end 2022 and March 31, 2023, financial statements. In addition, the reporting entity shall disclose the following:

i. If, based on information regarding the projected adjusted financial statement income for 2023, the entity or the controlled group of corporations of which the reporting entity is a member has determined if it is an "applicable corporation" to determine if CAMT exceeds the regular federal income tax payable. That is, disclose if the reporting entity (or the controlled group of corporations of which the reporting entity is a member) has determined if average "adjusted financial statement income" is above the thresholds for 2023 tax year that they expect to be required to perform the CAMT calculations. This disclosure is about being applicable corporation, not if the entity is required to pay.

c. Consistent with paragraph 14, CAMT updated estimates or other calculations affected by the Act determined subsequent to filing the December 31, 2022, and March 31, 2023, financial statements shall not be recognized as Type I subsequent events.

d. For year-end 2022 financial statements, the subsequent event exception is expanded to encompass events that occur prior to the issuance of statutory financial statements as well as events that occur before the date the audited financial statements are issued, or available to be issued. This provision intends to prevent reporting entities from having to amend statutory financial statements from material Type I subsequent events as a result of updated information / estimates received after the reporting date of year-end 2022 statutory financial statements pertaining to the accounting for the enactment of the Act.

18. With the extension, this interpretation will be automatically nullified on June 15, 2023.

19. No. further discussion is planned.

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

Issue: Leasehold Improvements After Lease Termination

Check (applicable entity):

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

Description of Issue:
During 2019, the Working Group adopted substantive revisions to *SSAP No. 22—Leases*, which created SSAP No. 22R. The updated guidance rejected financing lease treatment that was adopted in U.S. GAAP but incorporated language from ASC Topic 842, which kept SSAP No. 22R as consistent as possible with the principal concepts in the U.S. GAAP standard. The Working Group has addressed several additional FASB Accounting Standard Updates (ASU) since the initial adoption of Topic 842 and NAIC staff have received numerous inquiries from SAP reporting entities since the adoption of the substantive revisions to SSAP No. 22R.

NAIC staff received a question about the treatment of leasehold improvements in situations where a leased property is purchased by the lessee during the lease term and noted that there is no explicit guidance for these situations in *SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements* nor *SSAP No. 73—Health Care Delivery Assets and Leasehold Improvements in Health Care Facilities*. In these scenarios, it was identified that the reporting entity had acquired the property that was initially subject to a lease; however regardless of the scenario, amortization of leasehold improvements is only permitted over the shorter of the estimated useful life of the improvement or the lease term (as defined in SSAP No. 22R). In a normal lease termination, one where the lessee does not acquire said property, any remaining leasehold improvements shall be immediately expensed. This agenda item has been drafted to clarify this guidance, to eliminate future questions and ensure consistent application.

Existing Authoritative Literature:
Guidance for property improvements and integral equipment is included in *SSAP No. 40R—Real Estate Investments*.

SSAP No. 40R (underlines added for emphasis):

> 18. Recognition of profit on sales of real estate investments shall be accounted for in accordance with FASB Statement No. 66, Accounting for Sales of Real Estate (FAS 66), except as modified in paragraph 20 of this statement, FASB Emerging Issues Task Force No. 87-9, Profit Recognition on Sales of Real Estate with Insured Mortgages or Surety Bonds, FASB Emerging Issues Task Force No. 87-29, Exchange of Real Estate Involving Boot, FASB Interpretation No. 43, Real Estate Sales an interpretation of FASB Statement No. 66 (FIN 43) and FASB Emerging Issues Task Force No. 00-13, Determining Whether Equipment is "Integral Equipment" Subject to FASB Statements No. 66 and No. 98(INT 06-13). <u>This statement applies to all sales of real estate including real estate with property improvements or integral equipment. The terms "property improvements" and "integral equipment" refer to any physical structure or equipment attached to the real estate that cannot be removed and used separately without incurring significant costs, such as an office building.</u> Additionally, this guidance applies to all transfers of financial assets that are in substance real estate.
>
> 31. <u>This statement adopts FASB Interpretation No. 43, Real Estate Sales, an Interpretation of FASB Statement No. 66 (FIN 43), which clarifies that the phrase "all real estate sales" includes sales of real estate with property improvements or integral equipment that cannot be removed and used separately from the real estate without incurring significant costs.</u> This statement adopts FASB Emerging Issues Task Force No. 84-17, Profit Recognition on Sales of Real Estate with Graduated Payment Mortgages or Insured Mortgages, FASB Emerging Issues Task Force No. 89-13, Accounting for the Cost of Asbestos Removal, FASB Emerging Issues Task Force No. 89-14, Valuation of Repossessed Real Estate, FASB Emerging

Issues Task Force No. 90-8, Capitalization of Costs to Treat Environmental Contamination, FASB Emerging Issues Task Force No. 95-23, The Treatment of Certain Site Restoration/Environmental Exit Costs When Testing a Long-Lived Asset for Impairment, FASB Emerging Issues Task Force 97-11: Accounting for Internal Costs Relating to Real Estate Property Acquisitions, FASB Emerging Issues Task Force No. 98-8: Accounting for Transfers of Investments That Are in Substance Real Estate and FASB Emerging Issues Task Force No. 00-13, Determining Whether Equipment is "Integral Equipment" Subject to FASB Statements No. 66 and No. 98, which clarifies the term "integral equipment" as used in this statement.

Leasehold improvements are discussed in SSAP No. 19 and in SSAP No. 73.

SSAP No. 19:

5. Leasehold improvements that increase the value and enhance the usefulness of the leased asset meet the definition of assets established in SSAP No. 4. Within that definition, such items also meet the criteria defining nonadmitted assets. Accordingly, such assets shall be reported as nonadmitted assets and charged against surplus. These nonadmitted assets shall be amortized against net income over the shorter of their estimated useful life or the remaining lease term as defined in SSAP No. 22R. Leasehold improvements that do not meet the definition of assets shall be charged to expense when acquired.

SSAP No. 73:

9. Furniture, medical equipment and fixtures, and leasehold improvements shall be depreciated over their estimated useful lives but for a period not to exceed three years, except for a leasehold improvement which shall be amortized against net income over the shorter of its estimated useful life or the remaining lease term, using methods detailed in SSAP No. 19.

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): The Working Group adopted substantive revisions in agenda item 2016-02 to SSAP No. 22 to incorporate language from *ASU 2016-02, Leases (Topic 842)*, which retained the treatment of leases as operating leases by the lessor but incorporated some of the new language and guidance from ASU 2016-02.

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

Convergence with International Financial Reporting Standards (IFRS):
The intent of Topic 842 is to make U.S. GAAP lease treatment more closely resemble that of IFRS lease treatment in *IFRS 16—Leases*.

Staff Recommendation:
NAIC staff recommend that the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to SSAP No. 19 and SSAP No. 73 to ensure that the guidance for the leasehold improvements matched the treatment provided in *SSAP No. 40R—Real Estate Investments.* These edits will clarify that amortization of leasehold improvements will immediately end when a lease is terminated and will require that any remaining, unamortized leasehold improvement balance be immediately expensed. This will include scenarios where the lease terminates naturally or when the lessee purchases a property it was leasing. It is presumed that the purchase of a property from a third party would include the leasehold improvements as part of the full purchase price.

<u>SSAP No. 19:</u>

5. Leasehold improvements that increase the value and enhance the usefulness of the leased asset meet the definition of assets established in SSAP No. 4. Within that definition, such items also meet the criteria defining nonadmitted assets. Accordingly, such assets shall be reported as nonadmitted assets and charged against surplus. These nonadmitted assets shall be amortized against net income over the shorter

of their estimated useful life or the remaining lease term, as defined in SSAP No. 22R. Leasehold improvements that do not meet the definition of assets shall be charged to expense when acquired. The amortization of leasehold improvements (including property improvements and integral equipment) shall cease, with any remaining amount immediately expensed, in any event in which the lease is terminated in advance of the lease term. This includes situations in which leased real estate is acquired by the reporting entity lessor. If leased real estate is acquired, recognition of the real estate shall follow the provisions in *SSAP No. 40R—Real Estate Investments*.

SSAP No. 73:

9. Furniture, medical equipment and fixtures, and leasehold improvements shall be depreciated over their estimated useful lives but for a period not to exceed three years, except for a leasehold improvement which shall be amortized against net income over the shorter of its estimated useful life or the remaining lease term, using methods detailed in SSAP No. 19. The amortization of leasehold improvements (including property improvements and integral equipment) shall cease, with any remaining amount immediately expensed, in any event in which the lease is terminated in advance of the lease term. This includes situations in which leased real estate is acquired by the reporting entity lessor. If leased real estate is acquired, recognition of the real estate shall follow the provisions in *SSAP No. 40R—Real Estate Investments.*

Staff Review Completed by Jake Stultz, September 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. 19 and SSAP No. 73 to ensure that the guidance for the leasehold improvements matches the treatment provided in SSAP No. 40. These edits clarify that amortization of leasehold improvements will immediately end when a lease is terminated and will require that any remaining, unamortized leasehold improvement balance be immediately expensed. This will include scenarios where the lease terminates naturally or when the lessee purchases a property it was leasing.

On April 4, 2022, the Statutory Accounting Principles (E) Working Group reviewed comments on prior exposed revisions which intended to clarify that in any scenario in which a lease terminates early, all remaining leasehold improvements shall be immediately expensed. The Working Group directed NAIC staff to continue to work with interested parties to refine the guidance for subsequent consideration.

On August 10, 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 provide an explicit exception to companies that provide direct healthcare. It is limited to situations where the real estate lease agreement has a purchase option that contains language that allows leasehold improvements necessary for the functionality of specific health care delivery assets to be excluded from the purchase cost of the real estate.

SSAP No. 19:

5. Leasehold improvements that increase the value and enhance the usefulness of the leased asset meet the definition of assets established in SSAP No. 4. Within that definition, such items also meet the criteria defining nonadmitted assets. Accordingly, such assets shall be reported as nonadmitted assets and charged against surplus. These nonadmitted assets shall be amortized against net income over the shorter of their estimated useful life or the remaining lease term, as defined in SSAP No. 22R. Leasehold improvements that do not meet the definition of assets shall be charged to expense when acquired. The amortization of leasehold improvements (including property improvements and integral equipment) shall cease, with any remaining amount immediately expensed, in any event in which the lease is terminated in advance of the lease term. This includes situations in which leased real estate is acquired by the reporting entity lessee. Such improvements related to the functionality of health care delivery assets shall follow the accounting, reporting and impairment guidance in *SSAP No. 73—Health Care Delivery Assets and Leasehold Improvements in Health Care Facilities*, and an exception to the application of this guidance to

leasehold improvements necessary for the functionality of health care delivery assets is included in SSAP No. 73. If leased real estate is acquired, recognition of the real estate shall follow the provisions in *SSAP No. 40R—Real Estate Investments*.

SSAP No. 73:

9. Furniture, medical equipment and fixtures, and leasehold improvements shall be depreciated over their estimated useful lives but for a period not to exceed three years, except for a leasehold improvement which shall be amortized against net income over the shorter of its estimated useful life or the remaining lease term, using methods detailed in SSAP No. 19. The amortization of leasehold improvements (including property improvements and integral equipment) shall cease, with any remaining amount immediately expensed, in any event in which the lease is terminated in advance of the lease term. This includes situations in which leased real estate is acquired by the reporting entity lessee but excludes situations where the real estate lease agreement has a purchase option that contains language that allows leasehold improvements necessary for the functionality of specific health care delivery assets[1] to be excluded from the purchase cost of the real estate. Upon acquisition, such leasehold improvements necessary for the functionality of healthcare delivery assets shall follow the guidance for health care delivery assets in this statement. If leased real estate is acquired, recognition of the real estate shall follow the provisions in *SSAP No. 40R—Real Estate Investments*.

On December 13, 2022, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed revisions, as illustrated above, to *SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements* and *SSAP No. 73—Health Care Delivery Assets and Leasehold Improvements in Health Care Facilities*, which clarify that amortization of leasehold improvements shall immediately end when a lease is terminated and requires that any remaining, unamortized leasehold improvement balance be immediately expensed, with a limited, specific exclusion in SSAP No. 73 that allows leasehold improvements necessary for the functionality of specific health care delivery assets to be excluded in some cases from the purchase cost of the real estate. In addition to the exposed language, illustrated above, the Working Group adopted a minor revision to SSAP No. 19, paragraph 9, as illustrated below, to make this paragraph consistent with changes that were made on prior lease agenda items.

SSAP No. 19:

9. The acquisition cost of depreciable assets, net of salvage, shall be depreciated against net income over the estimated useful lives of the assets in a systematic and rational manner. The acquisition cost of a leasehold improvement shall be amortized against net income over the shorter of its estimated useful life or the ~~original~~ lease term as defined in SSAP No. 22R ~~excluding options or renewal periods~~. For leasehold improvements capitalized subsequent to inception of the lease, the cost shall be amortized over the shorter of its estimated useful life or the remaining ~~original~~ lease term ~~excluding options or renewal periods~~. Amounts capitalized for leasehold improvements in periods subsequent to the original lease term (i.e., during renewal periods), are amortized utilizing the shorter of the estimated useful life of the asset or the remaining lease term ~~of the renewal period~~.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2022/Fall - December/Adoptions/21-25 - Lease Improvements Termination.docx

[1] The application of this exception is limited to leasehold improvements necessary for the functionality of health care delivery assets that qualified for admittance under SSAP No. 73.

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

Issue: ASU 2022-01 – Fair Value Hedging – Portfolio Layer Method

Check (applicable entity):

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

Description of Issue: In August 2017, the FASB issued *ASU 2017-12, Derivatives and Hedging: Targeted Improvements to Accounting for Hedging Activities*. Under that ASU, the FASB added guidance to incorporate a "last-of-layer" method to make portfolio fair value hedge accounting more accessible for specific assets. Under the last-of-layer approach, for a closed portfolio of prepayable financial assets or one or more beneficial interests secured by a portfolio of prepayable financial instruments, entities were allowed to hedge a stated amount of the asset or assets in the closed portfolio that is anticipated to be outstanding for the designated hedged period. If the requirements for the last-of-layer method were met, prepayment risk is not incorporated into the measurement of the hedged item.

With the issuance of the last-of-layer guidance in ASU 2017-12, a number of questions were received. After considering those questions, *ASU 2022-01, Fair Value Hedging – Portfolio Layer Method* was issued to address. This ASU expanded the original guidance and provided additional specifications and guidance as follows:

- Expands the last-of-layer method that permitted only one hedged layer to allow multiple hedged layers of a single closed portfolio. This resulted in a name change from last-of-layer to "portfolio layer method."

- Expands the scope to include nonprepayable financial assets.

- Specifies that eligible hedging instruments in a single-layer hedge may include spot-starting or forward-starting constant notional swaps, or spot or forward-starting amortizing-notional swaps and that the number of hedged layers (that is single or multiple) corresponds with the number of hedges designated.

- Provides additional guidance on the accounting for and disclosure of hedge basis adjustments that are applicable to the portfolio layer method whether a single hedged layer or multiple hedged layers are designated.

- Specifies how hedge basis adjustments should be considered when determining credit losses (impairment) for the assets included in the closed portfolio.

The U.S. GAAP concepts for last-of-layer / portfolio layer method hedging within ASU 2017-12 and ASU 2022-01 are new concepts for statutory accounting. Although there is a general assessment that determination of effective hedges shall be consistent between SAP and U.S. GAAP, incorporating guidance to facilitate the portfolio layer method hedge approach for statutory accounting is expected to necessitate new concept revisions to *SSAP No. 86—Derivatives*.

Initial staff assessments on the U.S. GAAP guidance considered potential issues with how hedge basis adjustments are reflected, as U.S. GAAP prevents basis adjustments directly to assets hedged in a portfolio. However, after discussing with industry, and analyzing how the differences in measurement / recognition between U.S. GAAP and SAP impact this assessment, the basis adjustment impact for portfolio layer method hedges will only occur at the time of dedesignation. This is because SAP generally uses an amortized cost approach for effective hedges (if the

hedged item is valued at amortized cost), and the derivative mirrors that measurement method. Under U.S. GAAP, where they both use a fair value method, basis adjustments occur frequently to reflect the change in fair value. With the SAP measurement approach, fair value hedge basis adjustments only occur at hedge termination or at dedesignation. As such, this is not a key SAP impact.

As detailed in the recommended action, industry has proposed to also capture the partial term hedging concepts from U.S. GAAP as part of the revisions proposed from this agenda item. One of the key concerns for partial term hedges was the potential for interim adjustments to hedged items (as the derivative term would no longer commonly match the hedged item term). Industry has proposed to limit the application of the partial term guidance only to the hedge of recognized assets (and not liabilities). This is a different application scope for partial term hedges from U.S. GAAP but mirrors the U.S. GAAP guidance for the portfolio layer method and will limit the potential for hedge basis adjustments to result with a financial statement presentation that a liability has been reduced when the actual liability has not been reduced. Although the existing guidance within SSAP No. 86 can result with this impact, it is limited as most derivatives mirror the term of the hedged item. Although NAIC staff still recommends a review of the existing guidance in SSAP No. 86 on how basis adjustments are reflected, by limiting the partial term approach to hedges of recognized assets, it permits the partial term hedge guidance to be incorporated before the broader discussion. From discussions with industry, the current application of the partial term hedge approach is limited to recognized assets, so this modification satisfies the current need and prevents significant concerns on how the guidance could impact the presentation of liabilities. Discussion of the partial term hedge approach was detailed in agenda item 2021-20, but key aspects are summarized below:

> 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.

Key elements pertaining to portfolio layer method hedging under U.S. GAAP:

- For a closed portfolio of financial assets or one or more beneficial interests secured by a portfolio of financial instruments, an entity may designate as the hedged item or items a hedged layer or layers if the following criteria are met: (*Note – The FASB was asked to consider expanding the scope to include liabilities (specifically, insurance liabilities), and the FASB elected not to expand the portfolio layer method to include hedges of liabilities.)*
    - As part of the initial hedge documentation, an analysis is completed and documented to support the entity's expectation that the hedged item or items (that is, the hedged layer or layers in aggregate) is anticipated to be outstanding for the designated hedge period. That analysis shall incorporate the entity's current expectations of prepayments, defaults, and other factors affecting the timing and amount of cash flows associated with the closed portfolio.

  - For purposes of its analysis, the entity assumes that as prepayments, defaults, and other factors affecting the timing and amount of cash flows occur, they first will be applied to the portion of the closed portfolio that is not hedged.

  - The entity applies the partial-term hedging guidance to the assets or beneficial interests used to support the entity's expectation. An asset that matures on a hedged layer's assumed maturity date meets this requirement.

- After a closed portfolio is established, an entity may designate new hedging relationships associated with the closed portfolio without dedesignating any existing hedging relationships associated with the closed portfolio if the criteria are met for those newly designated hedging relationships.

- For one or more existing hedged layer or layers that are designated under the portfolio layer method, the gain or loss (that is, the change in fair value) on the hedged item attributable to the hedged risk shall not adjust the carrying value of the individual beneficial interest or individual assets in or removed from the closed portfolio. Instead, that amount shall be maintained on a closed portfolio basis and recognized currently in earnings.

- If the hedged item is a hedged layer designated in a portfolio layer method hedge on a closed portfolio and the closed portfolio includes only available-for-sale debt securities, the entire gain or loss (that is, the change in fair value) on the hedged item attributable to the hedged risk shall be recognized in earnings rather than in other comprehensive income to offset the gain or loss on the hedging instrument. If the closed portfolio includes available-for-sale debt securities and assets that are not available-for-sale debt securities, an entity shall determine the portion of the change in fair value on the hedged item attributable to the hedged risk associated with the available-for-sale debt securities using a systematic and rational method. That amount shall be recognized in earnings rather than in other comprehensive income. An entity shall not adjust the carrying amount of the individual available-for-sale debt securities included in the closed portfolio.

- For each closed portfolio with one or more hedging relationships designated and accounted for under the portfolio layer method, an entity shall perform and document at each effectiveness assessment date an analysis that supports the entity's expectation that the hedged layer or layers in aggregate is still anticipated to be outstanding for the designated hedge period. That analysis shall incorporate the entity's current expectations of prepayments, defaults, and other factors affecting the timing and amount of cash flows associated with the closed portfolio using a method consistent with the method used to perform the analysis at initial hedge documentation.

- An adjustment that is maintained on a closed portfolio basis in a portfolio layer method hedge in accordance shall be amortized to earnings. Amortization shall begin no later than when the hedged item ceases to be adjusted for changes in its fair value attributable to the risk being hedged. The entity shall fully amortize that adjustment by the hedged item's assumed maturity date.

- An asset or liability that has been designated as being hedged remains subject to the applicable requirements for assessing impairment or credit losses for that type of asset or for recognizing an increased obligation for that type of liability. A portfolio layer method basis adjustment that is maintained on a closed portfolio basis for an existing hedge shall not be considered when assessing the individual assets or individual beneficial interest included in the closed portfolio for impairment or credit losses or when assessing a portfolio of assets for impairment or credit losses. An entity may not apply this guidance by analogy to other components of amortized cost basis. Because the hedging instrument is recognized separately as an asset or liability, its fair value or expected cash flows shall not be considered in applying those impairment or credit loss requirements to the hedged asset or liability.

- For a fair value hedge of interest rate risk in which the hedged item is designated for a partial term, an entity may measure the change in the fair value of the hedged item attributable to interest rate risk using an

assumed term that begins when the first hedged cash flow begins to accrue and ends at the end of the designated hedge period. The assumed issuance of the hedged item occurs on the date that the first hedged cash flow begins to accrue. The assumed maturity of the hedged item occurs at the end of the designated hedge period. Additionally, an entity may have one or more separately designated partial-term hedging relationships outstanding at the same time for the same debt instrument (for example, 2 outstanding hedging relationships for consecutive interest cash flows in Years 1–3 and consecutive interest cash flows in Years 5–7 of a 10-year debt instrument).

- An entity may elect to discontinue (or partially discontinue) hedge accounting prospectively for all or a portion of the hedged layer for one or more hedging relationships associated with the closed portfolio at any time if a breach has not occurred and a breach is not anticipated. If multiple hedged layers are associated with the closed portfolio, the entity may voluntarily elect to dedesignate (or partially dedesignate) any hedges associated with that closed portfolio.

- For one or more hedging relationships designated under the portfolio layer method, an entity shall discontinue (or partially discontinue) hedge accounting in the following circumstances:

    - If the entity cannot support on a subsequent testing date that the hedged layer or layers are anticipated to be outstanding for the designated hedge period (that is, a breach is anticipated), it shall discontinue (or partially discontinue) hedge accounting for one or more hedging relationships for the portion of the hedged item that is no longer anticipated to be outstanding for the designated hedge period.

    - If on a subsequent testing date the outstanding amount of the closed portfolio of financial assets or one or more beneficial interests is less than the hedged layer or layers (that is, a breach has occurred), the entity shall discontinue (or partially discontinue) hedge accounting for one or more hedging relationships for the portion of the hedged item that is no longer outstanding.

- In the event of either an anticipated breach or a breach that has occurred, if multiple hedged layers are associated with a closed portfolio, an entity shall determine which hedge or hedges to discontinue (or partially discontinue) in accordance with an accounting policy election. That accounting policy election shall specify a systematic and rational approach to determining which hedge or hedges to discontinue (or partially discontinue). An entity shall establish its accounting policy no later than when it first anticipates a breach or when a breach has occurred (whichever comes first). After an entity establishes its accounting policy, it shall consistently apply its accounting policy to all portfolio layer method breaches (anticipated and occurred).

- If a portfolio layer method hedging relationship is discontinued (or partially discontinued) in a voluntary dedesignation or in anticipation of a breach, the basis adjustment associated with the dedesignated amount as of the discontinuation date shall be allocated to the remaining individual assets in the closed portfolio that supported the dedesignated hedged layer using a systematic and rational method. An entity shall amortize those amounts over a period that is consistent with the amortization of other discounts or premiums associated with the respective assets.

