

Interpretation of the Statutory Accounting Principles Working Group

INT 20-04: Mortgage Loan Impairment Assessment Due to COVID-19

INT 20-04 Dates Discussed

Email Vote to Expose March 26, 2020; April 15, 2020; July 30, 2020; August 17, 2020; November 12, 2020

INT 20-04 References

SSAP No. 26R—Bonds

SSAP No. 30—Common Stock

SSAP No. 37—Mortgage Loans

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

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

INT 20-04 Issue

1. A previously unknown virus began transmitting between October 2019 and March 2020, with the first deaths in the U.S. reported in early March 2020. The disease caused by the virus is known as Coronavirus Disease 2019 (COVID-19). Several states and cities have issued “stay home” orders and forced all non-essential businesses to temporarily close. This led to a significant increase in unemployment and the potential permanent closure of many businesses. Total economic damage is still being assessed however the total impact is likely to exceed \$1 trillion in the U.S. alone.
2. In response to COVID-19, Congress and Federal and state prudential banking regulators have considered provisions pertaining to loans as a result of the effects of the COVID-19. While primarily related to mortgage loans, these provisions are intended to be applicable for the term of a loan modification, but solely with respect to a modification, including a forbearance arrangement, an interest rate modification, a repayment plan, and any other similar arrangement that defers or delays the payment of principal or interest, that occurs during the applicable period for a loan that was not more than 30 days past due as of December 31, 2019.
3. Furthermore, guidance has been issued by the Financial Condition (E) Committee to all U.S. insurers filing with the NAIC in an effort to encourage insurers to work with borrowers who are unable to, or may become unable to meet their contractual payment obligations because of the effects of COVID-19. As detailed in that guidance, the Committee, which is the NAIC parent committee of all the solvency policy making task forces and working groups of the NAIC, supports the use of prudent loan modifications that can mitigate the impact of COVID-19.
4. This interpretation intends to address the impact of loan forbearance or prudent modifications on the statutory accounting and reporting requirements for bank loans, mortgage loans, as well as investments with underlying mortgage loans. Particularly, this interpretation considers whether a temporary, limited-time statutory exception for the assessment of impairment shall be granted for bank loans, mortgage loans and investment products with underlying mortgage loans. This exception would only defer the assessment of impairment due to situations caused by the forbearance or modification of mortgage loan payments and would not delay the recognition of other than temporary impairments if the entity made a decision to sell the investment and/or if provisions other than the limited-time forbearance or modifications of mortgage loans payments caused the entity to identify that they would not recover the reported carrying value of the investment.

INT 20-04 Discussion

5. Although a variety of structures have the potential to be impacted by the economic stimulus provisions, this interpretation is limited to investments specifically identified. Except for the specific inclusion of bank loans, this interpretation does not include investments captured in scope of *SSAP No. 26R—Bonds* or investments captured in the identified standards that are not predominantly impacted by underlying mortgage loans with forbearance or modification provisions in response to COVID-19. Investments in scope of this interpretation include:

- a. *SSAP No. 26R—Bonds*: Bank loans in scope of SSAP No. 26R
- b. *SSAP No. 37—Mortgage Loans*: All mortgage loans in scope of SSAP No. 37.
- c. *SSAP No. 30—Common Stock*: SEC registered investments with underlying mortgage loans (e.g., mortgage-backed mutual funds).
- d. *SSAP No. 43R—Loan-backed and Structured Securities*: Securities in scope of SSAP No. 43R with underlying mortgage loans. This includes residential and commercial mortgage backed securities (RMBS & CMBS), and credit risk transfers (CRTs) issued through government sponsored enterprises (GSEs). Other investments in scope of SSAP No. 43R are also captured within this interpretation if the underlying investments predominantly reflect mortgage loan products.
- e. *SSAP No. 48—Joint Ventures, Partnerships and Limited Liabilities Companies*: Investments in scope of SSAP No. 48 that have underlying characteristics of mortgage loans. These investments could include private equity mortgage loan funds.

Bank Loans

6. Bank loans, if meeting certain parameters, are in scope of *SSAP No. 26R—Bonds*. Bank loans per SSAP No. 26R, are defined as fixed-income instruments, representing indebtedness of a borrower, made by a financial institution. Bank loans can be issued directly by a reporting entity or acquired through an assignment, participation or syndication. The guidance in SSAP No. 26R states an other-than-temporary impairment shall be considered to have occurred if it is probable the reporting entity will be unable to collect amounts due according to the contract terms of a debt security in effect at the date of issue/acquisition. The measurement of the impairment loss shall not include partial recoveries of fair value subsequent to the balance sheet date. The impairment guidance applicable to bank loans states that if it is probable or if repayment does not occur according to the terms of the original contract (i.e. payment timing and amounts), an impairment shall be considered to have occurred.