- For a portfolio layer method hedging relationship that is discontinued because a breach has occurred, as of the discontinuation date an entity shall:

    - Determine the portion of the basis adjustment associated with the amount of the hedged layer that exceeds the closed portfolio (that is, the portion of the basis adjustment associated with the breach) using a systematic and rational method and immediately recognize that amount in interest income

    - Disclose the information specified for the breach.

- A closed portfolio may simultaneously have a layer or layers that have been breached and a layer or layers that it anticipates will be breached. In that case, an entity shall apply the guidance in this paragraph for the breach or breaches that have occurred and the guidance for the anticipated breach or breaches.

- New disclosures that include:
  - Amortized cost basis of closed portfolios of financial assets or beneficial interests
  - Amount that represents the hedged layers
  - Basis adjustments associated with the hedged layers
  - Hedge basis adjustment recognized in current-period interest income because of a breach.
  - Circumstances that led to a breach.

Existing Authoritative Literature:

SSAP No. 86—Derivatives

Establishes statutory accounting guidance for derivative instruments and hedging, income generation and replication (synthetic asset) transactions.

Guidance for portfolio hedges is limited to fair value hedges as follows:

> 26. Fair value hedges qualify for hedge accounting if all of the following criteria are met:
>
> d. The hedged item is specifically identified as either all or a specific portion of a recognized asset or liability or of an unrecognized firm commitment. The hedged item is a single asset or liability (or a specific portion thereof) or is a portfolio of similar assets or a portfolio of similar liabilities (or a specific portion thereof);
>
> e. If similar assets or similar liabilities are aggregated and hedged as a portfolio, the individual assets or individual liabilities must share the risk exposure for which they are designated as being hedged. The change in fair value attributable to the hedged risk for each individual item in a hedged portfolio must be expected to respond in a generally proportionate manner to the overall change in fair value of the aggregate portfolio attributable to the hedged risk; and

Under existing guidance, hedges identified as 'portfolio' hedges that did not qualify within the limited parameters in paragraph 26 did not qualify as hedging and were not permitted "hedge accounting" treatment in the statutory financial statements. Without hedge accounting, the hedging instruments are required to be reported at fair value, with fluctuations in fair value gains and losses recognized through surplus.

> 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).

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 2021-20: Effective Derivatives – ASU 2017-12 is considering other aspects pending from ASU 2017-12, primarily hedge effectiveness assessments, inclusion of guidance for excluded components and the measurement of excluded components.

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

Convergence with International Financial Reporting Standards (IFRS): NA

Recommendation:
NAIC staff has been working with industry representatives on ASU 2022-01 for portfolio hedges, as well as on the U.S. guidance for partial term derivatives issued in ASU 2017-12. With these efforts, industry has provided NAIC staff suggested edits to incorporate key aspects of the U.S. GAAP guidance for portfolio hedges and partial-term hedges into SSAP No. 86. NAIC staff recommends that the Working Group classify this agenda item as a New SAP Concept and expose the proposed edits for comment. It is also recommended that the Working Group direct NAIC staff to prepare one issue paper with all recent derivative revisions.

Summary of Revisions Proposed in this Agenda Item – Portfolio Layer Method and Partial Term:

- SSAP No. 86: Revisions are proposed to paragraph 26 (fair value hedges) to detail criteria for portfolio and partial-term hedges. A small disclosure edit is proposed to paragraph 62 and guidance for reporting when the hedge is discontinued is proposed for inclusion in Exhibit C.

  Revisions have also been proposed to identify the adoption of *ASU 2022-01, Fair Value Hedging – Portfolio Layer Method* and to adopt with modification the guidance for partial-term hedges from ASU 2017-12. For the current proposal, the partial term hedge guidance is limited to hedged assets (not liabilities.) This is different from U.S. GAAP, but further statutory discussion is needed on basis adjustments when hedging liabilities, especially under partial term. It has been suggested that the Working Group move forward with incorporating the guidance for hedged assets at this time, as that addresses the current industry need, and consider guidance for hedged liabilities subsequently. (It was noted that industry is not aware of situations of partial-term liability hedges. Furthermore, the adjustment for hedged liabilities is a broader issue in SSAP No. 86, so the revisions would be more expansive.) Portfolio hedges are limited to recognized assets under U.S. GAAP, so proposed guidance for SAP for those hedges is consistent. (Industry has identified that the FASB may consider expanding the scope of portfolio hedges to liabilities. If this occurs, consideration will then occur for statutory accounting.)

- Exhibit A – Assessment of Hedge Effectiveness: Limited revisions to paragraphs 17-18 to mirror updated U.S. GAAP guidance and a new section (beginning with paragraph 46) for specific hedge assessment guidance on the portfolio layer method.

Staff Review Completed by: Julie Gann - NAIC Staff, April 2022

Proposed Edits to SSAP No. 86:

Fair Value Hedges (Note- subparagraphs 26a-c are not affected and are omitted for brevity)

26. Fair value hedges qualify for hedge accounting if all of the following criteria are met:

    d. The hedged item is specifically identified as either all, ~~or~~ a specific portion, or the partial term of a recognized asset, or all or a specific portion of ~~or~~ a recognized liability or of an unrecognized firm commitment. The hedged item is a single asset or liability (or a specific portion or partial term

thereof) or is a portfolio of similar assets or a portfolio of similar liabilities (or a specific portion thereof) or a closed portfolio of assets (pursuant to paragraph 26f and Exhibit A, paragraph 46) where assumed layer or layers is anticipated to be outstanding (or a specific portion thereof)[1]. For a partial term hedge of one or more consecutive selected contractual cash flows where the hedged item begins when the first hedge cash flow begins to accrue and ends at the end of the designation hedge period, the assumed maturity of the hedged item occurs at the end of the designated hedge period; *(ASC 815-25-35-13B Partial Term Hedging.)*

e. If similar assets or similar liabilities are aggregated and hedged as a portfolio, the individual assets or individual liabilities must share the risk exposure for which they are designated as being hedged. The change in fair value attributable to the hedged risk for each individual item in a hedged portfolio must be expected to respond in a generally proportionate manner to the overall change in fair value of the aggregate portfolio attributable to the hedged risk; and

f. For a closed portfolio of financial assets or one or more beneficial interests secured by a portfolio of financial instruments, an entity may designate as the hedged item or items a hedged layer or layers (this designation is referred to throughout as the "portfolio layer method" (detailed in Exhibit A). *(ASC 815-20-25-12A Portfolio Layer Method)*

~~f.~~g. If the hedged item is a financial asset or liability, a recognized loan servicing right, or a nonfinancial firm commitment with financial components, the designated risk being hedged is:

i. The risk of changes in the overall fair value of the entire hedged item;

ii. The risk of changes in its fair value attributable to changes in benchmark interest rate;

iii. The risk of changes in its fair value attributable to changes in the related foreign currency exchange rates; or

iv. The risk of changes in its fair value attributable to both changes in the obligor's creditworthiness and changes in the spread over the benchmark interest rate with respect to the related financial asset's or liability's credit sector at inception of the hedge (referred to as credit risk).

If the risk designated as being hedged is not the risk in paragraph 26.f.i., two or more of the other risks (benchmark interest rate risk, foreign currency exchange risk, and credit risk) may simultaneously be designated as being hedged.

The benchmark interest rate being hedged in a hedge of interest rate risk must be specifically identified as part of the designation and documentation at the inception of the hedging relationship. In calculating the change in the hedged item's fair value attributable to changes in the benchmark interest rate, the estimated coupon cash flows used in calculating fair value shall ~~must~~ be based on either~~all of~~ the full contractual cash flows~~ of the entire hedged item~~ or the benchmark rate component of the contractual coupon cash flows of the hedged item determined at hedge inception. An entity may designate a fair value hedge of interest rate risk in which the hedged item is a prepayment instrument. The 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 change in the benchmark interest rate affect an obligor's decision to call a debt instrument when it has the right to do so.) The entity need not consider other factors that would

[1] For clarity, partial-term hedges and portfolio hedges addressed in paragraph 26.f.are limited to the situations in which the hedged item(s) is a recognized asset or a closed portfolio of financial assets. These hedging accounting methods are not permitted to hedge liabilities.

affect this decision (for example, credit risk) when assessing hedge effectiveness. *(ASU 815-25-35-13 & 815-20-25-6B)*~~Excluding some of the hedged item's contractual cash flows (for example, the portion of the interest coupon in excess of the benchmark interest rate) from the calculation is not permitted.~~[2] An entity may not simply designate prepayment risk as the risk being hedged for a financial asset. However, it can designate the option component of a prepayable instrument as the hedged item in a fair value hedge of the entity's exposure to changes in the fair value of that "prepayment" option, perhaps thereby achieving the objective of its desire to hedge prepayment risk. The effect of an embedded derivative of the same risk class must be considered in designating a hedge of an individual risk. For example, the effect of an embedded prepayment option must be considered in designating a hedge of benchmark interest rate risk.

Disclosure Requirements

62. Reporting entities shall disclose the following for all derivative contracts used:

a. General disclosures:

vii. The net gain or loss recognized in unrealized gains or losses during the perioding period resulting from derivatives that no longer qualify for hedge accounting. For portfolio layer method hedges, disclose circumstances that led to the breach. *(ASC 815-10-50-5C.)*

Staff Note: The shaded section reflects revised guidance adopted with agenda item 2021-20.

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 65b, 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*.

~~[2] The first sentence of paragraph 26.d. that specifically permits the hedged item to be identified as either all or a specific portion of a recognized asset or liability or of an unrecognized firm commitment is not affected by the provisions in this subparagraph.~~

65. 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, are 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.

c. Revisions effective January 1, 2023, with early adoption permitted, are limited to the criteria for the portfolio layer method detailed in ASU 2022-01, criteria to only consider how changes in the benchmark interest rate affect the decision to settle the hedged item before its scheduled maturity date in 815-20-25-6B, adding option in calculating the change in the hedged item's fair value attributed to changes in the benchmark interest rate based on the benchmark rate components of the contractual cash flows detailed in FASB ASC 815-25-35-13, and the partial-term hedging method detailed in FASB ASC 815-25-35-13B. The adoption of the partial term hedging method reflects statutory modifications that limits its use only when the hedged item is a recognized asset. This is different than U.S. GAAP, which permits the partial term method for hedged liabilities. The statutory limitation is established to prevent interim basis adjustments to hedged liabilities that could present a reduction of reported liabilities on the financial statements when the actual liability has not been reduced. Reconsideration of this statutory limitation may occur after a broader project to consider how derivative basis adjustments to hedged liabilities shall be reflected in the financial statements.

Effective Date and Transition

74.~~73~~ 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.

e. 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.*

f. Revisions adopted December 13, 2022 that adopt U.S. GAAP guidance for the portfolio layer method, U.S. GAAP guidance to only consider how changes in the benchmark interest rate affect the decision to settle the hedged item before its scheduled maturity, U.S. GAAP guidance adding option in calculating the change in the hedged item's fair value attributed to changes in the benchmark interest rate based on the benchmark rate component of the contractual coupon cash flows, that and adopt with modification U.S. GAAP guidance for partial term hedging are effective January 1, 2023, with early adoption permitted. These revisions shall be applied prospectively to qualifying new hedges.

Proposed Edits to Exhibit C – Interest Rate Hedging

2d. Gain/Loss on Termination of a swap, collar or forward accounted for under hedge accounting (includes closing, exercise, maturity, and expiry):

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. If a portfolio layer method hedging relationship is discontinued (or partially discontinued) in a voluntary dedesignation or in anticipation of a breach, the basis adjustment associated with the dedesignated amount as of the discontinuation date shall be allocated to the remaining individual assets in the closed portfolio that supported the dedesignated hedged layer using a systematic and rational method. 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. (ASU 815-25-40-9)

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.

Exhibit A – Assessment of Effectiveness

17. All of the following conditions apply to both fair value hedges and cash flow hedges: *(815-20-25-104)*

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~~ ends at the end of the designated hedge period, 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:

18. All of the following incremental conditions apply to fair value hedges only: *(815-20-25-105 & 815-25-35-13B)*

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 ends at the end of the designated hedge period ~~occur on the date in which the last hedged cash flow is due and payable~~~~in accordance with paragraph 815-25-35-13B~~.

Portfolio Layer Method (Note – New paragraphs at the end of Exhibit A.)

46. For a closed portfolio of financial assets or one or more beneficial interests secured by a portfolio of financial instruments, an entity may designate as the hedged item or items a hedged layer or layers (this designation is referred to throughout as the "portfolio layer method.*") (ASU 815-20-25-12A)*

a. As part of the initial hedge documentation, an analysis is completed and documented to support the entity's expectation that the hedged item or items (that is, the hedged layer or layers in aggregate) is anticipated to be outstanding for the designated hedge period. That analysis shall incorporate the entity's current expectations of prepayments, defaults, and other factors affecting the timing and amount of cash flows associated with the closed portfolio.

b. For purposes of its analysis in paragraph 46.a., the entity assumes that as prepayments, defaults, and other factors affecting the timing and amount of cash flows occur, they first will be applied to the portion of the closed portfolio that is not hedged; and

c. The entity applies the partial-term hedging guidance to the assets or beneficial interest used to support the entity's expectation in paragraph 46.a. An asset that matures on a hedged layer's assumed maturity date meets this requirement.

47. After a closed portfolio is established in accordance with paragraph 46, and entity may designate new hedging relationships associated with the closed portfolio without dedesignating any existing hedging relationships associated with the closed portfolio if the criteria of paragraph 46 are met for those newly designated hedging relationships. *(ASU 815-20-25-12B)*

48. For the portfolio layer method if both of the following conditions exist, the quantitative test described for similar assets (shared risk exposure) may be performed qualitatively on a hedge-by-hedge basis and only at hedge inception:

a. The hedged item is a hedged layer in a portfolio layer hedge and designated in accordance with paragraph 26.f. of SSAP No. 86.

b. An entity measures the change in fair value of the hedged item based on the benchmark rate component of the contractual coupon cash flows.

Using the benchmark rate component of the contractual coupon cash flows when all assets have the same assumed maturity date and prepayment risk does not affect the measurement of the hedged item results in all hedged items having the same benchmark rate component coupon cash flows. *(ASU 815-20-55-14A)*

49. For one or more hedging relationships designated under the portfolio layer method, an entity shall discontinue (or partially discontinue) hedge accounting in the following circumstances: *(ASU 815-25-40-8)*

a. If the entity cannot support on a subsequent testing date that the hedged layer or layers are anticipated to be outstanding for the designated hedge (that is, a breach is anticipated), it shall discontinue (or partially discontinue) hedge accounting for one or more hedging relationships for the portion of the hedged item that is no longer anticipated to be outstanding for the designated hedge period.

b. If on a subsequent testing date the outstanding amount of the closed portfolio of financial assets or one or more beneficial interests is less than the hedged layer or layers (that is, a breach has occurred), the entity shall discontinue (or partially discontinue) hedge accounting for one or more hedging relationships for the portion of the hedged item that is no longer outstanding.

50. In the event of either an anticipated breach (as described in paragraph 49.a.) or a breach that has occurred (as described in paragraph 49.b.) for portfolio layer method, if multiple hedged layers are associated with a closed portfolio, an entity shall determine which hedge or hedges to discontinue (or partially discontinue) in accordance with an accounting policy election. That accounting policy election shall specify a systematic and rational approach to determining which hedge or hedges to discontinue (or partially discontinue). An entity shall establish its accounting policy no later than when it first anticipates a breach or when a breach has occurred (whichever comes first). After an entity establishes its accounting policy, it shall consistently apply its accounting policy to all portfolio layer method breaches (anticipated and occurred). *(ASU 815-25-40-8A)*

In the issue paper, the U.S. GAAP references not pulled into Exhibit will also be updated as follows:

Consideration of Prepayment Risk Using the ~~Last-of-Layer~~ Portfolio Layer Method

815-20-25-118A In a fair value hedge of interest rate risk designated under the portfolio layer ~~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.

Status:
On December 13, 2022, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed revisions, as illustrated above, to *SSAP No. 86—Derivatives*. The revisions adopt with modification derivative guidance from *ASU 2017-12, Derivatives and Hedging* and *ASU 2022-01, Fair Value Hedging – Portfolio Layer* to include guidance for the portfolio layer method and partial-term hedges. These revisions are effective Jan. 1, 2023, with early adoption permitted.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2022/Fall - December/Adoptions/22-09 - ASU 2022-01 - Portfolio Hedges.docx

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

Issue: ASU 2022-02 – Troubled Debt Restructurings and Vintage Disclosures

Check (applicable entity):

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

Description of Issue: In April 2022, the Financial Accounting Standards Board (FASB) issued *Accounting Standards Update* (ASU) *2022-02: Troubled Debt Restructurings and Vintage Disclosures* to eliminate prior U.S. GAAP guidance for troubled debt restructurings (TDRs) by creditors and instead require an entity to evaluate whether the modification represents a new loan or a continuation of an existing loan. The elimination of the separate TDR recognition and measurement guidance was supported for U.S. GAAP as losses are captured in the allowance for credit losses, pursuant to *ASU 2016-13: Measurement of Credit Losses on Financial Instruments*. With ASU 2022-02, expanded U.S. GAAP disclosures have been incorporated for modifications provided to debtors experiencing financial difficulty. Also, the ASU revises the ASU 2016-13 vintage gross write-off disclosures for public business entities. The effective date of ASU 2022-02 is Jan. 1, 2023, for entities that have adopted ASU 2016-13. For entities that have yet to adopt ASU 2016-13 (also known as the 'current expected credit loss' - CECL standard), the effective date of ASU 2022-02 will occur concurrently when an entity adopts ASU 2016-13.

Previously issued U.S. GAAP guidance involving TDRs by creditors was adopted with modification in *SSAP No. 36—Troubled Debt Restructuring*. This guidance was originally issued in *FAS 15, Accounting for Debtors and Creditors for Troubled Debt Restructurings* and then captured in the *FASB Accounting Standards Codification (ASC) 310-40: Receivables – Troubled Debt Restructuring by Creditors.* This ASC guidance has been predominantly superseded with the issuance of ASU 2022-02. Under the existing statutory accounting guidance, if the fair value of the modified loan is less than the recorded investment in the loan (including accrued interest, net deferred loan fees or costs, and unamortized premium or discount), a new cost basis is established at the fair value, with the difference recorded as a realized loss in the statement of operations.

Under ASU 2016-13 (also known as the 'current expected credit loss' - CECL standard) assets are reported at the net amount expected to be collected. For assets held at amortized cost, a valuation allowance reflecting expected credit losses is established and is deducted from the amortized cost basis to present the net carrying amount expected to be collected. For assets held at fair value, there is still an allowance for credit losses, which permits reversals of credit losses previously recorded to be reflected in net income. (For assets held at fair value, the CECL model does not change measurement method, but changes the process for recognizing fluctuations in fair value as a result of credit losses.)

Although consideration of ASU 2016-13 is still pending statutory accounting review, from initial assessments and industry outreach, a full adoption of the CECL standard is not likely to be supported. This is because 1) insurers more commonly hold assets at amortized cost under SAP and at fair value (as available for sale) under U.S. GAAP – so the CECL model would significantly impact the measurement method under SAP, but not under U.S. GAAP, and 2) the asset-valuation reserve (AVR), a statutory accounting guidance applicable to life and fraternal insurers, establishes a reserve to offset potential credit-related investment losses on most investment categories. With ASU 2016-13 applicable to small public and non-public U.S. GAAP filers as of Jan. 1, 2023, NAIC staff are currently soliciting input from industry on key CECL impacts to assess for statutory accounting purposes. Once that information is received, a further review will occur on ASU 2016-13 to determine the extent that CECL concepts should be reflected within statutory accounting principles.

Under new U.S. GAAP guidance in ASU 2022-02, when the terms of the loan have been revised, creditors would determine whether the changes to the loan are more than minor and if the terms are at least as favorable to the lender as the terms for comparable loans to other customers with similar collection risks who are not refinancing / restructuring a loan. If these criteria are met, then the restructured loan would be accounted for as a new loan. If a new loan, any unamortized net fees or costs and any prepayment penalties from the original loan shall be recognized in interest income when the new loan is granted. If the criteria are not met, the unamortized net fees or costs from the original loan and any prepayment penalties shall be carried forward as a part of the net investment in the new loan. With this approach, the investment in the new loan consists of the net remaining investment in the original loan, any additional funds advanced to the borrower, any fees received, and direct loan origination costs associated with the refinancing or restructuring. It's important to highlight that this U.S. GAAP guidance does not address any loss for the restructured loan as recognition of losses would be captured in the allowance for credit losses pursuant to ASU 2016-13.

With ASU 2022-02, expanded disclosures on commitments and modified loans have been incorporated. Although some of the general concepts within the following U.S. GAAP disclosures are captured in SSAP No. 36, paragraph 23, the following U.S. GAAP disclosures are more specific that what was previously incorporated:

1. Disclose if the creditor has a commitment to lend additional funds to debtors experiencing financial difficulty for which the creditor has modified the terms of the receivables in the form of principal forgiveness, an interest rate reduction, and other-than-insignificant payment delay, or a term extension in the current reporting period (ASU 310-10-50-36). (Note – This is similar to a prior GAAP disclosure for TDRs and reflected in concept within SSAP No. 36, paragraph 23.b.)

2. In addition to disclosures about the type and magnitude of certain modifications of receivables made to debtors experiencing financial difficulty (summarized in paragraphs 3-5 below), the financial effect of those modifications and the degree of success of the modification in mitigating potential credit losses, an entity shall consider providing information that helps financial statement users understand significant changes in the type of magnitude of modifications, including those modifications that, for example, were caused by a major credit event, even if the modifications would not require the disclosures detailed below.) (ASU 310-10-50-38)

3. For each period in which a statement of income is presented, and entity shall disclose the following information related to modifications of receivables that are in the form of principal forgiveness, an interest rate reduction, an other-than insignificant payment delay, or a term extension (or a combination thereof) made to debtors experiencing financial difficulty during the reporting period. (ASU 310-10-50-42)

    a. By class of financing receivable, qualitative and quantitative information about:

        i. The types of modifications utilized by an entity, including the total period-end amortized cost basis of the modified receivables and the percentage of modifications of receivables made to debtors experiencing financial difficulty relative to the total period-end amortized cost basis of receivables in the class of financing receivable.

        ii. The financial effect of the modification by type of modification, which shall provide information about the changes to the contractual terms as a result of the modification and shall include the incremental effect of principal forgiveness on the amortized cost basis of the modified receivables, as applicable, or the reduction in weighted-average interest rates (versus a range) for interest rate reductions.

        iii. Receivable performance in the 12 months after a modification of a receivable made to a debtor experiencing financial difficulty.

b. By portfolio segment, qualitative information about how those modifications and the debtors' subsequent performance are factored into determining the allowance for credit losses.

4. Receivables made be modified in more than one manner. An entity that modifies the same receivable in more than one manner shall provide disclosures sufficient for users to understand the different types of combinations of modifications provided to borrowers. For example, a receivable may be modified to provide both principal forgiveness and an interest rate reduction. In that case, an entity shall disclose the period-end amortized cost basis of that receivable in a separate category that reflects that a combination of mortification types has been granted. If another receivable was modified to provide both an interest rate reduction and a term extension, the period-end amortized cost basis of that receivable shall be presented in a different category. Multiple separate combinations categories may be necessary if significant. The same receivable's period-end amortized cost basis shall not be presented in multiple categories. (310-10-50-43)

5. For each period in which a statement of income is presented, an entity shall disclose the following information about financing receivables that had a payment default during the period and had been modified in the form of principal forgiveness, an interest rate reduction, an other-than-insignificant payment delay, or a term extension (or a combination thereof) within the previous 12 months preceding the payment default when the debtor was experiencing financial difficulty at the time of the modification. (310-10-50-44)

   a. By class of financing receivable, qualitative and quantitative information about those defaulted financing receivables, including the following:

      i. The type of contractual change the modification provided.

      ii. The amount of financing receivables that defaulted, including the period-end amortized cost basis for financing receivables that defaulted.

   b. By portfolio segment, qualitative information about how those defaults are factored into determining the allowance for credit losses.

   Per the ASU, the disclosures in paragraphs 3, 4 and 5 shall be provided regardless of whether a modification of a receivable to a debtor experiencing financial difficulty results in a new loan. (ASU 310-10-50-41)

In addition to the TDR for creditors guidance, ASU 2022-02 also incorporates and revises "vintage" disclosures for gross write-offs for public business entities involving financing receivables and net investment in leases. These disclosures were originally captured as part of the CECL guidance in ASU 2016-13 for all entities, and the revisions modify and restrict the disclosures to public business entities:

- When disclosing credit quality indicators of financing receivables and net investment in leases, a public business entity shall present the amortized cost basis within each credit quality indicator by year of origination (that is, vintage year). For purchased financing receivables and net investment in leases, an entity shall use the initial date of issuance to determine the year of origination, not the date of acquisition. For origination years before the fifth annual period, a public business entity may present the amortized cost basis of financing receivables and net investments in leases in the aggregate. For interim-period disclosures, the current year-to-date originations in the current reporting period are considered to the current-period originations. (326-20-50-6)

- A public business entity shall present the gross write-offs recorded in the current period, on a current year-to-date basis, for financing receivables and net investments in leases by origination year. For origination years before the fifth annual period, a public business entity may present the gross write-offs in the current period for financing receivables and net investments in leases in aggregate. The requirement to present the amortized cost basis within each credit quality indicator by year of origination is not required for an entity that is not a public business entity. (326-20-50-6A)

Existing Authoritative Literature:

SSAP No. 36—Troubled Debt Restructuring

A troubled debt restructuring is defined as a debt restructuring whereby the creditor, for economic or legal reasons related to the debtor's financial difficulties, grants a concession to the debtor that it would not otherwise grant. Guidance in SSAP No. 36, adopted from U.S. GAAP for creditors, details the following:

- Determining whether a creditor has granted a concession
- Determining whether a debtor is experiencing financial difficulties
- Determining whether a restructuring results in a delay in payment that is insignificant
- Accounting by creditors
- Disclosure for creditors.

Key excerpts from the guidance in SSAP No. 36:

Accounting by Creditors

17. A creditor shall account for a troubled debt restructuring according to the type of the restructuring (receipt of assets in full satisfaction, modification of terms, combination of types). Generally, troubled debt restructuring involving the transfer of assets shall be accounted for at the fair value of the assets received. Troubled debt restructuring involving modification of terms shall be accounted for at fair value (as determined by acceptable appraisal methodologies) in accordance with *SSAP No. 100R—Fair Value*. If the restructured loan is collateral dependent, fair value shall be the fair value of the collateral. If the restructured loan is not collateral dependent, fair value shall be determined in accordance with SSAP No. 100R. If the determined fair value of the loan is less than the recorded investment in the loan (including accrued interest, net deferred loan fees or costs, and unamortized premium or discount), a new cost basis shall be established at the fair value with the difference being recorded as a realized loss in the statement of operations. After the troubled debt restructuring, a creditor shall account for the assets consistent with the statutory guidance for such assets.

18. A creditor shall account for assets, including foreclosed property and equity interests in corporations, joint ventures, or partnerships, received in satisfaction of the loan at their fair value (as determined by acceptable appraisal methodologies) at the time of restructuring or at the book value of the loan if lower. If the fair value is less than the book value, the required writedown shall be recognized as a realized capital loss. The creditor shall reclassify the asset from loans to the appropriate asset account, such as real estate or other invested assets, at the time that the creditor obtains clear title to the asset except for mortgage loans which shall follow the guidance in paragraph 18 of SSAP No. 37. After the troubled debt restructuring, a creditor shall account for the assets received in satisfaction of the loan consistent with the statutory guidance for similar assets.

19. Any fees received in connection with a modification of terms of a troubled debt restructuring shall be applied as a reduction of the recorded investment in the loan. All costs associated with the restructuring, including direct loan origination costs, shall be charged to expense as incurred.

Disclosure by Creditors

23. A creditor shall disclose in the financial statements the information captured in paragraphs 23.a., 23.b. and 23.c. about troubled debt restructuring as of the date of each balance sheet presented. Disclosures captured from paragraphs 23.d. and 23.e. are required in the statutory audited financial statements only:

a. As of the date of each statement of financial position presented, the recorded investment in the loans for which impairment has been recognized in accordance with this statement and the related realized capital loss. (For mortgage loans, the disclosures in SSAP No. 37 shall also be completed.)

b. The amount of commitments, if any, to lend additional funds to debtors owing receivables whose terms have been modified in troubled debt restructuring

c. The creditor's income recognition policy for interest income on an impaired loan

d. For troubled debt restructurings that occurred during the annual reporting period, aggregated by type of instrument, qualitative and quantitative information on (1) how the items were modified and (2) the financial effects of the modifications

e. If restructured within the previous 12 months and there has been a payment default during that period, disclose qualitative and quantitative information about the defaulted instruments, aggregated by type of instrument, including: (1) type of instruments that defaulted and (2) the amount of recorded investments for which default occurred

24. Refer to the Preamble for further discussion regarding disclosure requirements.

25. This statement is not intended to modify the requirement for life and health insurers to complete the annual statement exhibit disclosing long-term mortgage loans in good standing with restructured terms.

Relevant Literature

26. This statement adopts with modification *FASB Statement No. 15*, *Accounting by Debtors and Creditors for Troubled Debt Restructurings* (FAS 15) to specify that creditors shall reclassify assets obtained in a troubled debt restructuring from loans to the appropriate asset account at the time the creditor obtains clear title to the asset, except for mortgage loans which shall be reclassified at the beginning of the redemption period unless it is probable that the mortgage loan will be redeemed and with modification to require that gains and losses from extinguishment of debt be reported as capital gains or losses, and charged to operations. In August 2012, this statement was revised to adopt paragraphs 310-40-15-13 through 310-40-15-18 and 310-40-15-20 of the FASB Codification incorporated through *FASB ASU 2011-02, A Creditors Determination of Whether a Restructuring Is a Troubled Debt Restructuring*. Also in August 2012, this statement adopted with modification the disclosure requirements included in paragraphs 310-10-50-33 through 310-10-50-34 of the FASB Codification originally incorporated from *ASU 2010-20, Receivables (Topic 310), Disclosures About the Credit Quality of Financing Receivables and the Allowance for Credit Losses*, deferred by *ASU 2011-01, Receivables (Topic 310), Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings in Update No. 2010-20* and reinstated through ASU 2011-02. These disclosure requirements have been modified to be applicable for all troubled debt restructurings within the scope of SSAP No. 36, rather than limited to troubled debt restructurings of "financing receivables." The revisions adopted in August 2012 from ASU 2011-02 and ASU 2010-20 are effective January 1, 2013, with early application permitted.

27. This statement adopts paragraphs 9, 22, and 25 of *FASB Statement No. 114*, *Accounting by Creditors for Impairment of a Loan* (FAS 114). Paragraphs 6.d., 13 and 21 of FAS 114 are rejected. *FASB Statement No. 118*, *Accounting by Creditors for Impairment of a Loan—Income Recognition and Disclosures* is adopted as it relates to troubled debt restructuring.

28. This statement adopts *FASB Technical Bulletin 81-6, Applicability of Statement 15 to Debtors in Bankruptcy Situations* and *FASB Technical Bulletin 80-2, Classification of Debt Restructuring by Debtors and Creditors*. It also adopts *FASB Emerging Issue Task Force No. 87-18, Use of Zero Coupon Bonds in a Troubled Debt Restructuring*, *FASB Emerging Issue Task Force No. 87-19, Substituted Debtors in a Troubled Debt Restructuring*, *FASB Emerging Issue Task Force No. 89-15*, *Accounting for a Modification of Debt Terms When the Debtor is Experiencing Financial Difficulties* consistent with the modifications to FAS 15 discussed in this statement, *FASB Emerging Issues Task Force No. 96-22, Applicability of the Disclosures Required by FASB Statement No. 114 When a Loan Is Restructured in a Troubled Debt Restructuring into Two (or More) Loans* and *FASB EITF 02-4: Determining Whether a Debtor's Modification or Exchange of Debt Instruments is Within the Scope of FASB Statement No. 15.*

29. Although *FASB Statement No. 91, Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases* (FAS 91) was rejected in *SSAP No. 26R—Bonds*, this statement is consistent with paragraph 14 of *FAS No. 91.*

30. This statement rejects *FASB Emerging Issues Task Force No. 94-8, Accounting for Conversion of a Loan into a Security in a Troubled Debt Restructuring* and *FASB Technical Bulletin 94-1*, *Application of Statement 115 to Debt Securities Restructured in a Troubled Debt Restructuring*.

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 2020, in response to the COVID pandemic, the Statutory Accounting Principles (E) Working Group issued two interpretations providing limited time exceptions for troubled debt restructurings. INT 20-07, believed most widely used, provided limited-time practical expedients in determining whether restructured payments are considered insignificant. Both interpretations automatically expired on Jan. 2, 2022.

- INT 20-03: Troubled Debt Restructurings Due to COVID-19
- INT 20-07: Troubled Debt Restructuring of Certain Debt Investments Due to COVID-19

In 2016, with the issuance of ASU 2016-13, the Working Group began discussions on the CECL standard for statutory accounting. Although a number of preliminary discussions occurred, discussions halted as the effective date of U.S. GAAP standard (as well as other standards) was delayed in response to the COVID-19 pandemic. ASU 2016-13 is now effective January 2023 for smaller reporting public entities and nonpublic companies. When discussions were ongoing, a comment letter received from interested parties dated July 9, 2018, recommended that the NAIC retain the existing credit impairment guidance in statutory accounting principles. The discussion on ASU 2016-13 for statutory accounting is expected to resume in 2022.

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

Convergence with International Financial Reporting Standards (IFRS): NA

Recommendation:

NAIC staff recommends that the Working Group move this item to the active listing, categorized as a SAP clarification, and expose the intent to retain existing guidance in *SSAP No. 36—Troubled Debt Restructuring* along with revisions to the relevant literature section to identify the rejection of ASU 2022-02 and detail the GAAP/SAP differences for the accounting of troubled debt restructurings for creditors. Note that paragraph 26 addresses ASU 2022-02 and paragraphs 27-29 detail the historical differences that were previously in paragraphs 26-30 in a more reader friendly format including moving old effective date language from the relevant literature section to the effective date paragraph. With this exposure, comments are requested on whether the expanded U.S. GAAP disclosures for modifications should be considered for statutory accounting.

NAIC staff recommends that the CECL disclosures, including the revisions for "vintage gross write-offs' for public business entities be considered as part of the review of ASU 2016-13 for expected credit losses. However, NAIC staff requests comments on this recommendation and whether the disclosures should be considered for statutory accounting in advance of reviewing ASU 2016-13 for statutory accounting.

Staff Review Completed by: Julie Gann - NAIC Staff, April 2022

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/Maintenance/Active Form A's/2022/22-XX - ASU 2022-02 - TDR CECL - With Edits.docx

Proposed Revisions to SSAP No. 36:

Relevant Literature

26. This statement rejects *ASU 2022-02, Troubled Debt Restructurings and Vintage Disclosures* and the U.S. GAAP guidance within the Accounting Standards Codification for troubled debt restructurings for creditors. This ASU is rejected as the U.S. GAAP guidance for troubled debt restructuring by creditors has been significantly modified to eliminate the separate recognition of losses from restructurings as losses are captured within the allowance for credit losses valuation account established pursuant to *ASU 2016-13, Financial Instruments – Credit Losses*. As statutory accounting has not adopted ASU 2016-13, the prior troubled debt restructuring adopted from U.S GAAP in effect prior to ASU 2016-13 and ASU 2022-02 has been retained. With the rejection of ASU 2022-02, reporting entities shall continue to apply the prior concepts within SSAP No. 36 when assessing and classifying modifications as troubled debt restructurings. These retained concepts do not permit entities to consider troubled debt restructurings as new loans and therefore do not permit immediate recognition of unamortized fees, costs, or prepayment penalties as interest income at the time of restructuring. Additionally, fees received by a reporting entity from a restructuring shall continue to reduce the recorded investment and all costs incurred by a reporting entity with the restructuring shall continue to be charged to expense as incurred.

27. Although the statutory accounting guidance for troubled debt restructurings for creditors no longer reflects authoritative guidance from U.S. GAAP, the guidance in SSAP No. 36 reflects the following superseded U.S. GAAP guidance as follows:

a. Adopted with modification *FASB Statement No. 15, Accounting by Debtors and Creditors for Troubled Debt Restructurings* (FAS 15) to specify that creditors shall reclassify assets obtained in a troubled debt restructuring from loans to the appropriate asset account at the time the creditor obtains clear title to the asset, except for mortgage loans which shall be reclassified at the beginning of the redemption period unless it is probable that the mortgage loan will be redeemed and with modification to require that gains and losses from extinguishment of debt be reported as capital gains or losses, and charged to operations.

b. Adopted paragraphs 310-40-15-13 through 310-40-15-18 and 310-40-15-20 of the FASB Codification incorporated through *FASB ASU 2011-02, A Creditors Determination of Whether a Restructuring Is a Troubled Debt Restructuring*

c. Adopted with modification the disclosure requirements included in paragraphs 310-10-50-33 through 310-10-50-34 of the FASB Codification originally incorporated from *ASU 2010-20, Receivables (Topic 310), Disclosures About the Credit Quality of Financing Receivables and the Allowance for Credit Losses*, deferred by *ASU 2011-01, Receivables (Topic 310), Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings in Update No. 2010-20* and reinstated through ASU 2011-02. These disclosure requirements were modified to be applicable for all troubled debt restructurings within the scope of SSAP No. 36, rather than limited to troubled debt restructurings of "financing receivables."

d. Adopted paragraphs 9, 22, and 25 of *FASB Statement No. 114, Accounting by Creditors for Impairment of a Loan* (FAS 114). Adopted *FASB Statement No. 118, Accounting by Creditors for Impairment of a Loan—Income Recognition and Disclosures* as it relates to troubled debt restructuring.

e. Adopts *FASB Technical Bulletin 81-6, Applicability of Statement 15 to Debtors in Bankruptcy Situations* and *FASB Technical Bulletin 80-2, Classification of Debt Restructuring by Debtors and Creditors*, *FASB Emerging Issue Task Force No. 87-18, Use of Zero Coupon Bonds in a Troubled Debt Restructuring*, *FASB Emerging Issue Task Force No. 87-19, Substituted Debtors in a Troubled Debt Restructuring*, *FASB Emerging Issue Task Force No. 89-15, Accounting for a Modification of Debt Terms When the Debtor is Experiencing Financial Difficulties* consistent with the modifications to FAS 15, *FASB Emerging Issues Task Force No. 96-22, Applicability of the Disclosures Required by FASB Statement No. 114 When a Loan Is Restructured in a Troubled Debt Restructuring into*

Two (or More) Loans and *FASB EITF 02-4: Determining Whether a Debtor's Modification or Exchange of Debt Instruments is Within the Scope of FASB Statement No. 15.*

f. This statement is consistent with paragraph 14 of *FASB Statement No. 91, Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases* (FAS 91), but FAS 91 was rejected in *SSAP No. 26R*

28. For historical reference purposes, the following superseded U.S. GAAP guidance was previously rejected within this statement:

a. Paragraph 6.d, 13 and 21 of FAS 114.

b. *FASB Emerging Issues Task Force No. 94-8, Accounting for Conversion of a Loan into a Security in a Troubled Debt Restructuring* and *FASB Technical Bulletin 94-1, Application of Statement 115 to Debt Securities Restructured in a Troubled Debt Restructuring*.

~~26. This statement adopts with modification *FASB Statement No. 15, Accounting by Debtors and Creditors for Troubled Debt Restructurings* (FAS 15) to specify that creditors shall reclassify assets obtained in a troubled debt restructuring from loans to the appropriate asset account at the time the creditor obtains clear title to the asset, except for mortgage loans which shall be reclassified at the beginning of the redemption period unless it is probable that the mortgage loan will be redeemed and with modification to require that gains and losses from extinguishment of debt be reported as capital gains or losses, and charged to operations. In August 2012, this statement was revised to adopt paragraphs 310-40-15-13 through 310-40-15-18 and 310-40-15-20 of the FASB Codification incorporated through *FASB ASU 2011-02, A Creditors Determination of Whether a Restructuring Is a Troubled Debt Restructuring*. Also in August 2012, this statement adopted with modification the disclosure requirements included in paragraphs 310-10-50-33 through 310-10-50-34 of the FASB Codification originally incorporated from *ASU 2010-20, Receivables (Topic 310), Disclosures About the Credit Quality of Financing Receivables and the Allowance for Credit Losses*, deferred by *ASU 2011-01, Receivables (Topic 310), Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings in Update No. 2010-20* and reinstated through ASU 2011-02. These disclosure requirements have been modified to be applicable for all troubled debt restructurings within the scope of SSAP No. 36, rather than limited to troubled debt restructurings of "financing receivables." The revisions adopted in August 2012 from ASU 2011-02 and ASU 2010-20 are effective January 1, 2013, with early application permitted.~~

~~27. This statement adopts paragraphs 9, 22, and 25 of *FASB Statement No. 114, Accounting by Creditors for Impairment of a Loan* (FAS 114). Paragraphs 6.d., 13 and 21 of FAS 114 are rejected. *FASB Statement No. 118, Accounting by Creditors for Impairment of a Loan—Income Recognition and Disclosures* is adopted as it relates to troubled debt restructuring.~~

~~28. This statement adopts *FASB Technical Bulletin 81-6, Applicability of Statement 15 to Debtors in Bankruptcy Situations* and *FASB Technical Bulletin 80-2, Classification of Debt Restructuring by Debtors and Creditors*. It also adopts *FASB Emerging Issue Task Force No. 87-18, Use of Zero Coupon Bonds in a Troubled Debt Restructuring*, *FASB Emerging Issue Task Force No. 87-19, Substituted Debtors in a Troubled Debt Restructuring*, *FASB Emerging Issue Task Force No. 89-15, Accounting for a Modification of Debt Terms When the Debtor is Experiencing Financial Difficulties* consistent with the modifications to FAS 15 discussed in this statement, *FASB Emerging Issues Task Force No. 96-22, Applicability of the Disclosures Required by FASB Statement No. 114 When a Loan Is Restructured in a Troubled Debt Restructuring into Two (or More) Loans* and *FASB EITF 02-4: Determining Whether a Debtor's Modification or Exchange of Debt Instruments is Within the Scope of FASB Statement No. 15.*~~

~~29. Although *FASB Statement No. 91, Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases* (FAS 91) was rejected in *SSAP No. 26R—Bonds*, this statement is consistent with paragraph 14 of *FAS No. 91.*~~

~~30. This statement rejects *FASB Emerging Issues Task Force No. 94-8, Accounting for Conversion of a Loan into a Security in a Troubled Debt Restructuring* and *FASB Technical Bulletin 94-1, Application of Statement 115 to Debt Securities Restructured in a Troubled Debt Restructuring*.~~

Effective Date and Transition

~~31.~~29. ~~31.~~ This statement is effective for years beginning January 1, 2001. The provisions of this statement shall be applied to all troubled debt restructurings entered into on or after January 1, 2001. The adoption of FASB EITF 02-4: Determining Whether a Debtor's Modification or Exchange of Debt Instruments is within the Scope of FASB Statement No. 15 was incorporated from INT 03-12 and effective December 7, 2003. The revisions adopted in August 2012 from ASU 2011-02 and ASU 2010-20 are effective January 1, 2013, with early application permitted.

Comments Requested – Is additional disclosure information desired on troubled debt restructurings?

As detailed in the summary of new GAAP guidance, disclosures are expanded to allocate TDRs by type of modification – such as principal forgiveness, interest rate reduction, other-than-insignificant payment delay or term extension. Also under the new U.S. GAAP guidance, TDR disclosures are aggregated based on type of modification, and if more than one modification occurs, then a new category is reported to aggregate info for all contracts that have similar modifications. (So, modifications that encompass both principal forgiveness and interest rate reductions would be aggregated in a separate category, and modifications that include interest rate reductions and term extensions would be aggregated in a separate category.)

Below are the current disclosures and data-template for statutory financials. As shown, the data captured is limited.

Disclosure by Creditors

23. A creditor shall disclose in the financial statements the information captured in paragraphs 23.a., 23.b. and 23.c. about troubled debt restructuring as of the date of each balance sheet presented. Disclosures captured from paragraphs 23.d. and 23.e. are required in the statutory audited financial statements only:

a. As of the date of each statement of financial position presented, the recorded investment in the loans for which impairment has been recognized in accordance with this statement and the related realized capital loss. (For mortgage loans, the disclosures in SSAP No. 37 shall also be completed.)

b. The amount of commitments, if any, to lend additional funds to debtors owing receivables whose terms have been modified in troubled debt restructuring

c. The creditor's income recognition policy for interest income on an impaired loan

d. For troubled debt restructurings that occurred during the annual reporting period, aggregated by type of instrument, qualitative and quantitative information on (1) how the items were modified and (2) the financial effects of the modifications

e. If restructured within the previous 12 months and there has been a payment default during that period, disclose qualitative and quantitative information about the defaulted instruments, aggregated by type of instrument, including: (1) type of instruments that defaulted and (2) the amount of recorded investments for which default occurred

Note 5B. Debt Restructuring

		Current Year	Prior Year
(1)	The total recorded investment in restructured loans, as of year-end	$ _____	_____
(2)	The realized capital losses related to these loans	$ _____	_____
(3)	Total contractual commitments to extend credit to debtors owing receivables whose terms have been		

modified in troubled debt restructurings	$ _____	_____

Status:
On December 13, 2022, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed revisions, as illustrated above, to *SSAP No. 36—Troubled Debt Restructuring*. The revisions reject *ASU 2022-02, Troubled Debt Restructurings and Vintage Disclosures* and identifies that retained guidance reflects superseded U.S. GAAP.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2022/Fall - December/Adoptions/22-10 - ASU 2022-02 - TDR CECL.docx

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

Issue: Related Parties – Footnote Updates

Check (applicable entity):

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

Description of Issue: At its May 24, 2022, meeting, the Statutory Accounting Principles (E) Working Group adopted agenda item 2021-21 – Related Party Reporting. That agenda item encompassed two main goals:

1. Clarified the reporting of affiliate transactions within existing reporting lines in the investment schedules, while remaining 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. Incorporated new reporting requirements for investment transactions with related parties. This agenda item added a new column to annual statement reporting 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 where the reporting entity must select a code that best describes the related party relationship within the investment.

When agenda item 2021-21 was exposed for the final time on April 4, 2022, a footnote was added to SSAP No. 25, paragraph 9 that states "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." Among the comments received from interested parties after the April 4 exposure was a suggestion to extend the exemption to foreign open-end investment funds governed and authorized in accordance with regulations established by the applicable foreign jurisdiction, which are within the scope of *SSAP No. 30R—Unaffiliated Common Stock*.

As part of the adoption of agenda item 2021-21 at the May 24 meeting, NAIC staff were directed by the Working Group to make revisions to include foreign open-end funds SSAP No. 25 and SSAP No. 97 in the footnotes.

Existing Authoritative Literature:

SSAP No. 25—Affiliates and Other Related Parties (paragraph and footnote originally adopted on the May 24, 2022, Working Group call.)

> 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[FN], 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.

FN—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.

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

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[FN].

FN—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.

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.

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.

On May 24, 2022, the Working Group adopted agenda item 2021-21 – Related Party Reporting, which encompassed two main goals:

- Clarified the reporting of affiliate transactions within existing reporting lines in the investment schedules, while remaining consistent with the definition of an "affiliate" pursuant to Model #440, SSAP No. 25 and SSAP No. 97.

- Incorporated new reporting requirements for investment transactions with related parties. This agenda item added a new column to annual statement reporting 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 where the reporting entity must select a code that best describes the related party relationship within the investment.

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 a SAP clarification, and expose revisions to SSAP No. 25 and SSAP No. 97 to incorporate language to exempt foreign open-end investment funds governed and authorized in accordance with regulations established by the applicable foreign jurisdiction from the look-through provisions included in SSAP No. 25.