Mortgage Loans

7. Mortgage loans are in scope of *SSAP No. 37—Mortgage Loans* and reported on Schedule B: Mortgage Loans. The guidance in SSAP No. 37, paragraph 16 identifies that a mortgage loan shall be considered impaired when mortgage loan payments are not received in accordance with the contractual terms of the mortgage agreement. As such, a deference or modification of mortgage loan payments (whether interest or principal) would ordinarily trigger an impaired classification and require impairment assessment under SSAP No. 37. The guidance in SSAP No. 37 utilizes a valuation allowance to recognize unrealized losses from impairment assessments and permits subsequent reversals of unrealized losses reflected in the valuation allowance based on subsequent assessments. If an impairment is deemed other than temporary, the unrealized loss is realized without the potential for subsequent recoveries.

SEC Registered Funds with Underlying Mortgage Loans

8. The scope of *SSAP No. 30—Common Stock* includes SEC registered 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. Investments in scope of this statement include mortgage-backed mutual funds and other such investments. Items in scope of SSAP No. 30 are reported on Schedule D-2-2: Common Stock. These investments are reported at fair value, with changes in fair value recognized as unrealized gains or losses. The guidance in SSAP No. 30 requires recognition of an other than temporary impairment (OTTI) (realized loss) if a reporting entity decision has decided to sell the security at an amount below its carrying value or if the decline in fair value is determined to be other than temporary pursuant to *INT 06-07: Definition of Phrase “Other Than Temporary.”* As investments in scope of SSAP No. 30 are reported at fair value, subsequent recoveries (or losses) in fair value, after recognition of an OTTI, are recognized as unrealized gains or losses until sold or additional OTTI recognition.

Loan-Backed and Structured Securities with Underlying Mortgage Loans

9. The scope of *SSAP No. 43R—Loan-backed and Structured Securities* includes residential mortgage backed securities (RMBS), commercial mortgage backed securities (CMBS) and credit risk transfers (CRTs) issued through government sponsored enterprises (GSEs). (These are commonly referred as Structured Agency Credit Risk Securities (STACRs), which are issued by Freddie Mac, and Connecticut Avenue Securities (CAS), which are issued by Fannie Mae.) Other mortgage loan products that meet the structural requirements as a LBSS can also be captured in scope of SSAP No. 43R. Investments in scope of this statement securities are reported on Schedule D-1: Long-Term Bonds. Pursuant to the guidance in SSAP No. 43R, paragraphs 30-36, if a fair value of a LBSS is less than its amortized cost basis at the balance sheet date, an entity shall assess whether the impairment is other than temporary. Recognition of an OTTI is then contingent on the reporting entity intentions:

- a. If the entity intends to sell the security, an OTTI shall be considered to have occurred. In these situations, the entity shall recognize a realized loss for the difference between the amortized cost basis and fair value. These realizes losses are not permitted to be reversed.
- b. If the entity does not intend to sell the security, the entity shall assess whether it has the intent and ability to retain the investment in the security for a period of time sufficient to recover the amortized cost basis. If the entity does not have the intent and ability to retain the investment for the time sufficient to recover the amortized cost basis, an OTTI shall be considered to have occurred. In these situations, the entity shall recognize a realized loss for the difference between the amortized cost basis and fair value. These realizes losses are not permitted to be reversed.
- c. Regardless if the entity does not have the intent to sell or has the intent and ability to hold, if the entity does not expect to recover the entire amortized cost basis of the security, an OTTI shall be considered to have occurred. In these situations, the entity shall recognize a realized loss for the difference between the amortized cost basis and the present value of cash flows expected to be collected.

Other Invested Assets with Underlying Mortgage Loans

10. The scope of *SSAP No. 48—Joint Ventures, Partnerships and Limited Liabilities Companies* includes investments that may have underlying characteristics of mortgage loans. These items are reported on Schedule BA: Other Long-Term Invested Assets. These investments could include private equity mortgage loan funds as well mortgage or hybrid real estate investment trusts (REITs). The guidance in SSAP No. 48, paragraph 19 requires recognition of an OTTI if it is probable that the reporting entity will be unable to recover the carrying amount of the investment or sustain earnings to justify the carrying amount of the investment. The existing

guidance already indicates that a depressed fair value below the carrying amount or the existence of operating losses are not necessarily indicators of a loss that is other than temporary.