Proposed edits 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[FN], 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.

FN—Consistent with SSAP No. 97, footnote 1, investments in an exchange traded fund (ETF), ~~or~~ a mutual fund (as defined by the SEC) or a foreign open-end investment funds governed and authorized in accordance with regulations established by the applicable foreign jurisdiction 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 or foreign open-end investment fund unless ownership of the ~~ETF~~fund actually results in "control" with the power to direct or cause the direction of management of an underlying company. ETFs, ~~and~~ mutual funds and foreign open-end investment funds are comprised of portfolios of securities subject to the regulatory requirements of the federal securities laws or the applicable foreign jurisdictions laws.

Proposed edits to SSAP No. 97:

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[FN].

FN—Investments in an exchange traded fund (ETF), ~~or~~ a mutual fund (as defined by the SEC) or a foreign open-end investment fund governed and authorized in accordance with regulations established by the applicable foreign jurisdiction 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 or foreign open-end investment fund unless ownership of the fund~~ETF~~ actually results in "control" with the power to direct or cause the direction of management of an underlying company. ETFs, ~~and~~ mutual funds and foreign open-end investment funds are comprised of portfolios of securities subject to the regulatory requirements of the federal securities laws or the applicable foreign jurisdictions laws. ETFs, ~~and~~ mutual funds and foreign open-end investment funds held by a reporting entity shall be reported as common stock, unless the fund~~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 foreign open-end investment funds or to adjust the value of SCAs as a result of investments in ETFs, ~~or~~ mutual funds or foreign open-end investment funds.

Staff Review Completed by: Jake Stultz – NAIC Staff, July 2022

Status:
On August 10, 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. 25 and SSAP No. 97 to incorporate language to exempt foreign open-end investment funds governed and authorized in accordance with regulations established by the applicable foreign jurisdiction from the look-through provisions included in SSAP No. 25 and SSAP No. 97.

On December 13, 2022, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed revisions, as illustrated above, to SSAP No. 25 and SSAP No. 97. The revisions identify foreign open-end investment funds as a fund in which ownership percentage is not deemed to reflect control unless the entity actually controls with the power to direct management of the underlying company.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2022/Fall - December/Adoptions/22-13 - Related Party Footnote Rev.docx

Revisions to the
As of March 2023, Accounting Practices and Procedures Manual

On **March 22, 2023**, the Statutory Accounting Principles (E) Working Group adopted the following revisions to the *As of March 2023 Accounting Practices and Procedures Manual*. Documents associated with these revisions are linked to the reference items in bold text.

Ref #	SSAP/ Appendix	Title	Summary
Issue Paper No. 167	SSAP No. 86	*Issue Paper No. 167, Derivatives and Hedging* *New SAP Concept* Effective Immediately	Adoption of *Issue Paper No. 167—Derivatives and Hedging* to detail the historical actions of the authoritative guidance resulting in new SAP concepts within *SSAP No. 86—Derivatives*. As the statutory accounting guidance has already been adopted, the issue paper adoption is for historical documentation and does not change authoritative guidance.
2022-15	SSAP No. 25	SSAP No. 25 – Affiliate Reporting Clarification *SAP Clarification* Effective Immediately (March 22, 2023)	Revisions clarify that any invested asset held by a reporting entity which is issued by an affiliated entity, or which includes the obligations of an affiliated entity, is an affiliated investment.
2022-16	SSAP No. 100R	*ASU 2022-03, Fair Value Measurement of Restricted Securities* *SAP Clarification* Effective Immediately (March 22, 2023)	Revisions adopt with modification the fair value measurement guidance from *ASU 2022-03, Fair Value Measurement of Restricted Securities* to incorporate updated guidance for restricted securities for statutory accounting. The disclosures from ASU 2022-03 were not adopted.
2022-17	SSAP No. 34	Interest Income Disclosure Update *SAP Clarification* Effective December 31, 2023	Revisions adopt additional disclosures in SSAP No. 34 to data capture the gross, nonadmitted and admitted amounts of interest income due and accrued, and to reflect the cumulative amount of paid-in-kind interest income included in the current principal balance.

Ref #	SSAP/ Appendix	Title	Summary
2022-18	SSAP No. 105R	*ASU 2022-04, Disclosure of Supplier Finance Program Obligations* *SAP Clarification* Effective Immediately (March 22, 2023)	Revisions reject *ASU 2022-04, Disclosure of Supplier Finance Program Obligations* for statutory accounting.
AG 49-A	Appendix C	*Actuarial Guideline XLIX-A—The Application of the Life Illustrations Model Regulation to Policies with Index-Based Interest Sold (On or After December 14, 2020)*	Revisions to AG 49-A were adopted by the Life Actuarial (A) Task Force on December 11, 2022; adopted by the Life Insurance and Annuities (A) Committee on February 24, 2023; adopted by the Executive (EX) Committee and Plenary on March 25, 2023.
AG 54	Appendix C	*Actuarial Guideline LIV—Nonforfeiture Requirements for Index-Linked Variable Annuity Products*	New AG 49-A was adopted by the Life Actuarial (A) Task Force on December 11, 2022; adopted by the Life Insurance and Annuities (A) Committee on February 24, 2023; adopted by the Executive (EX) Committee and Plenary on March 25, 2023.

https://naiconline.sharepoint.com/teams/frsstatutoryaccounting/national meetings/a. national meeting materials/2023/3-22-23 - spring/adoptions/adoptions 03.22.2023 toc.docx

Statutory Issue Paper No. 167

Derivatives and Hedging

STATUS
Finalized March 22, 2023

Original SSAP and Current Authoritative Guidance: SSAP No. 86

Type of Issue:
Common Area

SUMMARY OF ISSUE

1. Statutory accounting guidance for derivatives is in *SSAP No. 86—Derivatives*. Although SSAP No. 86 indicates "adoption of the framework" of specific U.S. GAAP guidance, the accounting and reporting guidance for derivatives, particularly with regards to the four U.S. GAAP derivative cornerstones, is distinctly different between SSAP No. 86 and FAS 133/ASC 815. For example, under U.S. GAAP, assessment effectiveness under U.S. GAAP is largely an income statement management tool (to offset variations consistently through net income or other comprehensive income – OCI), but as SAP uses an amortized cost measurement method for a number of hedged items, the criteria for hedge effectiveness and the measurement approach for derivatives must be adjusted accordingly.

2. In August 2017, the FASB issued *ASU 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities* to improve the financial reporting of hedging relationships to better portray the economic results of an entity's risk management activities in its financial statements. In addition, the amendments incorporated certain targeted improvements to simplify the application of the hedge accounting guidance in current U.S. GAAP. ASU 2017-12 included a new concept for a 'last of layer' approach to make portfolio fair value hedge accounting more accessible for specific assets. With the issuance of the last-of-layer guidance, a number of questions were received. After considering those questions, *ASU 2022-01 Fair Value Hedging – Portfolio Layer Method* was issued. This ASU expanded the original guidance and provided additional specifications and guidance.

3. The Statutory Accounting Principles (E) Working Group has considered several revisions to SSAP No. 86 in response to the review of ASU 2017-12 and ASU 2022-01. This issue paper has been drafted to detail the revisions incorporated into statutory accounting. These revisions, except for those initially adopted in 2018, are considered new SAP concepts.

DISCUSSION

Topic 1: Hedge Documentation and Initial Assessment Efficiencies (Agenda Item 2018-30)

4. The overall intent of ASU 2017-12 was to reduce cost and complexity of applying hedge accounting by simplifying the way assessments of hedge effectiveness may be performed. It was noted that the efficiencies gained from the revisions in the ASU for U.S. GAAP filers would be lost if corresponding provisions were not considered for statutory accounting. Pursuant to a July 9, 2018, interested parties' comment letter, three elements were requested to be considered by the Statutory Accounting Principles (E) Working Group in a nonsubstantive (SAP clarification) proposal. Interested parties noted that these elements will reduce the costs associated with hedge accounting, while neither changing the underlying accounting, nor creating any additional regulatory risks or concerns:

a. Allow companies to perform subsequent assessments of hedge effectiveness qualitatively if certain conditions are met.

b. Allow companies more time to perform the quantitative hedge effectiveness assessment.

c. Clarify that companies may apply the "critical terms match" method for a group of forecaster transactions if the transactions occur and the derivatives mature within the same 31-day period or fiscal month, and the other requirements for applying the critical match method are satisfied.

5. On August 4, 2018, the Working Group exposed revisions to incorporate hedge documentation and assessment efficiencies from ASU 2017-12. This item was exposed with a shortened comment period to allow for potential revisions and re-exposure if needed, to permit adoption and application prior to year-end 2018. On November 15, 2018, the Working Group adopted the exposed revisions as final. The revisions were adopted with an effective date of January 1, 2019, with early adoption permitted for year-end 2018. U.S. GAAP filers could only early adopt if they had also early adopted ASU 2017-12.

6. Additionally, in ASU 2017-12, in response to comments requesting a more flexible approach to hedging interest rate risk, the FASB decided to amend the guidance for hedging interest rate risk of financial instruments for both fair value and cash flow hedges. With the revisions, the FASB decided to redefine the term interest rate risk and eliminate the benchmark interest rate concept for variable-rate financial instruments. With the changes, the FASB incorporated the SIFMA rate in the list of eligible rates for fixed income instruments and noted that the FASB will add to the list of eligible benchmark rates as necessary. The revisions adopted to SSAP No. 86 are detailed in Exhibit A.

7. With the inclusion of revisions, certain elements from the U.S.GAAP guidance were not duplicated within statutory accounting. The elements were considered part of the prior adoption of the "FAS 133 / technical guidance" originally reflected in SSAP No. 86:

a. Exceptions from the initial prospective quantitative assessment were not captured in the statutory guidance as they were not necessarily new under ASU 2017-12. The following overview details when an initial prospective quantitative assessment would not be required:

i. In a cash flow or fair value hedge, the entity applies the short-cut method.

ii. In a cash flow or fair value hedge, the entity determines that the critical terms of the hedging instrument and the hedged item match.

iii. In a cash flow hedge, the hedging instrument is an option and it meets specific criteria detailed in the U.S. GAAP guidance

iv. In a cash flow hedge, a private company that is not a financial institution applies the simplified hedge accounting approach.

v. In a cash flow hedge, the entity assesses hedge effectiveness under the change in variable cash flows method permitted under U.S. GAAP, with all noted conditions being met.

vi. In a cash flow hedge, the entity assesses hedge effectiveness under the hypothetical derivative method permitted under U.S. GAAP and all the critical terms of the hypothetical derivative and the hedging instrument are the same.

vii. In a net investment hedge, the entity assesses hedge effectiveness using a method based on changes in spot exchange rates, and the conditions noted under U.S. GAAP are met.

viii. In a net investment hedge, the entity assesses hedge effectiveness using a method based on changes in forward exchange rates and the noted condition under U.S. GAAP are met.

b. The short-cut method and critical terms match method are current method permitted under U.S. GAAP retained under ASU 2017-12. Under these methods, an entity may qualitatively assume, in very limited circumstances, that

8. Ultimately, the revisions incorporated in 2018, effective January 1, 2019, with early application permitted, from ASU 2017-12 were limited to specific provisions, and related transition guidance, pertaining to the documentation and assessment of hedge effectiveness: 1) provisions allowing more time to perform the initial qualitative 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 method for assessing hedge effectiveness. With the adoption of the limited provisions, it was identified that the remaining provisions of ASU 2017-12 would be subsequently assessed for statutory accounting and shall not be considered adopted for statutory accounting until that assessment is completed, with a conclusion to adopt the U.S. GAAP guidance.

9. The revisions adopted in November 2018 included revisions to both SSAP No. 86 as well as Exhibit B – Assessment of Hedging Effectiveness. The subsequent revisions adopted in 2022 eliminated Exhibit B as well as incorporated new guidance through the SSAP. Ultimately, the final adopted guidance, as reflected in the AP&P Manual, is the authoritative guidance.

Topic 2: Hedge Effectiveness and Measurement Methods for Excluded Components (Ref #2021-20)

10. In December 2011, consideration began on revisions to facilitate effective hedge assessments consistently between statutory accounting and U.S. GAAP. The Working Group exposed a concept agenda item to solicit comments and directed NAIC staff to work with regulators and industry in developing revisions for consistent hedge effectiveness assessments and with the treatment of excluded components.

11. After working with industry, on April 4, 2022, the Working Group exposed two documents for public comment. The first document proposed revisions in the form of a new exhibit A to SSAP No. 86, which would replace both Exhibit A and Exhibit B. This new exhibit A would adopt with modification U.S. Guidance in determining hedge effectiveness. The second document proposed revised guidance to SSAP No. 86 to update the permitted excluded components to mirror U.S. GAAP but establish statutory-specific measurement methods for the excluded components.

12. The new Exhibit A intends to reflect the position that the assessment of hedge effectiveness for derivatives should be consistent between U.S. GAAP and SAP. In order words, transactions identified to be highly effective hedges under U.S. would be identified as highly effective hedged 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.

13. The Exhibit A would adopt, with modification 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, statutory modifications are captured 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 adopt from U.S. GAAP only extends to

revisions incorporated through ASU 2017-12, as such, any subsequent U.S. GAAP edits would require statutory accounting consideration before they were considered adopted.

14. In addition to new Exhibit A to SSAP No. 86, the Working Group also exposed proposed revisions to SSAP No. 86, paragraphs 23, 40-41 and Exhibit C, to expand the list of permitted excluded components in assessing derivative effectiveness to match U.S. GAAP and to establish statutory specific measurement requirements for each type of excluded component.

15. The prior SSAP No. 86 guidance reflected the list of permitted excluded components originally adopted from U.S. GAAP. Since the original inclusion in SSAP No. 86, and within ASU 2017-12, U.S. GAAP had expanded the list, and it was noted that the statutory accounting treatment of excluded components related to foreign currency transactions were hindering the ability to engage in those transactions. It was also identified that current measurement guidance within the SSAP was conflicting between the guidance and specific hedge procedures detailed in Exhibit C. Through the discussions with industry, it was identified that different measurement or recognition provisions should be considered to properly reflect the type of excluded component with the financial statements, with specific guidance included in SSAP No. 86 accordingly:

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 spot 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. through 8.c.)

16. On August 10, 2022, after the exposure timeframe, in which interested party comments were received supporting the proposed revisions, the Working Group adopted the exposed revisions. This adoption resulted with both the new Exhibit A that adopts with modification U.S. GAAP guidance in determining hedge effectiveness and the revisions to SSAP No. 86 to incorporate measurement method guidance for excluded components. These revisions were adopted with a January 1, 2023, effective date, with early adoption permitted. With the action to adopt, the Working Group directed a blanks proposal to incorporate Schedule DB reporting fields and templates to capture the new disclosures for excluded components. These disclosure and investment schedule changes will be in effect for year-end 2023. Companies that early adopt the revisions are directly to complete the required disclosures in a narrative format for year-end 2022.

Topic 3: Portfolio Layer Method and Partial Term Hedging (Ref #2022-09)

17. In August 2022, considerations began to expand statutory accounting guidance to incorporate the portfolio layer method detailed in *ASU 2022-01, Fair Value Hedging – Portfolio Layer Method*. The guidance in ASU 2022-01 reflects an expansion of the last-of-layer method detailed in ASU 2017-12.

18. Under the last-of-layer approach captured in ASU 2017-12, for a closed portfolio of prepayable financial assets or one or more beneficial interests secured by a portfolio of prepayable financial instruments, entities were allowed to hedge a stated amount of the asset or assets in the closed portfolio that

is anticipated to be outstanding for the designated hedged period. If the requirements for the last-of-layer method were met, prepayment risk is not incorporated into the measurement of the hedged item. With the application of this guidance, a number of questions were received. After considering those questions, FASB issued *ASU 2022-01, Fair Value Hedging – Portfolio Layer Method,* which expanded the guidance and provided additional specifications for application. Ultimately, for a closed portfolio of financial assets or one of more beneficial interests secured by a portfolio of financial instruments, an entity may designate as the hedged item or items a hedged layer or layers if the following criteria is met:

a. As part of the initial hedge documentation, an analysis is completed and documented to support the entity's expectation that the hedged item or items (that is, the hedged layer or layers in aggregate) is anticipated to be outstanding for the designated hedge period. That analysis shall incorporate the entity's current expectations of prepayments, defaults, and other factors affecting the timing and amount of cash flows associated with the closed portfolio.

b. For purposes of its analysis, the entity assumes that as prepayments, defaults, and other factors affecting the timing and amount of cash flows occur, they first will be applied to the portion of the closed portfolio that is not hedged.

c. The entity applies the partial-term hedging guidance to the assets or beneficial interests used to support the entity's expectation. An asset that matures on a hedged layer's assumed maturity date meets this requirement.

19. Similar to concepts supporting the adoption of prior U.S. GAAP revisions, there is a general assessment that determination of effective hedges shall be consistent between statutory accounting and U.S. GAAP. As such, new SAP concepts revisions to reflect the portfolio layer method in establishing effective hedge dynamics was proposed to be consistent with U.S. GAAP. With the U.S. GAAP guidance limiting the application of this guidance to hedges of recognized financial assets, a consistent scope threshold was established for statutory accounting.

20. The review of the portfolio layer method identified that U.S. GAAP prevents basis adjustments directly to assets hedged in a portfolio and it was considered on whether statutory revisions would be necessary to address similar basis adjustment revisions under statutory accounting. However, after further assessments, it was identified that the fair value measurement method under U.S. GAAP, which results in ongoing basis adjustments from changes in fair value over the derivative term, would not be a prominent issue under statutory accounting, which predominantly uses an amortized cost approach for effective hedges. With the use of amortized cost, basis adjustments do not occur until hedge termination or at designation of the hedge, therefore this was identified as not a key statutory accounting impact.

21. In addition to considering guidance for the portfolio layer method, representatives from interested parties proposed to also capture concepts for partial term hedges from ASU 2017-12. (As detailed in the FASB criteria above in paragraph 18 for portfolio layer method hedges, application of a the partial-term hedging guidance is used to support the entity's expectation.) Prior review of partial term hedge concepts noted concern as how interim adjustments to hedged items, particularly for hedged liabilities, would be reflected in the financial statements. With the statutory accounting guidance to reflect derivative gains or losses as basis adjustments on the hedge item, if a hedge to a recognized liability resulted in a reduction to the presentation of the liability, this could misrepresent the financial statements as the liability itself had not been reduced. In considering these concerns and recognizing that a broader project would likely be needed to address these basis adjustments, representatives from industry recommended incorporated the U.S. GAAP guidance for partial term hedges, with a statutory modification to limit the application to hedges of recognized assets.

22. Although the proposal to limit partial term hedges to recognized assets is a modification from the overarching concept to mirror hedge effectiveness assessments between U.S. GAAP and SAP, it was identified as an approach that would be consistent with the U.S. GAAP scope application for the portfolio layer method and would reflect how industry currently uses partial term hedge transactions. As such, although the modification created a U.S. GAAP and SAP difference, the modification satisfies the current need for statutory guidance and prevents significant concerns on how the guidance could impact the presentation of liabilities. With this discussion, it was identified that subsequent consideration of the limitation to recognized assets could occur, with potential expansion to hedges of recognized liabilities as part of a broader discussion on how derivative gains and losses are recognized as basis adjustments.

23. The proposed revisions exposed to incorporate the portfolio layer method and the partial-term hedging method are summarized as follows:

a. Revisions to SSAP No. 86, predominantly in paragraph 26.d., 26.f., and 26.g., to detail the ability to hedge recognized assets under the portfolio layer method and partial-term hedge. Also, revisions to paragraph 62 for a new disclosure for portfolio layer derivatives that no longer qualify for hedge accounting and the circumstances that led to the breach, as well as guidance in paragraphs 65.c. and 74.f. to detail relevant U.S. GAAP literature and the effective date.

b. Revisions to SSAP No. 86 – Exhibit, Exhibit A – Assessment of Hedge Effectiveness, to add a new section on the assessment of portfolio layer method for hedge effectiveness. (Note – This exhibit was the new exhibit adopted in agenda item 2021-20 which replaced the prior Exhibit A and Exhibit B within SSAP No. 86.)

c. Revisions to SSAP No. 86 – Exhibit C, paragraph 2.d., for which a portfolio layer method is discontinued to detail how the basis adjustment shall be allocated to the remaining individual assets in the closed portfolio. (Note – With the adoption of agenda item 2021-20, this Exhibit was renamed as Exhibit B.)

24. The proposed revisions reflect adoption of U.S. GAAP for the criteria for the portfolio layer method detailed in ASU 2022-01, criteria to only consider how changes in the benchmark interest rate affect the decision to settle the hedged item before its scheduled maturity date in ASC 815-20-25-6B, adding option in calculating the change in the hedged item's fair value attributed to changes in the benchmark interest rate based on the benchmark rate components of the contractual cash flows detailed in FASB ASC 815-25-35-13, and the partial-term hedging method detailed in FASB ASC 815-25-35-13B. The adoption of the partial term hedging method reflects statutory modifications that limits its use only when the hedged item is a recognized asset. This is different than U.S. GAAP, which permits the partial term method for hedged liabilities. The statutory limitation is established to prevent interim basis adjustments to hedged liabilities that could present a reduction of reported liabilities on the financial statements when the actual liability has not been reduced. Reconsideration of this statutory limitation may occur after a broader project to consider how derivative basis adjustments to hedged liabilities shall be reflected in the financial statements.

25. On December 13, 2022, the Working Group adopted the exposed revisions. This adoption resulted with the revisions identified in paragraph 23 above. These revisions were adopted with a January 1, 2023 effective date, with early adoption permitted. The revisions shall be applied prospectively to qualifying new hedges.

~~25.~~26. An updated version of this Issue Paper was exposed on December 12, 2022, and adopted on March 22, 2023. The purpose of this Issue Paper is to document the historical actions resulting in new SAP concepts within *SSAP No. 86—Derivatives*. As issue papers are not represented in the statutory hierarchy, the adoption of this Issue Paper does not change the effective date of the previously adopted authoritative literature.

Exhibit 1 – Revisions adopted to SSAP No. 86 on November 15, 2018 (Agenda Item 2018-30)

38. At inception of the hedge, documentation must include:

a. A formal documentation of the hedging relationship and the entity's risk management objective and strategy for undertaking the hedge, including identification of the hedging instrument, the hedged item, the nature of the risk being hedged, and how the hedging instrument's effectiveness in offsetting the exposure to changes in the hedged item's fair value or variability in cash flows attributable to the hedged risk will be assessed, including whether an entity will perform subsequent effectiveness assessments on a qualitative basis (per paragraph 42) and how it intends to carry out that qualitative assessment. There must be a reasonable basis for how the entity plans to assess the hedging instrument's effectiveness;

b. An entity's defined risk management strategy for a particular hedging relationship may exclude certain components of a specific hedging derivative's change in fair value, such as time value, from the assessment of hedge effectiveness, as discussed in paragraph 37 and Exhibit B;

c. Signature of approval, for each instrument, by person(s) authorized, either by the entity's board of directors or a committee authorized by the board, to approve such transactions; and

d. A description of the reporting entity's methodology used to verify that opening transactions do not exceed limitations promulgated by the state of domicile.

39. At inception, if an entity is required to perform an initial prospective assessment of hedge effectiveness on a quantitative basis (using information applicable as of the date of hedge inception[FN]), the assessment is considered to be performed concurrently at hedge inception if it completed by the earliest of the following: *(815-20-25-3)*

a. The first quarterly hedge effectiveness assessment date.

b. The date that financial statements that include the hedged transaction are available to be issued.

c. The date that the hedging instrument and hedged item no longer qualify for hedge accounting.

d. The date of expiration, sale, termination or exercise of the hedging instrument.

e. The date of dedesignation of the hedging relationship.

f. For a cash flow hedge of a forecasted transaction, the date that the forecasted transaction occurs.

New Footnote – Entities are required to perform an initial prospective assessment unless qualifying for an exception in accordance with ASU 2017-12, paragraph 815-20-25-3.

40. For all derivatives terminated, expired, or exercised during the year:

a. Signature of approval, for each instrument, by person(s) authorized, either by the entity's board of directors or a committee authorized by the board, to approve such transactions;

b. A description, for each instrument, of the nature of the transaction, including:

i. The date of the transaction;

ii. A complete and accurate description of the specific derivative, including description of the underlying securities, currencies, rates, indices, commodities, derivatives, or other financial market instruments;

iii. Number of contracts or notional amount;

iv. Date of maturity, expiry or settlement;

v. Strike price, rate or index (termination price for futures contracts);

vi. Counterparty, or exchange on which the transaction was traded; and

vii. Consideration paid or received, if any, on termination.

c. Description of the reporting entity's methodology to verify that derivatives were effective hedges; and

d. Identification of any derivatives that ceased to be effective as hedges.

41. For derivatives open at quarter-end:

a. A description of the methodology used to verify the continued effectiveness of hedges, and whether the entity is using qualitative assessments pursuant to paragraph 42[FN];

b. An identification of any derivatives that have ceased to be effective as hedges;

c. A description of the reporting entity's methodology to determine fair values of derivatives;

d. Copy of Master Agreements, if any, where indicated on Schedule DB Part D.

New Footnote: For purposes of this requirement, this statement adopts the guidance for effectiveness assessment after initial designation reflected in ASU 2017-12, including the concepts and restrictions for use of the short-cut method and the critical terms match method.

42. An entity may subsequently qualitatively assess hedge effectiveness, on a hedge-by-hedge basis, if both the conditions in paragraphs 42.a. and 42.b. were initially met. When an entity performs subsequent 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. An entity may perform a quantitative assessment in any reporting period to validate whether qualitative assessments remain appropriate. When facts and circumstances change such that an entity no longer can assert qualitatively that the hedging relationship continue to be highly effective, then the entity shall begin performing quantitative assessments. (815-20-35-2A, 2C and 2D abbreviated)

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) 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.

RELEVANT LITERATURE

60~~59~~. 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. 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.

61 This statement adopts certain revisions to ASC 815-20 included in ASU 2017-12. 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. 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.

62~~60~~. This statement adopts with modification revisions to ASC 815 as reflected within ASU 2016-05, Effect of Derivative Contract Novations on Existing Hedge Accounting Relationships. This guidance is modified to require prospective application, as such it is only applicable to future counterparty changes in derivative instruments, and this guidance cannot be used to adjust derivative transactions previously terminated. This statement adopts revisions to ASC 815-20-25-15 as reflected within ASU 2010-08, Technical Corrections to Various Topics. This statement adopts revisions to ASC 815-10-50-4K as reflected within ASU 2010-11, Derivatives and Hedging (Topic 815), Scope Exception Related to Embedded Credit Derivatives, but rejects all other GAAP revisions from ASU 2010-11 and ASU 2014-16, Derivatives and Hedging, Determining Whether the Host Contract in a Hybrid Financial Instrument Issued in the Form of a Share is More Akin to Debt or to Equity and ASU 2016-06, Derivatives and Hedging, Contingent Put and Call Options in Debt Instruments. These GAAP revisions are rejected as embedded derivatives are not separated from the host contract and recognized as derivatives under SSAP No. 86. Revisions are also incorporated to SSAP No. 86 to require disclosures on embedded credit derivatives that expose the holder of a financial instrument to the possibility of being required to make future payments. This disclosure is a modification to the GAAP disclosures specific to statutory accounting as embedded credit derivatives are not separately recognized under statutory accounting. It should be noted that the conclusions reached in this statement are not intended to usurp the rules and regulations put forth by states in their respective investment laws. The contents of this statement are intended to provide accounting

guidance on the use of derivatives as allowed by an insurer's state of domicile. It is not intended to imply that insurers may use derivatives or cash instruments that the insurer's state of domicile does not allow under the state's insurance regulatory requirements, e.g., in replication transactions.

63~~61~~. This statement adopts revisions to ASC 815-20 as reflected within ASU 2013-10, Derivatives and Hedging, Inclusion of the Fed Funds Effective Swap Rate (or Overnight Index Swap Rate) as a benchmark interest rate for Hedge Accounting Purposes. These revisions define a benchmark interest rate, clarify what can be used in the U.S. for a benchmark interest rate, and eliminate the prior restriction on using different benchmark rates for similar hedges.

Effective Date and Transition

67~~65~~. 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. Revisions adopted to paragraph 59 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.) Revisions adopted in paragraph 15 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.) Revisions to incorporate limited provisions from ASU 2017-12 pertaining to the documentation of hedge effectiveness (detailed in paragraph 61) 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.

SSAP NO. 86 - EXHIBIT B – ASSESSMENT OF HEDGING EFFECTIVENESS

The following is based on paragraphs 62-70 of FAS 133 to offer additional guidance on assessing hedging effectiveness. The intent of such is to remain consistent with ~~FAS 133~~U.S. GAAP with respect to assessing hedge effectiveness, including guidance in ASU 2017-12 that outlines when an entity may perform subsequent assessments of hedge effectiveness qualitatively.

1. This statement requires that an entity define at the time it designates a hedging relationship the method it will use to assess the hedge's effectiveness in achieving offsetting changes in fair value or offsetting cash flows attributable to the risk being hedged. It also requires that an entity use that defined method consistently throughout the hedge period to assess at inception of the hedge and on an ongoing basis whether it expects the hedging relationship to be highly effective in achieving offset. If the entity identifies an improved method and wants to apply that method prospectively, it must discontinue the existing hedging relationship and designate the relationship anew using the improved method. Although this statement suggests a method for assessing whether a hedge is expected to be highly effective or measuring hedge ineffectiveness, the appropriateness of a given method of assessing hedge effectiveness can depend on the nature of the risk being hedged and the type of hedging instrument used. Ordinarily, however, an entity should assess effectiveness for similar hedges in a similar manner; use of different methods for similar hedges should be justified.

2. In defining how hedge effectiveness will be assessed, an entity must specify whether it will include in that assessment all of the gain or loss on a hedging instrument. As discussed in paragraph 33, this statement permits (but does not require) an entity to exclude all or a part of the hedging instrument's time value from the assessment of hedge effectiveness, as follows:

a. If the effectiveness of a hedge with an option contract is assessed based on changes in the option's intrinsic value, the change in the time value of the contract would be excluded from the assessment of hedge effectiveness.

b. If the effectiveness of a hedge with an option contract 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 would be excluded from the assessment of hedge effectiveness.

c. If the effectiveness of a hedge with a forward 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 would be excluded from the assessment of hedge effectiveness.

In each circumstance above, changes in the excluded component would be included in unrealized gains or losses. As noted in paragraph 1 of this Exhibit, the effectiveness of similar hedges generally should be assessed similarly; that includes whether a component of the gain or loss on a derivative is excluded in assessing effectiveness. No other components of a gain or loss on the designated hedging instrument may be excluded from the assessment of hedge effectiveness.

3. In assessing the effectiveness of a cash flow hedge, an entity generally will need to consider the time value of money if significant in the circumstances. Considering the effect of the time value of money is especially important if the hedging instrument involves periodic cash settlements. 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.

4. ~~Whether a hedging relationship qualifies as highly effective sometimes will be easy to assess.~~ If the critical terms of the hedging instrument and of the ~~entire~~ hedged item~~asset or liability~~ ~~(as opposed to selected cash flows)~~ 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 ~~highly~~ perfectly effective if:

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.

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

c. Either the change in the discount or premium on the forward contract is excluded from the assessment of effectiveness and included directly in unrealized gains and losses pursuant to paragraph 22.B. or the change in expected cash flows on the forecasted transaction is based on the forward price for the commodity.

5. In a cash flow hedge of a group of forecasted transactions, 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 if those forecasted transactions occur and the derivative matures within the same 31-day period or fiscal month. *(815-20-25-84A)*

~~5~~6. However, assessing hedge effectiveness can be more complex. For example, hedge effectiveness would be reduced by the following circumstances, among others:

a. A difference between the basis of the hedging instrument and the hedged item or hedged transaction (such as a Deutsche mark-based hedging instrument and Dutch guilder-based hedged item), 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 notional amounts, maturities, quantity, location, or delivery dates.

Hedge effectiveness also would be reduced if part of the change in the fair value of a derivative is attributable to a change in the counterparty's creditworthiness.

~~6~~7. A hedge that meets the effectiveness test specified in paragraphs 19.b. and 20.b. (that is, both at inception and on an ongoing basis, the entity expects the hedge to be highly effective at achieving offsetting changes in fair values or cash flows) also must meet the other hedge accounting criteria to qualify for hedge accounting. If the hedge initially qualifies for hedge accounting, the entity would continue to assess whether the hedge meets the effectiveness test. 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. The discussions of measuring hedge effectiveness in the examples in the remainder of this Exhibit assume that the hedge satisfied all of the criteria for hedge accounting at inception.

Exhibit 2 – Revisions adopted to SSAP No. 86 on August 10, 2021 (Agenda Item 2021-20)

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.

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

[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.

(as discussed in Exhibit ~~B~~A, 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 spot 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 paragraph 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 gain/loss, the fair value reflected in BACV, and for the excluded forward points (e.g., forward spot rates), the aggregate amount owed at maturity, along with current year and remaining amortization. (Note – These items will be captured in a blanks proposal/template.)

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*.

65. 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~~are 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

74.~~73~~ 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.

e. 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*

With the adoption of the new Exhibit A as detailed in the subsequent section, Exhibit C will be renamed Exhibit B. Due to the details of Exhibit A (including the FASB ASC paragraphs not duplicated in the SSAP), the following Exhibit B section is included before the new Exhibit A in this issue paper for ease of readability.

EXHIBIT ~~C~~ B – SPECIFIC HEDGE ACCOUNTING PROCEDURES FOR DERIVATIVES

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;

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);

(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, ~~T~~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) ~~will~~ 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.

~~notional amount or designated notional amount times the difference between the forward rate available for the remaining maturity of the~~

~~contract (i.e., the forward rate as of the balance sheet date) and the forward rate at the time it ceased to be an effective hedge.~~

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):

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.~~;~~

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.

The following new Exhibit A replaces both Exhibit A and Exhibit B within the existing SSAP No. 86. This is new guidance within SSAP No. 86, and the tracked changes shown in the section below reflect the modifications from U.S. GAAP. References to the FASB ASC are included in this issue paper for historical reference and will not be duplicated within the SSAP.

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.

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)*

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)[2] 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 derivative instrument and the hedged items for the period used to assess whether the

[2] Reference to this ASU 2017-12 guidance is consistent with the guidance in SSAP No. 86, paragraph 42, footnote 5.

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.~~

(ASC paragraph 815-20-25-79A not included in Exhibit A.)

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 are not adopted within SSAP No. 86 as they address measurement and recognition. Measurement and recognition guidance shall follow the provisions detailed in SSAP No. 86.

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)*

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 815-10-50-4EEEE. *(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 815-20-25-22A 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~~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 ~~815-20-25-84 through 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 ~~815-20-25-84 through 25-84A~~ are met ~~(see paragraph 815-20-25-3(b)(2)(iv)(01))~~. *(815-20-25-85)*

(ASC paragraphs 815-20-25-86 to 815-20-25-97 not included in Exhibit A.)

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)

(ASC paragraphs 815-20-25-100 and 815-20-25-101not included in Exhibit A.)

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 *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)*

a. The notional amount of the interest rate swap matches the principal amount of the interest-bearing asset or liability being hedged.

b. 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.

c. 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.

c. The interval between repricings of the variable interest rate in the interest rate swap is frequent enough to justify an assumption that the variable payment or receipt is at a market rate (generally three to six months or less).

d. For fair value hedges of a proportion 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 (a) in paragraph 815-20-25-104)~~ matches the portion of the asset or liability being hedged.

e. For fair value hedges of portfolios (or proportions thereof) of similar interest-bearing assets or liabilities, both of the following criteria are met:

i. The notional amount of the interest rate swap designated as the hedging instrument matches the aggregate notional amount of the hedged item (whether it is all or a proportion of the total portfolio).

ii. The remaining criteria for the shortcut method are met with respect to the interest rate swap and the individual assets or liabilities in the portfolio.

f. The index on which the variable leg of the interest rate swap is based matches the benchmark interest rate designated as the interest rate risk being hedged for that hedging relationship.

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.

e. 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.

f. 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 17.e.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 (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)

(ASC paragraphs 815-20-25-112 through 815-20-25-143 not included in Exhibit A.)

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)(iv)(01)(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 7~~815-20-25-81~~. (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 effective. ~~This shall include an assessment of the guidance in paragraph 815-20-25-100 when applicable.~~

b. There have been no adverse developments regarding the risk of counterparty default.

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 28-29~~815-20-35-2D 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)

a. Period-by-period approach. The period-by-period approach involves comparing the changes in the hedging instrument's fair values (or cash flows) that have occurred during the period being assessed to the changes in the hedged item's fair value (or hedged transaction's cash flows) attributable to the risk hedged that have occurred during the same period. If an entity elects to base its comparison of changes in fair value (or cash flows) on a period-by-period approach, the period cannot exceed three months. Fair value (or cash flow) patterns of the hedging instrument or the hedged item (or hedged transaction) in periods before the period being assessed are not relevant.

b. Cumulative approach. The cumulative approach involves comparing the cumulative changes (to date from inception of the hedge) in the hedging instrument's fair values (or cash flows) to the cumulative changes in the hedged item's fair value (or hedged transaction's cash flows) attributable to the risk hedged.

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 10-11~~815-20-25-84 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 offsetting 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 16~~815-20-25-103~~ 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

44. If the entity identifies an improved method of assessing hedge effectiveness in accordance with the guidance in paragraph 6~~815-20-25-80~~ 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.

45. 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 250~~SSAP No. 3—Accounting Changes and Corrections of Errors. (815-20-35-20)

U.S. GAAP ASC Excerpts Excluded from Exhibit A

This information is included to illustrate the guidance within the adopted ASC references that are not captured in Exhibit A. The guidance within these paragraphs is considered part of the statutory adoption unless they include specific accounting and reporting guidance.

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).

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

b. Hedge effectiveness of written options

c. Hedge effectiveness of options in general.

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).

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.

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.

> > > > 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. t 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 815-20-55-75.

Application of the Shortcut Method to a Portfolio of Hedged Items

815-20-25-116 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 dedesignating 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 dedesignate 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

815-20-25-133 Paragraphs 815-10-35-1A through 35-1C, 815-10-50-3, 815-20-25-3A, 815-20-25-119, 815-20-25-134 through 25-138, 815-20-55-79A through 55-79B, 825-10-50-3, and 825-10-50-8 provide guidance for an entity electing the simplified hedge accounting approach. See paragraph 815-10-65-6 for transition guidance on applying 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:

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.

Exhibit 3 – Revisions adopted to SSAP No. 86 on December 12, 2022 (Agenda Item 2022-09)

Fair Value Hedges (Note – Paragraphs 26.a. through 26.c. are not affected and are omitted for brevity.)

26. Fair value hedges qualify for hedge accounting if all of the following criteria are met:

d. The hedged item is specifically identified as either all, ~~or~~ a specific portion, or the partial term of a recognized asset, or all or a specific portion of ~~or~~ a recognized liability or of an unrecognized firm commitment. The hedged item is a single asset or liability (or a specific portion or partial term thereof) or is a portfolio of similar assets or a portfolio of similar liabilities (or a specific portion thereof) or a closed portfolio of assets (pursuant to paragraph 26.f. and Exhibit A, paragraph 46) where assumed layer or layers is anticipated to be outstanding (or a specific portion thereof)[3]. For a partial term hedge of one or more consecutive selected contractual cash flows where the hedged item begins when the first hedge cash flow begins to accrue and ends at the end of the designation hedge period, the assumed maturity of the hedged item occurs at the end of the designated hedge period; *(ASC 815-25-35-13B Partial Term Hedging.)*

e. If similar assets or similar liabilities are aggregated and hedged as a portfolio, the individual assets or individual liabilities must share the risk exposure for which they are designated as being hedged. The change in fair value attributable to the hedged risk for each individual item in a hedged portfolio must be expected to respond in a generally proportionate manner to the overall change in fair value of the aggregate portfolio attributable to the hedged risk; and

f. For a closed portfolio of financial assets or one or more beneficial interests secured by a portfolio of financial instruments, an entity may designate as the hedged item or items a hedged layer or layers (this designation is referred to throughout as the "portfolio layer method" (detailed in Exhibit A). *(ASC 815-20-25-12A Portfolio Layer Method)*

~~f.~~g. If the hedged item is a financial asset or liability, a recognized loan servicing right, or a nonfinancial firm commitment with financial components, the designated risk being hedged is:

i. The risk of changes in the overall fair value of the entire hedged item;

ii. The risk of changes in its fair value attributable to changes in benchmark interest rate;

iii. The risk of changes in its fair value attributable to changes in the related foreign currency exchange rates; or

iv. The risk of changes in its fair value attributable to both changes in the obligor's creditworthiness and changes in the spread over the benchmark interest rate with respect to the related financial asset's or liability's credit sector at inception of the hedge (referred to as credit risk).

[3] For clarity, partial-term hedges and portfolio hedges addressed in paragraph 26.f. are limited to the situations in which the hedged item(s) is a recognized asset or a closed portfolio of financial assets. These hedging accounting methods are not permitted to hedge liabilities.

If the risk designated as being hedged is not the risk in paragraph 26.f.i., two or more of the other risks (benchmark interest rate risk, foreign currency exchange risk, and credit risk) may simultaneously be designated as being hedged.

The benchmark interest rate being hedged in a hedge of interest rate risk must be specifically identified as part of the designation and documentation at the inception of the hedging relationship. In calculating the change in the hedged item's fair value attributable to changes in the benchmark interest rate, the estimated coupon cash flows used in calculating fair value shall ~~must~~ be based on either~~all of~~ the full contractual cash flows ~~of the entire hedged item~~ or the benchmark rate component of the contractual coupon cash flows of the hedged item determined at hedge inception. An entity may designate a fair value hedge of interest rate risk in which the hedged item is a prepayment instrument. The 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 change in the benchmark interest rate affect an obligor's decision to call a debt instrument when it has the right to do so.) The entity need not consider other factors that would affect this decision (for example, credit risk) when assessing hedge effectiveness. *(ASU 815-25-35-13 & 815-20-25-6B)*~~Excluding some of the hedged item's contractual cash flows (for example, the portion of the interest coupon in excess of the benchmark interest rate) from the calculation is not permitted.~~[4] An entity may not simply designate prepayment risk as the risk being hedged for a financial asset. However, it can designate the option component of a prepayable instrument as the hedged item in a fair value hedge of the entity's exposure to changes in the fair value of that "prepayment" option, perhaps thereby achieving the objective of its desire to hedge prepayment risk. The effect of an embedded derivative of the same risk class must be considered in designating a hedge of an individual risk. For example, the effect of an embedded prepayment option must be considered in designating a hedge of benchmark interest rate risk.

Disclosure Requirements

62. Reporting entities shall disclose the following for all derivative contracts used:

a. General disclosures:

vii. The net gain or loss recognized in unrealized gains or losses during the perioding period resulting from derivatives that no longer qualify for hedge accounting. For portfolio layer method hedges, disclose circumstances that led to the breach. *(ASC 815-10-50-5C.)*

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

[4] ~~The first sentence of paragraph 26.d. that specifically permits the hedged item to be identified as either all or a specific portion of a recognized asset or liability or of an unrecognized firm commitment is not affected by the provisions in this subparagraph.~~

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*.

65. 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, are 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**.**

c. Revisions effective January1, 2022, with early adoption permitted, are limited to the criteria for the portfolio layer method detailed in ASU 2022-01, criteria to only consider how changes in the benchmark interest rate affect the decision to settle the hedged item before its scheduled maturity date in 815-20-25-6B, adding option in calculating the change in the hedged item's fair value attributed to changes in the benchmark interest rate based on the benchmark rate components of the contractual cash flows detailed in FASB ASC 815-25-35-13, and the partial-term hedging method detailed in FASB ASC 815-25-35-13B. The adoption of the partial term hedging method reflects statutory modifications that limits its use only when the hedged item is a recognized asset. This is different than U.S. GAAP, which permits the partial term method for hedged liabilities. The statutory limitation is established to prevent interim basis adjustments to hedged liabilities that could present a reduction of reported liabilities on the financial statements when the actual liability has not been reduced. Reconsideration of this statutory limitation may occur after a broader project to consider how derivative basis adjustments to hedged liabilities shall be reflected in the financial statements.

Effective Date and Transition

74.~~73~~ 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.

e. 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.*

f. Revisions adopted December 12, 2022 that adopt U.S. GAAP guidance for the portfolio layer method, U.S. GAAP guidance to only consider how changes in the benchmark interest rate affect the decision to settle the hedged item before its scheduled maturity, U.S. GAAP guidance adding option in calculating the change in the hedged item's fair value attributed to changes in the benchmark interest rate based on the benchmark rate component of the contractual coupon cash flows, that and adopt with modification U.S. GAAP guidance for partial term hedging are effective January 1, 2023, with early adoption permitted. These revisions shall be applied prospectively to qualifying new hedges.

Edits to New Exhibit A – Discussion of Hedge Effectiveness

17. All of the following conditions apply to both fair value hedges and cash flow hedges: *(815-20-25-104)*

    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~~ ends at the end of the designated hedge period, 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:

18. All of the following incremental conditions apply to fair value hedges only: *(815-20-25-105 & 815-25-35-13B)*

    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 ends at the end of the designated hedge period ~~occur on the date in which the last hedged cash flow is due and payablein accordance with paragraph 815-25-35-13B~~.

Portfolio Layer Method (New paragraphs at the end of Exhibit A.)

46. For a closed portfolio of financial assets or one or more beneficial interests secured by a portfolio of financial instruments, an entity may designate as the hedged item or items a hedged layer or layers (this designation is referred to throughout as the "portfolio layer method.*") (ASU 815-20-25-12A)*

    a. As part of the initial hedge documentation, an analysis is completed and documented to support the entity's expectation that the hedged item or items (that is, the hedged layer or layers in aggregate) is anticipated to be outstanding for the designated hedge period. That analysis shall incorporate the entity's current expectations of prepayments, defaults, and other factors affecting the timing and amount of cash flows associated with the closed portfolio.

    b. For purposes of its analysis in paragraph 46.a., the entity assumes that as prepayments, defaults, and other factors affecting the timing and amount of cash flows occur, they first will be applied to the portion of the closed portfolio that is not hedged; and

    c. The entity applies the partial-term hedging guidance to the assets or beneficial interest used to support the entity's expectation in paragraph 46.a. An asset that matures on a hedged layer's assumed maturity date meets this requirement.

47. After a closed portfolio is established in accordance with paragraph 46, and entity may designate new hedging relationships associated with the closed portfolio without dedesignating any existing hedging

relationships associated with the closed portfolio if the criteria of paragraph 46 are met for those newly designated hedging relationships. *(ASU 815-20-25-12B)*

48. For the portfolio layer method if both of the following conditions exist, the quantitative test described for similar assets (shared risk exposure) may be performed qualitatively on a hedge-by-hedge basis and only at hedge inception:

a. The hedged item is a hedged layer in a portfolio layer hedge and designated in accordance with paragraph 26.f. of SSAP No. 86.

b. An entity measures the change in fair value of the hedged item based on the benchmark rate component of the contractual coupon cash flows.

Using the benchmark rate component of the contractual coupon cash flows when all assets have the same assumed maturity date and prepayment risk does not affect the measurement of the hedged item results in all hedged items having the same benchmark rate component coupon cash flows. *(ASU 815-20-55-14A)*

49. For one or more hedging relationships designated under the portfolio layer method, an entity shall discontinue (or partially discontinue) hedge accounting in the following circumstances: *(ASU 815-25-40-8)*

a. If the entity cannot support on a subsequent testing date that the hedged layer or layers are anticipated to be outstanding for the designated hedge (that is, a breach is anticipated), it shall discontinue (or partially discontinue) hedge accounting for one or more hedging relationships for the portion of the hedged item that is no longer anticipated to be outstanding for the designated hedge period.

b. If on a subsequent testing date the outstanding amount of the closed portfolio of financial assets or one or more beneficial interests is less than the hedged layer or layers (that is, a breach has occurred), the entity shall discontinue (or partially discontinue) hedge accounting for one or more hedging relationships for the portion of the hedged item that is no longer outstanding.