INT 20-04 Consensus

11. The Working Group reached a consensus for limited time exceptions to defer assessments of impairment for bank loans, mortgage loans and investments which predominantly hold underlying mortgage loans, which are impacted by forbearance or modifications in response to COVID-19. These exceptions are applicable for the March 31st and June 30th, 2020 (1st and 2nd quarter) financial statements and only in response to mortgage loan forbearance or modifications granted in response to COVID-19. As such, the exceptions provided in this interpretation are not applicable in the September 30, 2020 (3rd quarter) financial statements.

12. For modification programs designed to provide temporary relief for borrowers current as of December 31, 2019, the reporting entities may presume that borrowers are current on payments are not experiencing financial difficulties at the time of the modification for purposes of determining impairment status and thus no further impairment analysis is required for each loan modification in the program. The exceptions granted in this interpretation are detailed as follows:

- a. *SSAP No. 26R—Bonds*: Provide a limited-time exception for assessing impairment under SSAP No. 26, paragraph 13, for bank loans with payments (either principal or interest) that have short-term deferrals or modifications in response to COVID-19. This interpretation shall not delay impairment assessments for reasons other than the short-term deferral or modification of interest or principal payments in response to COVID-19 and shall not delay recognition of realized losses if a reporting entity believes a bank loan is OTTI.
- b. *SSAP No. 37—Mortgage Loans*: Provide a limited-time exception for assessing impairment under SSAP No. 37, paragraph 16, for mortgage loans with payments (either principal or interest) that have short-term deferrals or modifications in response to COVID-19. This interpretation shall not delay impairment assessments for reasons other than the short-term deferral or modification of interest or principal payments in response to COVID-19 and shall not delay recognition of realized losses if a reporting entity believes a mortgage loan is OTTI.
- c. *SSAP No. 30R—Common Stock*: Provide a limited-time exception for assessing OTTI under SSAP No. 30, paragraph 10, and INT 06-07 due to fair value declines for SEC registered funds that have underlying mortgage loans that have been deferred or modified in response to COVID-19 unless the reporting entity intends to sell the security. If the entity has made a decision to sell the security, recognition of the OTTI shall continue to be required. As these investments are reported at fair value, declines in fair value would continue to be reported as unrealized losses.
- d. *SSAP No. 43R—Loan-backed and Structured Securities*: Provide a limited-time exception for assessing OTTI under SSAP No. 43R, paragraphs 30-36, due to fair value declines in investments that have underlying mortgage loans deferred or modified in response to COVID-19 unless the reporting entity intends to sell the security. If the entity has made a decision to sell the security, then recognition of an OTTI shall continue to be required.
- e. *SSAP No. 48—Joint Ventures, Partnerships and Limited Liabilities Companies*: Provide a limited-time exception for assessing OTTI under SSAP No. 48 due to fair value declines in investments that have underlying mortgage loans deferred or modified in response to COVID-19 unless the entity intends to sell the security. Additionally, an OTTI shall be assessed if factors other than the mortgage loan forbearance or modification have resulted with a decline that is considered other than temporary, or the reporting entity does not believe it is probable they will collect the carrying amount of the investment.

13. Subsequent to modifications or restructurings that impact original contractual terms of items in scope of this interpretation, future assessments of impairment shall be based on the modified terms.

14. As detailed in paragraph 11, the exceptions granted in this interpretation are applicable for the March 31st and June 30th, 2020 (1st and 2nd quarter) financial statements and only in response to bank and mortgage loan forbearance or modifications granted in response to COVID-19. As the exceptions provided in this interpretation are not applicable in the September 30, 2020 (3rd quarter) financial statements, this interpretation will automatically expire as of September 29, 2020. This interpretation will be publicly posted on the Statutory Accounting Principles (E) Working Group's website. This interpretation will be automatically nullified on September 29, 2020 and will be included as a nullified INT in Appendix H – Superseded SSAPs and Nullified Interpretations in the “as of March 2021” *Accounting Practices and Procedures Manual*.

- a. On August 17, 2020, the provisions in this INT were extended to be applicable for the September 30, 2020 (3rd quarter) financial statements. With this extension, this Interpretation will automatically expire as of December 30, 2020 (prior to the year-end 2020 financial statements). Subsequent consideration will occur to determine if an extension is needed beyond September 30, 2020.

INT 20-04 Status

15. On July 30, 2020, the Statutory Accounting Principles (E) Working Group exposed this interpretation for possible extension to September 30, 2020 (3rd quarter financial statements). If the extension were adopted, the proposed paragraph 14.a would be incorporated into the INT. On August 17, 2020, the Statutory Accounting Principles (E) Working Group extended the provisions of this INT to be applicable for the September 30, 2020 (3rd quarter) financial statements, incorporating paragraph 14.a. into the INT.

16. No further discussion is planned.