50. In the event of either an anticipated breach (as described in paragraph 49.a.) or a breach that has occurred (as described in paragraph 49.b.) for portfolio layer method, if multiple hedged layers are associated with a closed portfolio, an entity shall determine which hedge or hedges to discontinue (or partially discontinue) in accordance with an accounting policy election. That accounting policy election shall specify a systematic and rational approach to determining which hedge or hedges to discontinue (or partially discontinue). An entity shall establish its accounting policy no later than when it first anticipates a breach or when a breach has occurred (whichever comes first). After an entity establishes its accounting policy, it shall consistently apply its accounting policy to all portfolio layer method breaches (anticipated and occurred). *(ASU 815-25-40-8A)*

U.S. GAAP references not pulled into Exhibit will also be updated as follows:

Consideration of Prepayment Risk Using the ~~Last-of-Layer~~ Portfolio Layer Method

815-20-25-118A In a fair value hedge of interest rate risk designated under the portfolio layer ~~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.

Edits to Exhibit ~~C~~ B – Specific Hedge Accounting Procedures for Derivatives

2. Swaps, Collars, and Forwards (see also discussion in Introduction above):

d. Gain/Loss on Termination of a swap, collar or forward accounted for under hedge accounting (includes closing, exercise, maturity, and expiry):

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. If a portfolio layer method hedging relationship is discontinued (or partially discontinued) in a voluntary dedesignation or in anticipation of a breach, the basis adjustment associated with the dedesignated amount as of the discontinuation date shall be allocated to the remaining individual assets in the closed portfolio that supported the dedesignated hedged layer using a systematic and rational method. 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. (ASU 815-25-40-9)

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/2023/3-22-23 - Spring/Adoptions/17-33 - IP Derivatives - 2022.docx

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

Issue: SSAP No. 25 – Affiliate Reporting Clarification

Check (applicable entity):

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

Description of Issue:
At its May 24, 2022, meeting, the Statutory Accounting Principles (E) Working Group adopted agenda item 2021-21: Related Party Reporting, which included revisions 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. During the meeting discussion, it was suggested that there needs to be a clarification of when an investment is considered to be and affiliated investment and reported on the affiliated line in the investment schedules. When agenda item 2021-21 was adopted, it included a recommendation that NAIC staff look to further clarify when investments should be classified as affiliated in the reporting schedules. This agenda item intends to clarify that an investment held from an affiliate is considered an affiliated investment.

Existing Authoritative Literature:

The *Insurance Holding Company System Regulatory Act* (Model #440) establishes the laws for holding company structures. The Act also establishes the concept of an affiliate in Section 1A, and this definition is used for statutory accounting purposes.

> A. "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.

SSAP No. 25—Affiliates and Other Related Parties establishes statutory accounting principles for affiliates and related parties. This definition is the language that is used to help define when an investment is affiliated or nonaffiliated for reporting in the various investment schedules.

> 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.

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.

On May 24, 2022, the Working Group adopted revisions to SSAP No. 25 and *SSAP No. 43R—Loan-Backed and Structured Securities*, 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, and included a new disclosure that was adopted by the Blanks (E) Working Group in proposal 2021-22BWG, which adds a new electronic-only column for the investment schedules and the related instructions which describes the nature of any related party relationship that exists related to the investment.

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 a SAP clarification, and expose revisions to SSAP No. 25 to clarify that any invested asset held by a reporting entity which is issued by an affiliated entity, or which includes the obligations of an affiliated entity is an affiliated investment. Staff also recommend that Working Group direct the Blanks (E) Working Group to modify the Annual Statement Instructions as illustrated below.

Proposed edits to SSAP No. 25:

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. Any invested asset held by a reporting entity which is issued by an affiliated entity, or which includes the obligations of an affiliated entity is an affiliated investment.

Proposed Annual Statement Reporting Changes*: (These will be captured in a blanks proposal.)*

This will be included in the Investment Schedules General Instructions in several places covering several different types of investment, and this revision is proposed to be included in each place under the header "Parent, Subsidiaries and Affiliates."

Parent, Subsidiaries and Affiliates:

> Defined by *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*. Any invested asset held by a reporting entity which is issued by an affiliated entity, or which includes the obligations of an affiliated entity is an affiliated investment.

Staff Review Completed by: Jake Stultz—NAIC Staff, November 2022

Status:
On December 13, 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. 25 to clarify that any invested asset held by a reporting entity which is issued by an affiliated entity, or which includes the obligations of an affiliated entity is an affiliated investment.

On March 22, 2023, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed revisions illustrated above to SSAP No. 25 which clarify that any invested asset held by a reporting entity which is issued by an affiliated entity, or which includes the obligations of an affiliated entity is an affiliated investment.

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

Issue: ***ASU 2022-03, Fair Value Measurement of Equity Securities Subject to Contractual Sale Restrictions***

Check (applicable entity):

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

Description of Issue:
In June 2022, the Financial Accounting Standards Board (FASB) issued *ASU 2022-03, Fair Value Measurement of Equity Securities Subject to Contractual Sale Restrictions* to 1) clarify the guidance in Topic 820, Fair Value Measurement, when measuring the fair value of an equity security subject to contractual restrictions that prohibit the sale of an equity security, 2) amend a related illustrative example, and 3) add a new disclosure of the fair value of equity securities subject to contractual sale restrictions, nature and remaining duration of the restrictions, and circumstances that could cause a lapse in the restrictions, in accordance with Topic 820.

These amendments do not change the principles of fair value measurement. They provide clarity in situations involving equity securities that have restrictions related to the sale of the asset. This ASU provides updated guidance for two specific scenarios, one where the restriction is based on the entity holding the equity security and one where the restriction is a characteristic of the equity security.

- First, it clarifies situations where an equity security cannot be sold on the measurement date because of a contractual sale restriction where the entity is not allowed to sell an asset. An example of this would be lock-up periods, where the assets cannot be sold for a set period but can be readily priced based on a public security exchange.

- Second, it provides guidance for situations where the restriction is based on characteristics of the asset that limits if it can be sold in regular markets. An example would be an equity security issued through a private placement and not SEC registered and are legally restricted from being sold on a national securities exchange or an over-the-counter market. These assets would be available to be sold on an existing market (not on the public exchange) but would have a fair value based on the market price of the similar unrestricted equity security adjusted to reflect the effect of the restriction.

Guidance for restricted assets is in *SSAP No. 4—Assets and Nonadmitted Assets*, and additional guidance specific to securities in ASU 2022-03 are included in *SSAP No. 30R—Unaffiliated Common Stock*, *SSAP No. 32R—Preferred Stock*, and *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*. Under these SSAPs, restricted securities are generally considered to be admitted assets to the extent that they can be used to cover policyholder obligations.

Existing Authoritative Literature:
The primary guidance for fair value is in *SSAP No. 100R—Fair Value*. *SSAP No. 30R—Unaffiliated Common Stock* and *SSAP No. 32R—Preferred Stock*, include some guidance on restricted investments involving common and preferred stock, but neither goes into detail on the specific guidance discussed in ASU 2022-03. Additionally, *SSAP No. 1—Accounting Policies, Risks & Uncertainties, and Other Disclosures* and *SSAP No. 4—Assets and Nonadmitted Assets* include references to restricted assets, primarily related to disclosures.

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 a SAP clarification, and expose revisions to *SSAP No. 100R—Fair Value* to adopt *ASU 2022-03, Fair Value Measurement of Equity Securities Subject to Contractual Sale Restrictions* with modification to be consistent with statutory language in the respective statutory accounting statements. Proposed revisions are illustrated below.

Proposed edits to SSAP No. 100R:

Equity Securities Subject to Contractual Sale Restrictions

15. An equity security that an entity cannot sell on the measurement date because of a contractual sale restriction shall be measured at fair value on the basis of the price in the principal (or most advantageous) market[FN]. A contractual sale restriction does not change the market in which that equity security would be sold. A discount applied to the price of an equity security because of a contractual sale restriction is not a characteristic of the equity security. A contractual sale restriction is a characteristic of the reporting entity holding the equity security rather than a characteristic of the asset and, therefore, is not considered in measuring the fair value of an equity security. A contractual sale restriction prohibiting the sale of an equity security is a characteristic of the reporting entity holding the equity security and shall not be separately recognized as its own unit of account.

16. The effect on a fair value measurement arising from a restriction on the sale or use of an asset by a reporting entity will differ depending on whether the restriction would be taken into account by market participants when pricing the asset. When the restriction is a characteristic of the asset, the restriction ~~is a characteristic of the asset and~~ should be considered in measuring the fair value of the asset. For example, an equity security issued through a private placement is not registered and is legally restricted from being sold on a national securities exchange or an over-the-counter market until the shares are registered or the conditions necessary for an exemption from registration have been satisfied. A market participant would sell the private placement equity securities in a different market than the market used for registered equity securities on the measurement date. Because that restriction would be a characteristic of the equity security, a market participant would consider the inability to resell the security on a national securities exchange or an over-the-counter market when pricing the equity security; therefore, the reporting entity that holds the Class A shares acquired through a private placement transaction would consider that restriction a characteristic of the asset, and the reporting entity should measure the fair value of the equity security on the basis of the market price of the similar unrestricted equity security adjusted to reflect the effect of the restriction[FN].

FN—Refer to *SSAP No. 4—Assets and Nonadmitted Assets* for admissibility guidance for restricted equity securities.

60. For equity securities that are subject to contractual sales, disclose the fair value of equity securities subject to contractual sale restrictions.

65. This standard adopts *ASU 2022-03, Fair Value Measurement of Equity Securities Subject to Contractual Sale Restrictions*, with modification to be consistent with statutory language in the respective statutory accounting statements.

Staff Review Completed by: Jake Stultz– NAIC Staff, November 2022

Status:
On December 13, 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. 100R to adopt *ASU 2022-03,*

Fair Value Measurement of Equity Securities Subject to Contractual Sale Restrictions with modification to be consistent with statutory language in the respective statutory accounting statements, as illustrated above. Note that this agenda item does not recommend incorporating the new proposed GAAP disclosures on sales restrictions, but identifies that items restricted as to sale would be captured as restricted assets per SSAP No. 1 and subject to admittance considerations under SSAP No. 4.

On March 22, 2023, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed revisions, as illustrated above, to SSAP No. 100R to adopt ASU 2022-03 with modification to be consistent with statutory language in the respective statutory accounting statements. The adoption does not incorporate the new GAAP disclosures on sales restrictions, as items restricted as to sale would be captured as restricted assets per SSAP No. 1 and subject to admittance considerations under SSAP No. 4.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2023/3-22-23 - Spring/Adoptions/22-16 - ASU 2022-03 - FV.docx

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

Issue: Interest Income Disclosure Update

Check (applicable entity):

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

Description of Issue:
This agenda item is the result of comments received from interested parties from the Principles-Based Bond Project. In the Oct. 7, 2022, comment letter, which provided comments on the Aug. 10 exposure by the Working Group, interested parties suggested some revisions to further enhance reporting of interest income on Schedule D-1-1 Bonds, and recommended that NAIC staff look further at if this should be added to any of the other reporting schedules where interest income is reported in accordance with *SSAP No. 34—Investment Income Due and Accrued*.

There were two distinct items noted in the interested parties' comments that are addressed by this agenda item. First, they suggested data capturing the gross, nonadmitted and admitted amounts for interest income due and accrued. Second, they suggested that a data element that is included in the bond proposal project be changed to reflect the cumulative amount of paid-in-kind (PIK) interest included in the current principal balance.

With this agenda item, the Working Group will sponsor a proposal at the Blanks (E) Working Group to expand disclosures, with data capturing, to include gross, nonadmitted and admitted amounts for interest income due and accrued. The blanks proposal will also include cumulative amounts of paid-in-kind (PIK) interest included in the current principal balances.

Existing Authoritative Literature:
The guidance for disclosure of interest income is included in *SSAP No. 34—Investment Income Due and Accrued*.

Disclosures

7. The following disclosures shall be made for investment income due and accrued in the financial statements. (SSAP No. 37 captures disclosures for mortgage loans on nonaccrual status pursuant to paragraph 6.)

   a. The bases by category of investment income for excluding (nonadmitting) any investment income due and accrued;

   b. Disclose total amount excluded.

8. Refer to the Preamble for further discussion regarding disclosure requirements.

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 noted above, this agenda item comes from a suggestion from interested parties, which was included in their Oct. 7, 2022, comment letter.

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 a SAP clarification, and expose revisions to *SSAP No. 34—Investment Income Due and Accrued* to add additional disclosures to data capture the gross, nonadmitted and admitted amounts for interest income due and to add disclosure of the cumulative amount of paid-in-kind (PIK) interest included in the current principal balance. Adoption of this agenda item will also signify support for a corresponding Blanks (E) Working Group proposal to add these disclosures to Note 7 of the annual statement blanks.

Proposed edits to SSAP No. 34:

Disclosures

7. The following disclosures shall be made for investment income due and accrued in the financial statements. (SSAP No. 37 captures disclosures for mortgage loans on nonaccrual status pursuant to paragraph 6.)

   a. The bases by category of investment income for excluding (nonadmitting) any investment income due and accrued;

   b. Disclose total amount excluded;.

   c. Disclose the gross, nonadmitted and admitted amounts for interest income due and accrued.

   d. Disclose aggregate deferred interest and cumulative amounts of paid-in-kind (PIK) interest included in the current principal balance.

8. Refer to the Preamble for further discussion regarding disclosure requirements.

Staff Review Completed by: Jake Stultz—NAIC Staff, November 2022

Status:
On December 13, 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. 34, to add additional disclosures, as illustrated above, and to data-capture the disclosures.

On March 22, 2023, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed revisions, with minor edits as illustrated below, to SSAP No. 34 to add additional disclosures to data capture the gross, nonadmitted and admitted amounts for interest income due and to add disclosure of the cumulative amount of paid-in-kind (PIK) interest included in the current principal balance. These disclosures are effective for year-end 2023 reporting.

Disclosures

7. The following disclosures shall be made for investment income due and accrued in the financial statements. (SSAP No. 37 captures disclosures for mortgage loans on nonaccrual status pursuant to paragraph 6.)

   a. The bases by category of investment income for excluding (nonadmitting) any investment income due and accrued;

   b. Disclose total amount excluded;

c. Disclose the gross, nonadmitted and admitted amounts for interest income due and accrued;

d. Disclose aggregate deferred interest;

e. Disclose cumulative amounts of paid-in-kind (PIK) interest included in the current principal balance.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2023/3-22-23 - Spring/Adoptions/22-17 - Interest Income.docx

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

Issue: ***ASU 2022-04, Disclosure of Supplier Finance Program Obligations***

Check (applicable entity):

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

Description of Issue:
In September 2022, the Financial Accounting Standards Board (FASB) issued *Accounting Standards Update 2022-04, Liabilities—Supplier Finance Programs (Subtopic 405-50) Disclosure of Supplier Finance Program Obligations.* The Board issued ASU 2022-04 to enhance the transparency of supplier finance programs. ASU 2022-04 is effective for fiscal years beginning after December 15, 2022.

The amendments in ASU 2022-04 apply to all entities that use supplier finance programs in connection with the purchase of goods and services (described as buyer parties). Supplier finance programs, which also may be referred to as reverse factoring, payables finance, or structured payables arrangements, allow a buyer to offer its suppliers the option to access payment in advance of an invoice due date through a third-party finance provider or intermediary on the basis of invoices that the buyer has confirmed as valid.

Typically, a buyer in a program 1) enters into an agreement with a finance provider or an intermediary to establish the program, 2) purchases goods and services from suppliers with a promise to pay at a later date, and 3) notifies the finance provider or intermediary of the supplier invoices that it has confirmed as valid. Suppliers may then request early payment from the finance provider or intermediary for those confirmed invoices. Suppliers generally agree to accept an amount less than owed to receive payment from the intermediary timelier than the invoice due date. The full amount owed by the buyer is then paid to the intermediary, resulting in a spread income to the financing intermediary.

The ASU amendments require that a buyer in a supplier finance program disclose sufficient information about the program to allow a user of financial statements to understand the program's nature, activity during the period, changes from period to period, and potential magnitude. These disclosures were supported as buyers who utilize these programs are getting a form of financing, but the amounts owed to the financial intermediaries have been reported differently, with some entities reporting as trade payables and others reporting as debt. As such, users of the financial statements do not have clear information on the use of these financing structures. ASU 2202-04 requires the buyer to make the following annual disclosures of qualitative and quantitative information about its supplier finance programs:

1. The key terms of the program, including a description of the payment terms (including payment timing and basis for its determination) and assets pledged as security or other forms of guarantees provided for the committed payment to the finance provider or intermediary

2. For the obligations that the buyer has confirmed as valid to the finance provider or intermediary:

    a. The amount outstanding that remains unpaid by the buyer as of the end of the annual period (the outstanding confirmed amount)

    b. A description of where those obligations are presented in the balance sheet

    c. A rollforward of those obligations during the annual period, including the amount of obligations confirmed and the amount of obligations subsequently paid.

In each interim reporting period, the buyer should disclose the amount of obligations outstanding that the buyer has confirmed as valid to the finance provider or intermediary as of the end of the interim period.

SSAP No. 105R—Working Capital Finance Investments addresses programs similar to some of the ones described in ASU 2022-04, however it addresses such programs from the perspective of evaluating investments in such programs for admissibility for the **investor** in such programs. That is, the insurers tend to act as a finance provider or an investor in the supplier chain finance program, not the "buyer." Insurers are not typically "buyers" in such programs as they are described in ASU 2022-04. The guidance in SSAP No. 105R would describe the "buyer" in the ASU 2022-04 as an obligor of the working capital finance program. Therefore, since the disclosures in ASU 2022-04 are for buyers/obligors of supplier finance programs, not for providers of liquidity – the investors, the disclosures do not seem relevant to require of the investors in such programs for statutory accounting.

Note that if an insurer were to sell its premium receivables, existing guidance in S*SAP No. 42—Sale of Premium Receivables* and *SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishment of Liabilities* provide guidance which distinguishes sales from financing transactions. Therefore, the new GAAP disclosures in ASU 2022-04 are not recommended for incorporation into statutory accounting.

Existing Authoritative Literature:
SSAP No. 105R—Working Capital Finance Investments

1. This statement establishes statutory accounting principles for working capital finance investments held by reporting entities. This statement amends *SSAP No. 20—Nonadmitted Assets* (SSAP No. 20) to allow working capital finance investments as admitted assets to the extent they conform to the requirements of this statement.

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):
The Working Group most recently updated SSAP No. 105R with substantive revisions which were effective June 30, 2020. Revisions to SSAP No. 105R were from agenda item 2019-25: Working Capital Finance Notes which also resulted in *Issue Paper No. 163—Working Capital Finance Investment Updates*. In agenda item 2019-25 the Working Group reviewed ten industry requests and incorporated 7 out of 10 revisions to SSAP No. 105R.

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 a SAP clarification, and expose revisions to SSAP No. 105R to reject ASU 2022-04 as illustrated below. As insurance reporting entities are not the buyers (obligors) of supplier chain finance programs, the disclosures in ASU 2022-04 are not relevant. Reporting entities that invest in working capital finance programs are the providers of capital (investors) not the buyers (obligors) of such programs. Revisions to SSAP No. 105R:

33. *ASU 2022-04, Disclosure of Supplier Finance Program Obligations* is rejected.

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

Status:
On December 13, 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. 105R to reject ASU 2022-04 for statutory accounting as the disclosures are not relevant for insurance entity preparers.

On March 22, 2023, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed revisions to SSAP No. 105R, as illustrated above, to reject ASU 2022-04 for statutory accounting.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2023/3-22-23 - Spring/Adoptions/22-18 ASU 2022-04 supply chain .docx

Adopted by the Life Actuarial (A) Task Force – Dec. 11, 2022
Adopted by the Life Insurance and Annuities (A) Committee – Feb. 24, 2023
Adopted by the Executive (EX) Committee and Plenary – March 25, 2023

Actuarial Guideline XLIX-A

THE APPLICATION OF THE LIFE ILLUSTRATIONS MODEL REGULATION TO POLICIES WITH INDEX-BASED INTEREST SOLD (On or After December 14, 2020)

Background

The *Life Insurance Illustrations Model Regulation* (#582) was adopted by the NAIC in 1995. Since that time there has been continued evolution in product design, including the introduction of benefits that are tied to an index or indices. Although these policies are subject to Model #582, not all of their features are explicitly referenced in the model, resulting in a lack of uniform practice in its implementation. In the absence of uniform guidance, two illustrations that use the same index and crediting method often illustrated different credited rates. The lack of uniformity can be confusing to potential buyers and can cause uncertainty among illustration actuaries when certifying compliance with Model #582.

~~In 2019, the NAIC decided that illustrations of products with multipliers, cap buy-ups, and other enhancements that are linked to an index or indices should not illustrate better than products without such features. This new requirement is intended to apply to illustrations on policies sold on or after the effective date of this guideline while the existing requirements continue to apply for inforce illustrations on policies sold before the effective date of this guideline.~~

This guideline provides uniform guidance for policies with index-based interest. In particular, this guideline:

(1) Provides guidance in determining the maximum crediting rate for the illustrated scale and the earned interest rate for the disciplined current scale.

(2) Limits the policy loan leverage shown in an illustration.

(3) Requires additional consumer information (side-by-side illustration and additional disclosures) that will aid in consumer understanding.

Text

1. Effective Date

This Actuarial Guideline shall be effective for all new business and in force illustrations on policies sold on or after December 14, 2020.

2. Scope

This Actuarial Guideline shall apply to any life insurance illustration that meets both (i) and (ii), below:

i. The policy is subject to Model #582.

ii. The policy offers Indexed Credits.

3. Definitions

A. Alternate Scale: A scale of non-guaranteed elements currently being illustrated such that:

i. The Annual Rate of Indexed Credits for each Index Account does not exceed the lesser of the maximum Annual Rate of Indexed Credits for the illustrated scale less 100 basis points and the credited rate for the Fixed Account. If the insurer does not offer a Fixed Account with the illustrated policy, the Annual Rate of Indexed Credits for each Index Account shall not exceed the average of the maximum Annual Rate of Indexed Credits for the illustrated scale and the guaranteed Annual Rate of Indexed Credits for that account. However, the Annual Rate of Indexed Credits for each Index Account shall never be less than the guaranteed Annual Rate of Indexed Credits for that account.

ii. If the illustration includes a loan, the illustrated Policy Loan Interest Credited Rate shall not exceed the illustrated Policy Loan Interest Rate. For example, if the illustrated Policy Loan Interest Rate is 4%, the Policy Loan Interest Credited Rate shall not exceed 4%.

iii. All other non-guaranteed elements are equal to the non-guaranteed elements for the illustrated scale.

B. Annual Net Investment Earnings Rate: Gross portfolio annual earnings rate of the general account assets (excluding hedge assets for Indexed Credits), less provisions for investment expenses and default cost, allocated to support the policy. Charges of any kind cannot be used to increase the Annual Net Investment Earnings Rate.

C. Annual Rate of Indexed Credits: The total annualized Indexed Credits expressed as a percentage of the account value used to determine the Indexed Credits.

D. Benchmark Index Account: An Index Account with the following features:

i. The interest calculation is based on the percent change in S&P 500® Index value only, over a one-year period using only the beginning and ending index values. (S&P 500® Index ticker: SPX)

ii. An annual cap is used in the interest calculation.

iii. The annual floor used in the interest calculation shall be 0%.

iv. The participation rate used in the interest calculation shall be 100%.

v. Interest is credited once per year.

vi. The Hedge Budget used to determine the cap in 3 (D) (ii) does not exceed the Annual Net Investment Earnings Rate. Charges of any kind cannot be used to increase the annual cap.

vii. There are no enhancements or similar features that provide additional Indexed Credits in excess of the interest provided by 3 (D) (i) through 3 (D) (v), including but not limited to experience refunds, multipliers, or bonuses.

viii. There are no limitations on the portion of account value allocated to the account.

ix. A single Benchmark Index Account will be determined for each policy. This can be either an Index Account offered with the illustrated policy or determined according to Section 4 (A) (ii) for purposes of complying with this guideline. A policy shall have no more than one Benchmark Index Account.

E. Fixed Account: An account where there are no Indexed Credits.

F. Hedge Budget: For each Index Account, the total annualized amount assumed to be used to generate the Indexed Credits of the account, expressed as a percent of the account value in the Index Account. This total annualized amount should be consistent with the hedging program of the company.

G. Index Account: An account where some or all of the amounts credited are Indexed Credits.

H. Indexed Credits: Any interest credit, multiplier, factor, bonus, charge reduction, or other enhancement to policy values that is linked to an index or indices. Amounts credited to the policy resulting from a floor greater than zero on an account with any interest credit, multiplier, factor, bonus, charge reduction, or other enhancement to policy values that is linked to an index or indices are included.

I. Loan Balance: Any outstanding policy loan and loan interest, as defined in the policy.

J. Policy Loan Interest Rate: The current annual interest rate as defined in the policy that is charged on any Loan Balance. This does not include any other policy charges.

K. Policy Loan Interest Credited Rate: The annualized interest rate credited that applies to the portion of the account value backing the Loan Balance:

i. For the portion of the account value in the Fixed Account that is backing the Loan Balance, the Policy Loan Interest Credited Rate is the applicable annual interest crediting rate.

ii. For the portion of the account value in an Index Account that is backing the Loan Balance, the Policy Loan Interest Credited Rate is the Annual Rate of Indexed Credits, net of any applicable Supplemental Hedge Budget, for that account.

L. Supplemental Hedge Budget: For each Index Account, the Hedge Budget minus the minimum of the Annual Net Investment Earnings Rate and the Hedge Budget that is used in the determination of the Benchmark Index Account. The Supplemental Hedge Budget will never be less than zero. This amount should be consistent with the hedging program of the company.

4. Illustrated Scale

The total Annual Rate of Indexed Credits for the illustrated scale for each Index Account shall be limited as follows:

A. Calculate the geometric average annual credited rate for the Benchmark Index Account for the 25-year period starting on 12/31 of the calendar year that is 66 years prior to the current calendar year (e.g., 12/31/1949 for 2015 illustrations) and for each 25-year period starting on each subsequent trading day thereafter, ending with the 25- year period that ends on 12/31 of the prior calendar year.

i. If the insurer offers a Benchmark Index Account with the illustrated policy, the illustration actuary shall use the current annual cap for the Benchmark Index Account in 4 (A).

ii. If the insurer does not offer a Benchmark Index Account with the illustrated policy, the illustration actuary shall use actuarial judgment to determine a hypothetical, supportable current annual cap for a hypothetical, supportable Index Account that meets the definition

of the Benchmark Index Account, and shall use that cap in 4 (A).

B. For the Benchmark Index Account the Annual Rate of Indexed Credits shall not exceed the minimum of (i) and (ii):

i. The arithmetic mean of the geometric average annual credited rates calculated in 4 (A).

ii. 145% of the Annual Net Investment Earnings Rate.

C. For any other Index Account that is not the Benchmark Index Account in 3 (D), the Annual Rate of Indexed Credits illustrated as a percentage of the account value in the Index Account prior to the deduction of any charges used to fund a Supplemental Hedge Budget shall not exceed the minimum of (i) and (ii) for policies sold prior to May 1, 2023, and shall not exceed the minimum of (i), (ii), and (iii) for policies sold on or after May 1, 2023:

i. The Annual Rate of Indexed Credits for the Benchmark Index Account calculated in 4 (B) plus the Supplemental Hedge Budget for the Index Account.

ii. The Annual Rate of Indexed Credits reflecting the fundamental characteristics of the Index Account and the appropriate relationship to the expected risk and return of the Benchmark Index Account. The illustration actuary shall use actuarial judgment to determine this value using lookback methodology consistent with 4 (A) and 4 (B) (i) where appropriate.

iii. The lesser of (1) and (2) multiplied by the Annual Rate of Index Credits for the Benchmark Index Account, calculated in 4 (B), divided by (2); plus, the Supplemental Hedge Budget for the Index Account:

1. The Hedge Budget of the Index Account

2. Hedge Budget of the Benchmark Index Account.

D. For the purposes of compliance with Section 6 (C) of Model #582, the Supplemental Hedge Budget is subtracted from the Annual Rate of Indexed Credits before comparing to the earned interest rate underlying the disciplined current scale.

At the beginning of each calendar year, the insurer shall be allowed up to three (3) months to update the credited rate for each Index Account in accordance with 4 (B) and 4 (C).

5. Disciplined Current Scale

The earned interest rate for the disciplined current scale shall be limited as follows:

A. If an insurer engages in a hedging program for Indexed Credits in an account, the assumed earned interest rate underlying the disciplined current scale for that account, inclusive of all general account assets, both hedge and non-hedge assets, that support the policy, net of default costs and investment expenses (including the amount spent to generate the Indexed Credits of the policy) shall not exceed the lesser of (i) and (ii):

i. The Annual Net Investment Earnings Rate, plus 45% of the lesser of (1) and (2):

1. Hedge Budget minus any annual floor, to the extent that the floor is supported by the Hedge Budget.

2. The minimum of the Annual Net Investment Earnings Rate and the Hedge Budget that is used in the determination of the Benchmark Index Account.

ii. The Annual Rate of Indexed Credits plus the Annual Net Investment Earnings Rate minus the Hedge Budget.

These rates should be adjusted for timing differences in the hedge cash flows to ensure that fixed interest is not earned on the Hedge Budget minus any annual floor, to the extent that the floor is supported by the Hedge Budget.

Guidance Note: The above approach does not stipulate any required methodology as long as it produces a consistent limit on the assumed earned interest rate underlying the disciplined current scale.

For a policy with multiple Index Accounts, a maximum rate in 5 (A) should be calculated for each account. All accounts, fixed and indexed, within a policy can be tested in aggregate.

B. If an insurer does not engage in a hedging program for Indexed Credits, the assumed earned interest rate underlying the disciplined current scale shall not exceed the Annual Net Investment Earnings Rate.

C. These experience limitations shall be included when testing for self-support and lapse-support under Model #582, accounting for all illustrated benefits including any illustrated benefits and bonuses that impact the policy's account value.

6. Policy Loans

If the illustration includes a loan, the illustrated Policy Loan Interest Credited Rate shall not exceed the illustrated Policy Loan Interest Rate by more than 50 basis points. For example, if the illustrated Policy Loan Interest Rate is 4.00%, the Policy Loan Interest Credited Rate shall not exceed 4.50%.

7. Additional Standards

The basic illustration shall also include the following:

A. A ledger using the Alternate Scale shall be shown alongside the ledger using the illustrated scale with equal prominence.

B. A table showing the minimum and maximum of the geometric average annual credited rates calculated in 4 (A).

C. For each Index Account illustrated, a table showing actual historical index changes and corresponding hypothetical Indexed Credits using current index parameters for the most recent 20-year period.

Adopted by the Life Actuarial (A) Task Force – Dec. 11, 2022
Adopted by the Life Insurance and Annuities (A) Committee – Feb. 24, 2023
Adopted by the Executive (EX) Committee and Plenary – March 25, 2023

Actuarial Guideline LIV

Nonforfeiture Requirements for Index-Linked Variable Annuity Products

Background

The purpose of this guideline is to specify the conditions under which an Index-Linked Variable Annuity (ILVA) is consistent with the definition of a variable annuity and exempt from Model 805 and specify nonforfeiture requirements consistent with variable annuities.

A number of insurers have developed and are issuing annuity products with credits based on the performance of an index with caps on returns, participation rates, spreads or margins, or other crediting elements, that include a risk of negative index returns subject to limitations on the loss, such as a floor or a buffer. These products are not unitized and do not invest directly in the assets whose performance forms the basis for the credits.

There is no established terminology for these annuity products. These products go by several names, including structured annuities, registered index-linked annuities (RILA), or index-linked variable annuities, among others. This guideline refers to these products as index-linked variable annuities (ILVA).

Variable annuities are exempted from the scope of NAIC Model 805, *Standard Nonforfeiture Law for Individual Deferred Annuities;* however, NAIC Model 805 does not define the term "variable annuity".

NAIC Model 250, *Variable Annuity Model Regulation*, defines variable annuities as “contracts that provide for annuity benefits that vary according to the investment experience of a separate account.” Section 7B of NAIC Model 250 provides that "to the extent that a variable annuity contract provides benefits that do not vary in accordance with the investment performance of a separate account" the contract shall satisfy the requirements of the NAIC Model 805.

The application of the NAIC Model 250 to a traditional variable annuity with unitized values is straightforward. The unitized feature provides an automatic linkage between annuity values and the investment experience of a separate account. Daily values (market values of the separate account assets) are the basis of all the benefits, including surrender values.

The fact that ILVA accounts are not unitized means they do not have values determined directly by the market prices of the underlying assets. Therefore, this guideline sets forth principles and requirements for determining values, including death benefit, withdrawal amount, annuitization amount or surrender values, such that an ILVA is considered a variable annuity and thereby exempt from Model 805. An ILVA that does not comply with the principles and requirements of this guideline is not considered a variable annuity and therefore is subject to Model 805.

Drafting Note: This guideline interprets the term “variable annuity” for purposes of exemption from Model 805. It is not intended to modify the definition of a variable annuity under Model 250 or other Model Regulations.

Scope

This guideline applies to any index-linked annuity exempt from the NAIC Model 805 on the basis that it is a variable annuity and includes index-linked crediting features that are built into policies or contracts (with or without unitized subaccounts) or added to such by rider, endorsement, or amendment.

Principles

This guideline is based on the following principles:

1. Interim Values defined in the contract provide equity between the contract holder and the insurance company.
2. Interim Values are consistent with the value of the Hypothetical Portfolio over the Index Strategy Term.

Definitions

"Derivative Asset Proxy" means a package of hypothetical derivative assets established at the beginning of an Index Strategy Term that is designed to replicate credits provided by an Index Strategy at the end of an Index Strategy Term.

"Fixed Income Asset Proxy" is a hypothetical fixed income asset.

"Hypothetical Portfolio" means a hypothetical portfolio composed of a Fixed Income Asset Proxy and a Derivative Asset Proxy.

"Index" means a benchmark designed to track the performance of a defined portfolio of securities.

"Index Strategy" means a method used to determine index credits with specified index or indices and cap, buffer, participation rate, spread, margin or other index crediting elements.

"Index Strategy Base" means the notional amount used to determine index credits that does not change throughout the Index Strategy Term except for withdrawals, transfers, deposits, loans, and any explicit charges.

"Index Strategy Term" means the period of time from the term start date to the term end date over which an index changes and the index credit is determined.

"Interim Value" means the Strategy Value at any time other than the start date and end date of an Index Strategy Term.

"Strategy Value" means the value, attributable to an Index Strategy, used in determining values including death benefit, withdrawal amount, annuitization amount or surrender values.

"Trading Cost" means the additional cost of liquidating the derivative assets in the Derivative Asset Proxy or actual derivative assets supporting the Index Strategy that is not accounted for in the Derivative Asset Proxy calculation.

Text

The Index Strategy Base must equal the Strategy Value at the Index Strategy Term start date.

The Fixed Income Asset Proxy is assumed to be a hypothetical fixed income asset with a yield that results in

i. At the beginning of the Index Strategy Term, the book value of the Fixed Income Asset Proxy equal to the Index Strategy Base less the Derivative Asset Proxy value; and
ii. At the end of the Index Strategy Term, the book value of the Fixed Income Asset Proxy, assuming no change in yield, projected to equal the Index Strategy Base.

Drafting Note: The guideline defines the conditions under which an index-linked variable annuity is exempt from Model 805 on the basis that it is a variable annuity. A variable annuity provides daily values (analogous to Interim Values in this guideline) based on the market value of separate account assets. In order to more closely align an ILVA to a variable annuity Interim Values should be consistent with the market value of hypothetical assets supporting the ILVA (i.e. Hypothetical Portfolio). The market value of the assets may be determined by a fair value methodology or by applying an MVA to the book value. A state may want to consider whether including or

excluding an MVA is appropriate. In making a determination regarding whether including or excluding an MVA is appropriate and, if applicable, what an acceptable MVA formula is, the state should consider whether the Interim Values provide reasonable equity between the contract holder and the insurance company.

The value of the package of derivative assets is determinable daily. Assumptions used to determine the market value of the Derivative Asset Proxy including implied volatilities, risk-free rates, and dividend yields must be consistent with the observable market prices of derivative assets, whenever possible.

Interim Values must be materially consistent with the value of the Hypothetical Portfolio over the Index Strategy Term less a provision for the cost attributable to reasonably expected or actual Trading Costs at the time the Interim Value is calculated.

If a contract provides Interim Values determined using a methodology other than a Hypothetical Portfolio methodology as described in this guideline, the company must demonstrate that the contractually defined Interim Values will be materially consistent over the Index Strategy Term with the Interim Values that would be produced using the Hypothetical Portfolio methodology for each combination of Index Strategy and Index Strategy Term under a reasonable number of realistic economic scenarios that include index changes that test crediting constraints and recognize initial option pricing market conditions.

The company must provide an actuarial memorandum with each ILVA product filing that includes the following:

1. Actuarial certifications must be included with each ILVA product filing and must include the following:
    a. Interim Values defined in the contract provide equity between the contract holder and the insurance company;
    b. The assumptions used to determine the market value of the Derivative Asset Proxy including implied volatilities, risk-free rates, dividend yields, and other parameters required to value the derivatives are consistent with the observable market prices of derivative assets over the Index Strategy Term, whenever possible. Valuation techniques include the standard Black-Scholes method, Monte-Carlo Simulation techniques, and other market consistent option valuation techniques for more complex options;
    c. The contractually defined Interim Values are materially consistent with the Interim Values that would be produced using the Hypothetical Portfolio methodology for each combination of Index Strategy and Index Strategy Term over the Index Strategy Term less a provision for the Trading Costs at the time the Interim Value is calculated; and
    d. Any Trading Costs represent reasonably expected or actual costs at the time the Interim Value is calculated.

2. If the Interim Values are determined using a methodology other than the Hypothetical Portfolio methodology described in this guideline, the actuary shall describe the testing performed to verify that the values are materially consistent with the Hypothetical Portfolio methodology. The actuary should define any parameters or assumptions used in determining material consistency and provide a summary of the results of the testing.

3. Descriptions of
    a. The value of the Fixed Income Asset Proxy;
    b. The market value adjustment formula, if any;
    c. The market value of the Derivative Asset Proxy including any Trading Costs; and
    d. All formulas, methodologies and assumptions used to calculate these values for each Index Strategy and Index Strategy Term as well as the sources for all assumptions.

    ILVA nonforfeiture benefits for Index Strategies subject to this guideline must comply with Section 7 of Model 250 not including Section 7.B with net investment return consistent with the requirements for determining Interim Values in this guideline.

Effective Date

The Guideline applies to all contracts (including associated riders, endorsements, or amendments) issued on or after July 1, 2024.

Revisions to the
As of March 2023 Accounting Practices and Procedures Manual

On **May 16, 2023**, the Statutory Accounting Principles (E) Working Group adopted the following revisions to the *As of March 2023 Accounting Practices and Procedures Manual*. Documents associated with these revisions are linked to the reference items in bold text.

Ref #	SSAP/ Appendix	Title	Summary
INT 22-02	SSAP No. 9 SSAP No. 101	INT 22-02: Third Quarter 2022 through Second Quarter 2023 Reporting of the Inflation Reduction Act - Corporate Alternative Minimum Tax *SAP Clarification* Effective Immediately (May 16, 2023)	Adoption of *INT 22-02* extends this interpretation for the second quarter 2023 statutory financial statements. For application to the second quarter 2023 financial statements, reporting entities shall follow the guidance in this interpretation paragraphs 17 a-c.
2023-11EP	SSAP No. 86 Various	Editorial and Maintenance Update *Editorial Revisions* Effective Immediately (May 16, 2023)	Revisions change SSAP No. 86 references of "Intrinsic Value" to reflect "Volatility Value". In addition, "percent" is changed to "%" and all citations to *the Purposes and Procedures Manual of the NAIC Investment Analysis Office* are streamlined so they do not reflect a specific location in the Manual or a webpage.

https://naiconline.sharepoint.com/teams/frsstatutoryaccounting/national meetings/a. national meeting materials/2023/-23/adoptions/adoptions .2023 toc.docx

Interpretation of the
Statutory Accounting Principles (E) Working Group

INT 22-02: Third Quarter 2022 through ~~First~~ Second Quarter 2023 Reporting of the Inflation Reduction Act - Corporate Alternative Minimum Tax

INT 22-02 Dates Discussed

October 6, 2022; October 24, 2022, November 16, 2022; December 13, 2022; April 12, 2023; May 16, 2023

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 "applicable 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 corporation for purposes of 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, an applicable 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[1] 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 on October 24, 2022, 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.

17. On December 13, 2022, the Working Group adopted a consensus to extend this interpretation for December 31, 2022, and first quarter 2023 statutory financial statements. For application as of year-end 2022 and first quarter 2023:

a. Consistent with paragraphs 12 and 13, the Working Group has concluded that a reasonable estimate is not determinable for December 31, 2022, and March 31, 2023, therefore impacts related to the CAMT in the year-end 2022 and March 31, 2023, financial statements are not required.

~~b. The reporting entity shall include disclosures in paragraph 13 in the year-end 2022 and March 31, 2023, financial statements. In addition, the reporting entity shall disclose the following:~~

~~i. If, based on information regarding the projected adjusted financial statement income for 2023, the entity or the controlled group of corporations of which the reporting entity is a member has determined if it is an "applicable corporation" to determine if CAMT exceeds the regular federal income tax payable. That is, disclose if the reporting entity (or the controlled group of corporations of which the reporting entity is a member) has determined if average "adjusted financial statement income" is above the thresholds for 2023 tax year that they expect to be required to perform the CAMT calculations. This disclosure is about being applicable corporation, not if the entity is required to pay.~~

~~c.~~b. Consistent with paragraph 14, CAMT updated estimates or other calculations affected by the Act determined subsequent to filing the December 31, 2022, and March 31, 2023, financial statements shall not be recognized as Type I subsequent events.

~~d.~~c. For year-end 2022 financial statements, the subsequent event exception is expanded to encompass events that occur prior to the issuance of statutory financial statements as well as events that occur before the date the audited financial statements are issued, or available to be issued. This provision intends to prevent reporting entities from having to amend statutory financial statements from material Type I subsequent events as a result of updated information / estimates received after the reporting date of year-end 2022 statutory financial statements pertaining to the accounting for the enactment of the Act.

18. On May 16, 2023, the Working Group adopted a consensus to extend this interpretation for the second quarter 2023 statutory financial statements. For application to the second quarter 2023 financial statements, reporting entities shall follow the guidance in this interpretation paragraphs 17.a. through 17.c.

~~18.~~19. With the extension, this interpretation will be automatically nullified on ~~June 15, 2023~~August 16, 2023.

~~19.~~20. No. further discussion is planned.

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NAIC Accounting Practices and Procedures Manual
Editorial and Maintenance Update
May 16, 2023

Maintenance updates provide revisions to the *Accounting Practices and Procedures Manual*, such as editorial corrections, reference changes and formatting.

SSAP/Appendix	Description/Revision
SSAP No. 86	Paragraph 43.g.ii.: Revise "Intrinsic Value" to reflect "Volatility Value"
P&P Manual References	All citations to the *Purposes and Procedures Manual of the NAIC Investment* Analysis *Office* (P&P Manual) are proposed to be reviewed and streamlined so they do not reflect a specific location in the P&P Manual or web page. These references will be eliminated to prevent inappropriate citations.
Percent References	Instances in which 'percent' is spelled out in combination with a number will be eliminated with retention of the % sign. This is a consistency change as the usage is currently inconsistent within the AP&P Manual.

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

SSAP No. 86R—Derivatives
Revise the reference to "Intrinsic Value" to reflect "Volatility Value." This change was proposed by industry to clarify the disclosure category for the excluded component to the Blanks (E) Working Group and a corresponding revision is needed in SSAP No. 86R.

43.a. 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 gain/loss.

ii. In the notes to the financial statements, provide information on the aggregate excluded components by category: Time Value, ~~Intrinsic~~ Volatility Value, Forward Points and Cross Currency Basis Spread. The aggregate amounts reported should include the following (as applicable): current fair value, recognized unrealized gain/loss, the fair value reflected in BACV, and for the excluded forward points (e.g., forward spot rates), the aggregate amount owed at maturity, along with current year and remaining amortization.

Purposes and Procedure Manual References
The following SSAPs will be revised to update references to the P&P Manual.

SSAP No. 25—Affiliates and Other Related Parties

21.h. The amount deducted from the value of an upstream intermediate entity or ultimate parent owned, either directly or indirectly, via a downstream subsidiary, controlled, or affiliated entity, in accordance with *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities.* ~~the *Purposes and Procedure Manual of the NAIC Investment Analysis Office*, "Procedures for Valuing Common Stocks and Stock Warrants."~~

SSAP No. 26R—Bonds

4.a. Exchange traded funds (ETFs), which qualify for bond treatment, as identified in ~~Part Three of~~ the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* and published on the SVO web page ~~at *https://content.naic.org/industry/securitiesvaluation- office*~~. (SVO-identified ETFs are reported on Schedule D – Part 1.)

SSAP No. 30R—Unaffiliated Common Stock

4.c. Shares of SEC registered Investment Companies3 captured under the Investment Company Act of 1940 (open-end investment companies (mutual funds), closed-end funds and unit investment trusts), regardless of the types or mix of securities owned by the fund (e.g., bonds or stocks), including shares of funds referenced in the "NAIC Fixed Income-Like SEC Registered Funds List" as identified in ~~Part Three of~~ the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* and published on the SVO web page.~~;~~

4.d. Exchange Traded Funds, except for those identified for bond or preferred stock treatment, as identified in ~~Part Three of~~ the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* and published on the SVO web page ~~at *https://content.naic.org/industry/securities-valuation-office*~~;

SSAP No. 32R—Preferred Stock

4.a. Exchange Traded Funds, which qualify for preferred stock treatment, as identified in ~~Part Three of~~ the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* and published on the SVO web page ~~at *https://content.naic.org/industry/securities-valuationoffice*~~. SVO-identified preferred stock ETFs shall follow the accounting provisions for perpetual preferred stock.

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

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.

Percent References

The following SSAPs will be revised to update the percent reference.

SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets:

13. As directed by *SSAP No. 101—Income Taxes*, tax loss contingencies (including related interest and penalties) for current and all prior years, shall be computed in accordance with this SSAP, with the following modifications:

    a. The term "probable" as used in this standard shall be replaced by the term "more likely than not (a likelihood of more than 50% ~~percent~~)" for federal and foreign income tax loss contingencies only.

    b. For purposes of the determination of a federal and foreign income tax loss contingency, it shall be presumed that the reporting entity will be examined by the relevant taxing authority that has full knowledge of all relevant information.

    c. If the estimated tax loss contingency is greater than 50% ~~percent~~ of the tax benefit originally recognized, the tax loss contingency recorded shall be equal to 100% ~~percent~~ of the original tax benefit recognized.

As noted in SSAP No. 101, state taxes (including premium, income and franchise taxes) shall also be computed in accordance with this SSAP. These items (as detailed in SSAP No. 101) are not impacted by the modifications detailed in paragraphs 13.a.-13.c.

SSAP No. 16R—Electronic Data Processing Equipment and Software

4. The aggregate amount of admitted EDP equipment and operating system software (net of accumulated depreciation) shall be limited to 3% ~~three percent~~ of the reporting 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 EDP equipment and operating system software, net deferred tax assets and net positive goodwill.(INT 01-18)

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

FN 10: Changes in the interest rate of a "plain-vanilla," variable-rate beneficial interest (a plain-vanilla, variable-rate beneficial interest does not include those variable-rate beneficial interests with interest rate reset formulas that involve either leverage or an inverse floater) generally should not result in the recognition of an other-than-temporary impairment. For plain-vanilla, variable-rate beneficial interests, the yield is changed to reflect the revised interest rate based on the contractual interest rate reset formula. For example, if a beneficial interest pays interest quarterly at a rate equal to LIBOR plus 2% ~~percent~~, the yield of that beneficial interest is changed prospectively to reflect changes in LIBOR. However, changes in the fair value of a plain-vanilla, variable-rate beneficial interest due to credit events should be considered when evaluating whether there has been an other-than-temporary impairment.

SSAP No. 57—Title Insurance

19.g. An investment in a title plant or plants in an amount equal to the actual cost shall be allowed as an admitted asset for title insurers. The aggregate carrying value of an investment in a title plant or plants shall not exceed the lesser of 20% of admitted assets or ~~forty percent (~~40%~~)~~ of surplus to policyholders, both as required to be shown on the statutory balance sheet of the insurer for its most recently filed statement with the domiciliary state commissioner; if the amount of the investment exceeds the above limits, the excess amount shall be recorded as a nonadmitted asset.

SSAP No. 60—Financial Guarantee Insurance

10. The contingency reserve shall be the greater of 50%~~fifty percent~~ of premiums written for each category or the amount provided by applying the following percentages to the principal guaranteed in each calendar year. The premiums written shall be net of reinsurance if the reinsurer has established a contingency reserve.

a.	Municipal obligation bonds	0.55%~~ percent~~
b.	Special revenue bonds	0.85%~~ percent~~
c.	Investment grade Industrial Development Bonds (IDBs) secured by collateral or having a term of seven years or less, and utility first mortgage obligations	1.00%~~ percent~~
d.	Other investment grade IDBs	1.50%~~ percent~~
e.	Other IDBs	2.50%~~ percent~~
f.	Investment grade obligations, secured by collateral or having a term of seven years or less	1.00%~~ percent~~
g.	Other investment grade obligations not secured	1.50%~~ percent~~
h.	Non-investment grade consumer debt obligations	2.00%~~ percent~~
i.	Non-investment grade asset backed securities	2.00%~~ percent~~
j.	All other non-investment grade obligations	2.50%~~ percent~~

SSAP No. 62R—Property and Casualty Reinsurance

116.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

116.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.

Exhibit C – Assumptions

Premium = $1,000 (assumes no commissions or allowances)
Coverage Period = 1 year
Initial expected recoveries = $225 per year (at end of year) for five years
Initial Implicit rate = 4%~~ percent~~*

*present value of $225 per year for five years at 4%~~ percent~~ = $1,000

At the end of Year 2, the timing of anticipated recoveries under the reinsurance contract changes. A reevaluation of the implicit interest rate produces a rate of 3.63%~~ percent~~ and an asset of $640 at the end of the year.

SSAP No. 65—Property and Casualty Contracts

37. If the reporting entity does not hold specific collateral for the policy, amounts accrued for reimbursement of the deductible shall be billed in accordance with the provisions of the policy or the contractual agreement and shall be aged according to the contractual due date. In the absence of a contractual due date, billing date shall be utilized for the aging requirement. Deductible recoverables that are greater than ninety days old shall be nonadmitted. However, if the reporting

entity holds specific collateral for the high deductible policy, 10%~~ten percent~~ of deductible recoverable in excess of collateral specifically held and identifiable on a per policy basis, shall be reported as a nonadmitted asset in lieu of applying the aging requirement; however, to the extent that amounts in excess of the 10% are not anticipated to be collected they shall also be nonadmitted. The collateral requirements of this paragraph may be satisfied when an insured provides one collateral instrument to secure amounts owed under multiple policies, provided that the reporting entity has the contractual right to apply the collateral to the high deductible policy. Collateral obtained at a group level that is not supported by an existing pooling agreement requires a written allocation agreement among all collateral beneficiaries. The terms of such agreement must be fair and equitable. Documentation supporting any allocation of collateral among reporting entities must be maintained to allow proper calculation of the nonadmitted amounts and prohibit double counting of collateral.

SSAP No. 78—Multiple Peril Crop Insurance

3. Catastrophic insurance is designed to provide farmers with protection against extreme crop losses for a small processing fee. Buy-up insurance provides protection against more typical and smaller crop losses in exchange for a policyholder-paid premium. The government subsidizes the total premium for catastrophic insurance and a portion of the premium for buy-up insurance. Farmers who purchase buy-up crop insurance must choose both the coverage level (the proportion of the crop to be insured) and the unit price (such as, per bushel) at which any loss is calculated. With respect to the coverage level of production, farmers can choose to insure as much as 85% ~~percent~~ of normal production or as little as 50% ~~percent~~ of normal production at different price levels. With respect to the unit price, farmers choose whether to value their insured production at FCICs full estimated market price or at a percentage of the full price.

5. Companies participate in the MPCI program with FCIC through the Standard Reinsurance Agreement (SRA) per the terms of which the insurance companies share in the underwriting results of each policy. The SRA reinsurance terms provide a company the flexibility to limit its exposure on a state-by-state basis. MPCI premium is not expense loaded, therefore FCIC pays the insurance companies, on behalf of the policyholder, a percent of premium for administrative expenses associated with selling and servicing crop insurance policies, including the expenses associated with adjusting claims.

15. FCIC pays the insurance companies a percent of premium for administrative expenses associated with selling and servicing crop insurance policies, including the expenses associated with adjusting claims. The expense payment associated with the catastrophic coverage shall be recorded as a reduction of loss expenses whereas the expense payment for the buy-up coverage shall be recorded as a reduction of other underwriting expenses. The company shall disclose the total amounts received for each type of coverage.

SSAP No. 86—Derivatives

26.c. The term highly effective describes a cash flow hedging relationship where the change in fair value of the derivative hedging instrument is within 80 to 125% ~~percent~~ of the opposite change in the fair value of the hedged item attributable to the hedged risk. It shall also apply when an R-squared of .80 or higher is achieved when using a regression analysis technique. Further guidance on determining effectiveness can be found within Exhibit A;

27.c. The term highly effective describes a cash flow hedging relationship where the change in cash flows or present value of cash flows of the derivative hedging instrument is within 80 to 125% ~~percent~~ of the opposite change in the cash flows or present value of the cash flows of the hedged item attributable to the hedged risk. It shall also apply when an R-squared of .80 or higher is achieved when using a regression analysis technique. Further guidance on determining effectiveness can be found within Exhibit A.

Exhibit A, 19.c.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.

Exhibit A, 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~~.

SSAP No. 92—Postretirement Benefits Other Than Pensions

49. As a minimum, amortization of a net gain or loss included in unassigned funds (surplus) shall be included as a component of net periodic postretirement benefit cost for a year if, as of the beginning of the year, that net gain or loss exceeds 10% ~~percent~~ of the greater of the accumulated postretirement benefit obligation or the fair value of plan assets. If amortization is required, the minimum amortization shall be that excess divided by the average remaining service period of active plan participants. If all or almost all of a plan's participants are inactive, the average remaining life expectancy of the inactive participants shall be used instead of the average remaining service period.

75. An employer shall disclose the amount of contributions to multiemployer plans for each annual period for which a statement of income is presented. An employer may disclose total contributions to multiemployer plans without disaggregating the amounts attributable to pension plans and other postretirement benefit plans. The disclosures shall include a description of the nature and effect of any changes affecting comparability, such as a change in the rate of employer contributions, a business combination, or a divestiture. This disclosure shall identify whether the contributions represent more than 5% ~~percent~~ of total contributions to the plan as indicated in the plan's most recently available annual report.

108.b.i ~~Ten~~10% ~~percent~~ of the calculated surplus impact as of the transition date; and

SSAP No. 93—Low-Income Housing Tax Credit Property Investments

Exhibit A Assumptions

1. All cash flows (except initial investment) occur at the end of each year.

2. Depreciation expense is computed, for book and tax purposes, using the straight-line method with a 27.5 year life (the same method is used for simplicity).

3. The investor made a $100,000 investment for a 5% ~~percent~~ limited partnership interest in the project at the beginning of the first year of eligibility for the tax credit.

4. The partnership finances the project cost of $4,000,000 with 50% ~~percent~~ equity and 50% ~~percent~~ debt.

5. The annual tax credit allocation (equal to 4% ~~percent~~ of the project's original cost) will be received for a period of 10 years.

6. The investor's tax rate is 40% ~~percent~~.

Chart Footnotes:

(1) End-of-year investment for a 5% ~~percent~~ limited liability interest in the project net of amortization in Column (2).

(3) 4% ~~Four percent~~ tax credit on $200,000 tax basis of the underlying assets.

SSAP No. 100R—Fair Value

52.g. If a group of investments would otherwise meet the criteria in paragraph 45 but the individual investments to be sold have not been identified (for example, if a reporting entity decides to sell 20% ~~percent~~ of its investments in private equity funds but the individual investments to be sold have not been identified), so the investments continue to qualify for the practical expedient in paragraph 39, the reporting entity shall disclose its plans to sell and any remaining actions required to complete the sale(s).

SSAP No. 101—Income Taxes

2. For purposes of accounting for federal and foreign income taxes, reporting entities shall adopt *FASB Statement No. 109, Accounting for Income Taxes* (FAS 109) with modifications for state income taxes[INT 18-03], the realization criteria for deferred tax assets, and the recording of the impact of changes in deferred tax balances. One objective of accounting for income taxes is to recognize the estimated amount of taxes payable or refundable for the current year as a tax liability or asset. A second objective is to recognize deferred tax liabilities and assets for the future tax consequences of events that have been recognized in a reporting entity's statutory financial statements or tax returns. However, the second objective is realistically constrained because (a) the tax payment or refund that results from a particular tax return is a joint result of all the items included in that return, (b) taxes that will be paid or refunded in future years are the joint result of events of the current or prior years and events of future years, and (c) information available about the future is limited. As a result, financial statements will recognize current and deferred income tax assets and liabilities in accordance with the provisions of this statement based upon estimates and approximations. For purposes of this statement, only adjusted gross deferred tax assets that are more likely than not (a likelihood of more than 50% ~~percent~~) to be realized shall be considered in determining admitted adjusted gross deferred tax assets.

3.a.i The term "probable" as used in SSAP No. 5R shall be replaced by the term "more likely than not (a likelihood of more than 50% ~~percent~~)" for federal and foreign income tax loss contingencies only.

7.e. Gross DTAs are reduced by a statutory valuation allowance adjustment if, based on the weight of available evidence, it is more likely than not (a likelihood of more than 50% ~~percent~~) that some portion or all of the gross DTAs will not be realized. The statutory valuation allowance adjustment, determined in a manner consistent with paragraphs 20-25 of FAS 109, shall reduce the gross DTAs to the amount that is more likely than not to be realized (the adjusted gross deferred tax assets).

1.3 SSAP No. 101 – Gross DTAs are reduced by a statutory valuation allowance adjustment that is determined on a separate company, reporting entity basis. Pursuant to paragraphs 2 and 7.e. of SSAP No. 101, gross DTAs are adjusted to an amount that is more likely than not to be realized (a likelihood of more than 50% ~~percent~~). Only adjusted gross DTAs shall be considered in determining admitted adjusted gross DTAs. See Question 2 for further discussion of the statutory valuation allowance adjustment. See Question 4 for a further discussion of the admissibility test. See Question 12 for further discussion of presentation and disclosure of the statutory valuation allowance adjustment.

1.11 SSAP No. 101 – FIN 48 is rejected for statutory accounting pursuant to paragraph 31 of SSAP No. 101. SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets provides guidance in determining the amount of federal and foreign income tax loss contingencies with the following modifications. The term "probable" as used in SSAP No. 5R is replaced by the term "more likely than not (a likelihood of more than 50% ~~percent~~)". In determining the amount of a federal or foreign income tax loss contingency, it shall be assumed that the reporting entity will be examined by the

tax authority that has full knowledge of all relevant information. If the estimated tax loss contingency is greater than 50% of the tax benefit originally recognized, the tax loss contingency recorded shall be equal to 100% of the original tax benefit recognized. See Question 9 for further discussion of income tax loss contingencies.

2.1 A – An enterprise shall record a gross deferred tax liability or asset for all temporary differences and operating loss, capital loss and tax credit carryforwards. Temporary differences include unrealized gains and losses and nonadmitted assets but do not include AVR, IMR, Schedule F penalties and, in the case of a mortgage guaranty insurer, amounts attributable to its statutory contingency reserve to the extent that "tax and loss" bonds have been purchased. In general, temporary differences produce taxable income or result in tax deductions when the related asset is recovered or the related liability is settled. A deferred tax asset or liability represents the increase or decrease in taxes payable or refundable in future years as a result of temporary differences and carryforwards at the end of the current year. Additionally, gross DTAs are reduced by a statutory valuation allowance adjustment if, based on the weight of available evidence, it is more likely than not (a likelihood of more than 50% ~~percent~~) that some portion or all of the gross DTAs will not be realized. The statutory valuation allowance adjustment, determined in a manner consistent with paragraphs 20-25 of FAS 109, shall reduce gross DTAs to the amount that is more likely than not to be realized (the adjusted gross deferred tax assets). This answer only addresses the recognition of adjusted gross DTAs and gross DTLs and does not address the admissibility of such amounts. See Question 4 for a discussion of the admissibility criteria of SSAP No. 101.

5.12 The temporary difference related to property and casualty unearned premiums is typically ~~twenty percent (~~20%~~)~~ of the outstanding statutory unearned premium reserve. If a company issues only one-year policies, it is reasonable to assume that the entire temporary difference will reverse in one year. If a company writes multi-year contracts, management will be required to estimate the percentage of the unearned premium that will be earned within each year of the applicable reversal period and apply these percentages to the outstanding temporary difference.

5.14 For those temporary differences that do not have a defined reversal period, such as unrealized losses on common stock or deferred compensation liabilities, management will need to determine when the temporary difference is “expected” to reverse. For instance, assume a company has an unrealized loss of $200 in its equity portfolio and that, on average, the portfolio turns over ~~twenty percent~~ (20%~~)~~ per year. It would be appropriate for the company to conclude that $40 of the temporary difference will reverse in each year in the applicable reversal period. When determining when the temporary difference would be “expected” to reverse, management should normally consider events that are likely to occur using information, facts and circumstances in existence as of the reporting date. The estimates used in this circumstance should not be extended to other tests of impairment. For instance, when the entity assumed a 20% turnover in its equity portfolio, it is not involuntarily required to record an impairment in accordance with paragraph 10 of SSAP No. 30R—Unaffiliated Common Stock.

10.3 As an example, assume Company X files its 20X1 federal income tax return and reports $1,000,000 of taxable income comprised of $800,000 of ordinary income and $200,000 of capital gain income. Since the company is subject to taxation at a 21% ~~percent~~ tax rate on all its income, it incurred federal income tax expense of $210,000. In preparing its 20X1 statutory income tax provision, the company estimated that its liability for 20X1 federal income tax would be $147,000 based on $600,000 of ordinary income and $100,000 realized capital gains.

10.8 For example, assume the reporting entity has DTAs of $1,000 relating to temporary differences other than unrealized losses, and a $100 DTL relating to unrealized gains as of the beginning of the year. Since the entity is subject to tax at 21% ~~percent~~ and all of its DTAs are expected to reverse within one year, the entity recorded a $900 net admitted DTA as of the beginning of the year.

12.20 The Company has not recognized a deferred tax liability of approximately $30,000 of foreign withholding taxes for the undistributed earnings of its 100% ~~percent~~ owned foreign subsidiaries that arose in 20X2 and prior years because the Company does not expect those unremitted earnings to reverse and become taxable to the Company in the foreseeable future. A deferred tax liability will be recognized when the Company expects that it will recover those undistributed earnings in a

taxable manner, such as through receipt of dividends or sale of the investments. As of December 31, 20X2, the undistributed earnings of these subsidiaries were approximately $200,000.

SSAP No. 102—Pensions

22. As a minimum, amortization of a net gain or loss included in unassigned funds (surplus) shall be included as a component of net pension cost for a year if, as of the beginning of the year, that net gain or loss exceeds 10% ~~percent~~ of the greater of the projected benefit obligation or the fair value of plan assets. If amortization is required, the minimum amortization shall be that excess divided by the average remaining service period of active employees expected to receive benefits under the plan. If all or almost all of a plan's participants are inactive, the average remaining life expectancy of the inactive participants shall be used instead of average remaining service.

79. A reporting entity shall disclose the amount of contributions to multiemployer plans for each annual period for which a statement of income is presented. A reporting entity may disclose total contributions to multiemployer plans without disaggregating the amounts attributable to pension plans and other postretirement benefit plans. The disclosures shall include a description of the nature and effect of any changes affecting comparability, such as a change in the rate of employer contributions, a business combination, or a divestiture. This disclosure shall identify whether the contributions represent more than 5% ~~percent~~ of total contributions to the plan as indicated in the plan's most recently available annual report.

93.b.i. ~~Ten~~10% ~~percent~~ of the calculated surplus impact as of the transition date;

SSAP No. 103R—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities

22. An exchange of debt instruments with substantially different terms is also considered a debt extinguishment and shall be accounted for in accordance with paragraph 21. A debtor's exchange of debt instruments (in a nontroubled debt situation) is accomplished with debt instruments that are substantially different if the present value of the cash flows under the terms of the new debt instrument is at least 10% ~~percent~~ different from the present value of the remaining cash flows under the terms of the original instrument. If the difference between the present value of the cash flows under the terms of the new debt instrument and the present value of the remaining cash flows under the terms of the original debt instrument is less than 10% ~~percent~~, a creditor should evaluate whether the modification is more than minor based on the specific facts and circumstances (and other relevant considerations) surrounding the modification.

91. The reporting entity shall receive collateral having a fair value as of the transaction date at least equal to 102% ~~percent~~ of the fair value of the loaned securities at that date. If at any time the fair value of the collateral received from the counterparty is less than 100% ~~percent~~ of the fair value of the loaned securities, the counterparty shall be obligated to deliver additional collateral by the end of the next business day, the fair value of which, together with the fair value of all collateral then held in connection with the transaction at least equals 102% ~~percent~~ of the fair value of the loaned securities. If the collateral received from the counterparty is less than 100% ~~percent~~ at the reporting date, the difference between the actual collateral and 100% ~~percent~~ will be nonadmitted. Collateral value is measured and compared to the loaned securities in aggregate by counterparty.

92. In the event that foreign securities are loaned and the denomination of the currency of the collateral is other than the denomination of the currency of the loaned foreign securities, the amount of collateral shall be at least equal to 105% ~~percent~~ of the fair value of the loaned securities at that date. If at any time the fair value of the collateral received from the counterparty is less than 102% ~~percent~~ of the fair value of the loaned securities, the reporting entity must obtain additional collateral by the end of the next business day, the fair value of which together with the fair value of all collateral then held in connection with the transaction at least equals 105% ~~percent~~ of the fair value of the loaned securities. If the collateral received from the counterparty is less than 100% ~~percent~~ at the reporting date, the difference between the actual collateral and 100% ~~percent~~ will be nonadmitted. Collateral value is measured and compared to the loaned securities in aggregate by counterparty.

113. The collateral requirements for repurchase and reverse repurchase agreements are as follows:

Repurchase Transaction

a. The reporting entity shall receive collateral having a fair value as of the transaction date at least equal to 95% ~~percent~~ of the fair value of the securities transferred by the reporting entity in the transaction as of that date. If at any time the fair value of the collateral received from the counterparty is less than 95% ~~percent~~ of the fair value of the securities so transferred, the counterparty shall be obligated to deliver additional collateral by the end of the next business day the fair value of which, together with the fair value of all collateral then held in connection with the transaction, at least equals 95% ~~percent~~ of the fair value of the transferred securities. If the collateral is less than 95% ~~percent~~ at the reporting date, the difference between the actual collateral and 95% ~~percent~~ will be nonadmitted.

Reverse Repurchase Transaction

b. The reporting entity shall receive as collateral transferred securities having a fair value at least equal to 102% ~~percent~~ of the purchase price paid by the reporting entity for the securities. If at any time the fair value of the collateral is less than 100% ~~percent~~ of the purchase price paid by the reporting entity, the counterparty shall be obligated to provide additional collateral, the fair value of which, together with fair value of all collateral then held in connection with the transaction, at least equals 102% ~~percent~~ of the purchase price.

130. Exchanges of debt instruments or debt instrument modifications are considered extinguishments if the exchange or modification results with substantially different terms or is considered more than minor. If the cash flows under the terms of the new debt instrument are at least 10% ~~percent~~ different from the present value of the remaining cash flows under the terms of the original instrument, then the exchange of, or modification to, debt instruments is consider substantially different and/or more than minor.

Illustration 3 Company C originates $1,000 of loans that yield 10% ~~percent~~ interest income for their estimated lives of 9 years. Company C transfers the entire loans to an entity and the transfer is accounted for as a sale. Company C receives as proceeds $1,000 cash, a beneficial interest to receive 1% ~~percent~~ on the contractual interest on the loans (an interest-only strip receivable), and an additional 1% ~~percent~~ of the contractual interest as compensation for servicing the loans. The fair values of the servicing asset and the interest-only strip receivable are $40 and $60, respectively.

Illustration 4 – Facts

Transferor's carrying amount and fair value of security loaned	$1,000
Cash "collateral"	1,020
Transferor's return from investing cash collateral at a 5% ~~percent~~ annual rate	5
Transferor's rebate to the securities borrower at a 4% ~~percent~~ annual rate	4

SSAP No. 104R—Share-Based Payments

117.a.ii. Any purchase discount from the market price does not exceed the per-share amount of share issuance costs that would have been incurred to raise a significant amount of capital by a public offering. A purchase discount of 5% ~~percent~~ or less from the market price shall be considered to comply with this condition without further justification. A purchase discount greater than 5% ~~percent~~ that cannot be justified under this condition results in compensation cost for the entire amount of the discount. Note that an entity that justifies a purchase discount in excess of 5% ~~percent~~ shall reassess at least annually, and no later than the first share purchase offer during the fiscal year, whether it can continue to justify that discount pursuant to this paragraph.

122. Changes in total employee withholdings during a purchase period that occur solely as a result of salary increases, commissions, or bonus payments are not plan modifications if they do not

represent changes to the terms of the award that was offered by the employer and initially agreed to by the employee at the grant (or measurement) date. Under those circumstances, the only incremental compensation cost is that which results from the additional shares that may be purchased with the additional amounts withheld (using the fair value calculated at the grant date). For example, an employee may elect to participate in the plan on the grant date by requesting that 5% ~~percent~~ of the employee's annual salary be withheld for future purchases of stock. If the employee receives an increase in salary during the term of the award, the base salary on which the 5% ~~percent~~ withholding amount is applied will increase, thus increasing the total amount withheld for future share purchases. That increase in withholdings as a result of the salary increase is not considered a plan modification and thus only increases the total compensation cost associated with the award by the grant date fair value associated with the incremental number of shares that may be purchased with the additional withholdings during the period. The incremental number of shares that may be purchased is calculated by dividing the incremental amount withheld by the exercise price as of the grant date (for example, 85% ~~percent~~ of the grant date stock price).

SSAP No. 108—Derivatives Hedging Variable Annuity Guarantees

11. The term "highly effective" describes a fair value hedging relationship where the change in fair value of the derivative instrument is within 80 to 125% ~~percent~~ of the opposite change in fair value of the hedged item attributed to the hedged risk. It shall also apply when an R-squared of .80 or higher is achieved when using a regression analysis technique.

Status:
On March 22, 2023, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a SAP clarification, and exposed editorial revisions as illustrated within the agenda item.

On May 16, 2023, the Statutory Accounting Principles (E) Working Group adopted, as final, the exposed editorial revisions, as illustrated above, to the *Accounting Practices and Procedures Manual*.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2023/05-16-23/Adoptions/2 23-11EP - Spring 2023.docx